Gambles with the Economic Constitution:
The Reregulation of Labour in New Zealand

The Employment Relations Bill 2000

In March 2000, the New Zealand government introduced the Employment Relations Bill 2000 (ERB) into parliament (New Zealand Government 2000), giving substance to election promises to repeal the Employment Contracts Act of 1991 (ECA). The new Bill, which contains nearly 200 pages of complex and prescriptive detail,[1] was based on a draft by the New Zealand central trade union organisation (Knowles 2000). The key features of the legislation were agreed upon between the union leadership and the Minister for Labour, Margaret Wilson, a former union secretary and law academic, at an unpublicised meeting on 22 December 1999. Reportedly, the instructions from that meeting then went straight to the writers of the Bill in the Department of Labour, bypassing the relevant cabinet committee and cabinet, as well as the junior coalition partner, the Alliance, and key economic ministries, such as Treasury. The Minister for Labour recently showed her hand when she said that the ECA had 'sought quite deliberately to disempower one side, so we are reempowering that side' (Kelly 2000: 22).

The ERB not only overturns existing, liberal labour-market institutions, but also imposes an elaborate and often highly prescriptive new labour code. It proposes to subject the work relationship to much collective direction by the visible hands of an ascendant 'political class' of government agents, official mediators and labour organisers. Many matters of interaction in the work sphere that were subject to voluntary interaction and private law are now to be placed, again, under coercive control and public law. The ERB draft provides for a number of new organisations and administrative means designed to enforce the new rules.

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[1] The New Zealand ERB is nonetheless much more compact than the convoluted 300-page Australian Workplace Relations Act, which the Howard government implemented. No one running a small business could ever hope to understand the legislation. Unsurprisingly, it failed the test of getting Australian industrial relations conflicts out of the headlines. Most notably, it failed during the waterfront dispute.

The reregulation of labour has to be seen as the defining signal of a host of rule changes that the New Zealand parliament and executive now resolutely implement. It flags a readiness to risk fundamental institutional changes, as well as the new political elite's confidence that the visible hand of government can attain better results than the liberal order which previous Labour and National governments worked so hard to institute in the 1980s and early 1990s.

The present changes in the ground rules of economic conduct—what we shall call New Zealand's economic constitution—promise to shape up as a litmus test for establishing what scope a small open country still has left, in this era of globalisation, to implement sovereign political and regulatory market interventions.

Key features

Good faith and promotion of trade unions: The preamble to the ERB makes great play about the principle of good faith behaviour and the need to decree 'the promotion of mutual trust and confidence in all aspects of the employment environment . . . It includes all participants, not just employers and employees' (p.1). It explicitly promotes collective bargaining with reference to the International Labour Organisation (ILO) conventions that stipulate the right of workers to organise and bargain collectively; and 'acknowledges and addresses the inherent inequality of bargaining power in employment relationships' (p.1). Nonetheless, membership in unions and employer associations is to remain voluntary (no closed shop), and wage fixing will not be automatically centralised (no return to a compulsory industrial awards system).

The major reason offered by the government for the collective organisation of work is the recognition of 'the inherent imbalance of power and influence in the employment relationship . . . Accordingly unions are given specific legal recognition as representatives of employees' interests' (p.1) It is also immediately understandable that the political wing of the labour movement wants to promote its industrial wing. As elsewhere, union membership in New Zealand has declined and is currently at 15-18% (Lingard 2000: 40). The new government's target is to spread union membership throughout the economy, raising it to 30% of the workforce (Kelly 2000: 22).

Collective agreements (CAs) are to be favoured by the legislator over individual contracts. Current work contracts between groups of workers and employers (collective employment contracts or CECs) will over time be replaced by CAs, which can only be negotiated by a licensed union (clause 21). Licensed unions are the only agents who can negotiate CAs and call a strike. They can demand CA coverage for everyone in a workplace, from the CEO downwards. Those groups of employees who, under the ECA, opted for hiring private and competing agents to represent them in negotiating work conditions with their employers will in future not be free to do so, as union agency is to be granted monopoly status by the country's parliament. The ERB (clause 66) proposes to guarantee employment of workers for the term of a collective agreement as well as a mandatory 12-month period after the expiry of the agreement.

Once a CA is in the process of being negotiated, individual workers will not be able to speak on their own behalf to managers. They will instead be represented by monopoly agents. This seems a gross violation of individual freedom. The prohibition of direct negotiation and communication between involved parties during bargaining exceeds even what the New Zealand parliament has prescribed for broken-down marriages and divorce cases. Under divorce law, the draconian measure of prohibiting direct communication is imposed only rarely!

Employees may negotiate individual agreements (IAs). However, in the future they will have no say whether a strike is to be called. They will also have to base their contracts on CA conditions. Individual employees cannot agree to conditions less favourable than the relevant CA, even if that were to give them a foothold on the job ladder and access to work experience. Only after 30 days employment can IAs deviate from CA conditions. But then new employees have the right to become union members, so that they can convert their contracts into CA coverage.

The new Employment Relations Authority (see pages XX) is to be given the power to cancel IAs if they have been negotiated unfairly, and to prescribe specific employment conditions. This is a massive intervention in the freedom of private contract and the common law. It will, in practice, be a hindrance both to the practice of negotiating IAs and to job creation. The ERB also outlaws 'take it or leave it offers' of job conditions in IAs.

Everything must be negotiated—another potentially draconian limitation to job creation. What would happen to transaction costs in the retail trade if the New Zealand parliament prohibited 'take it or leave it offers' in supermarkets?

It is likely that there will be few IAs in future, and that unions will be able to capture a large share of employment deals across all industries. In practice, there are bound to be many bargains between a multiplicity of unions and one employer (Lingard 2000: Appendix 1). But it is also possible that the fixed transaction costs of formalised bargaining and the shift in bargaining power will force employers to form industry-wide, multi-employer associations. Where this is the case, one can expect the attention-getting ambit claims, public posturing and strikes familiar from New Zealand history of the 1970s and 1980s. If the international experience with institutional change is any guide, old habits and attitudes will probably re-assert themselves and the New Zealand employment scene will in important respects return to pre-1984 patterns. The deleterious consequences of a higher degree of unionisation on productivity growth, profitability and growth are now well documented (for a survey of the empirical literature, see Hirsch 1997). There is little reason not to expect these same consequences from the acceptance of the ERB.

The changes to be instituted under the ERB are not expected by experts to have a major impact in already unionised workplaces (Lingard 2000: Attachment 1), and the ERB makes it difficult for employees to hop from one CA to another more advantageous CA. This gives unions a firmer hold over 'their' workers.

Bosses' liability: A potentially revolutionary innovation of the ERB is that the directors and officers of a company are made personally liable for the payment of wages and holiday pay. It is rumoured that this rule may soon be extended to redundancy pay.

Class action: Another major innovation is the explicit provision by the New Zealand legislature for class action by a union or the government's Labour Inspectorate to determine whether contractors are to be deemed employees. In practice this means that firms will have less incentive to save costs by negotiating with sub-contractors, as such cost savings may be taken away retrospectively by the visible hand of government. The practice of class action has been central to the increase in litigation costs in the United States, as it creates a strong

financial incentive for enterprising law firms to initiate litigation before a court on behalf of a class of people without having obtained their individual, contractual consent. If individual members of a class object explicitly to such representation, they may avoid automatic representation. Otherwise, members of a class need not take any individual initiative to become a party in judicial proceedings. A self-appointed agent may act on behalf of putatively damaged parties without those parties even knowing about it. Damages awarded by a court under class action are then distributed to all aggrieved parties—after the deduction of frequently hefty legal fees.

Mandatory leave: The 1986 Union Representatives Education Leave Act is being resurrected by the ERB. Provision is made for government-financed education programmes about industrial relations matters. Employers have to give staff paid time off to attend classes on industrial relations that are organised by unions or employer organisations. Union organisers will administer the leave entitlements. The ERB also makes provision for additional paid leave from work on union business. Employers will also be obligated to collect membership fees of licensed unions (clause 67), overturning the current practice of direct payment by the member to the union in favour of automatic pay deduction by employers, as was standard before 1994. Union members will also have a statutory right to two paid stop-work meetings of two hours' duration a year.

Protection of strikers: Strikes and lockouts are explicitly allowed but, as under present legislation, only after the expiry of existing employment agreements (clauses 98-110). When one of the new CAs has expired, the union may call a strike. The legislators then give striking workers tenure, as they cannot be dismissed during strikes. Neither must 'their' work be covered by non-strikers, for example managerial staff carrying out operational work normally done by the strikers (clause 111). In designated essential services, the Department of Labour must be notified in advance of planned strike action.

Grievances: Another potentially important innovation of the ERB is the extension of grievances to new categories of workplace behaviour; for example, an 'indirect. . .request to an employee for. . .sexual activity' or the 'use of language. . .of a sexual nature' (clause 121). Under certain conditions, the grievance period has also been lengthened from 90 days to six months. The rules under which workers who feel unfairly dismissed can demand

reinstatement have been extended too. They can now demand reinstatement. This provision will make the dismissal of workers even more difficult that it is now. During the 1990s, the Employment Court created legal precedents under which increased grounds for overturning dismissals are recognised. This has greatly inflated the compliance costs of hiring and firing. If international experience is anything to go by, the difficulty and cost in dismissing an employee is a direct obstacle to hiring others.

Contractors: A possible loophole for employees and employers against being subjected to the intrusive paternalism of the new Bill might have been to shift from an employment to a sub-contracting relationship. This loophole has been closed, however, as the ERB contains narrow new criteria for dependent contractors. It will no longer be the declared intent of the two contracting parties that determines whether such dependent contractors are covered by union conditions (as was the case under the ECA), but the control and integration of contractors with the operations of their client. Thus, a team of maintenance workers who have been working as contractors in a firm may in future lose their independence and be deemed by officials as wage labour who has to 'buy' union patronage.

New organisations

The ERB will be enforced by a number of formal organisations with overlapping assignments. Apart from a bigger and more important Department of Labour, there will be a new Employment Relations Authority; a mediation service to replace the present Employment Tribunal; an Employment Court; a Labour Inspectorate; tripartite panels to oversee industrial relations education; and panels that formulate binding rules which determine what is meant by 'good faith bargaining' in New Zealand.

Where there are 'employment problems', workers and shop-floor managers will no longer be expected to sort these out face-to-face as under the ECA. Instead, a Labour Inspectorate, an organisation of the Department of Labour, will intervene pro-actively and directly to ensure that the regulations are obeyed on the ground. Inspectors will be able to enter business premises and investigate a vast array of evidence (clauses 223-238). They will be able to issue 'demand notices' against employers who offend provisions of the new

legislation; similar to on-the-spot fines issued by the traffic police. In certain circumstances, the Inspectors can also bring class action against an employer.

Where 'employment problems' persist, the government can also intervene through its mediation service (clauses 157-167), to be set up by the Chief Executive of the Labour Department. Official third-party mediation in labour conflicts will be more formal and more activist. Where this first-stop intervention does not work, the new Employment Relations Authority (ERA) will investigate and possibly order more mediation. Compared to the present rule-based Employment Tribunal, the ERA will have greater powers to intervene administratively and, by issuing injunctions like a High Court, will act as a kind of multi-dimensional ombudsman—an institutionally messy mix of quasi-judicial and administrative functions. The declared intent of the legislators is to promote pragmatic and expedient conflict resolution. However, institutional theory suggests that a mix of judicial and administrative functions frequently leads to the opportunistic use of power and capture by organised interest groups, as well as widespread disregard for the rulebook and, ultimately, contempt for the visible hand of government. The extension of public law into what was the private law sphere is a frequent cause of the growing contempt for electoral democracy and parliaments that one can now observe in many affluent countries[2].

Where 'employment problems' persist further, matters can in future be taken before a slightly reshaped Employment Court, which will hear the evidence *de novo*. The traditional Employment Court had been retained as a special tribunal concerned with employment matters when the current ECA was implemented. As a holdover from the post-war era of industrial relations, it created much case law that went against the free market spirit of the ECA, which earned it the sobriquet of 'friend of the workers, but an enemy of the unemployed'. It will in future also deal with torts and injunctions. Its rulings will continue to

[2] Since the mid-1990s, the New Zealand legislature has extended the intrusion of public law into private life enormously. The parliament has ratified a flood of new decrees. Businesses were confronted with over 1000 new rules during the 1990s, and a medium sized firm has to fill out an estimate 168 forms every year (Myers 1999: 6).

In Australia, the proliferation of public law has progressed even further, with the Commonwealth legislature alone promulgating well over 40 000 pages of new legislation during the 1990s—more than the cumulative aggregate from 1901 to 1990! Lawyers have benefited from this 'diarrhoea of statutes', which has little to do with the law and everything to do with rent creation and political favouritism for organised groups. The number of lawyers in Australia has tripled from 14 000 in 1978 to 46 000 in 1999 (Institute for Public Affairs 2000: 1).

be subject to revisions in the Court of Appeal, a possible fourth-stop intervention in a conflict between employee and employer.

There will also be tripartite panels, made up of representatives of the union, the employers and government, who will approve the government-financed education programmes about industrial relations. Given the complexities of the new legislation, such education may well be necessary. Other tripartite panels will decree technical interpretations of the law; specifically, what is meant by 'good faith bargaining'.

It is expected that parliament will, in addition to the many instruments of the ERB, soon establish, under its proposed Minimum Code of Employment Rights, an Employment Rights Unit (ERU) and Employment Equity Office (EEO).

The wider political and historic context

The full meaning of the ERB and its likely impact on the economic future of New Zealand cannot be assessed in isolation. Given the interdependence of the labour market with all other markets and with what happens overseas, the ERB has to be assessed in the context of (i) other, complementary new initiatives by the Clark-Anderton government, and (ii) New Zealand's long tradition of isolationist interventionism and the comprehensive overhaul of the basic rules of economic interaction in the past two decades.

1999-2000: A sharp left turn

In the wake of a recession that lasted from late 1997 to mid-1999, a slim majority of New Zealanders voted in November 1999 for political parties that promised social justice and protection from further reforms. Labour, the Alliance and the Greens won 51.9% of the vote (Alvey 2000). This enabled a left-leaning Labour-Alliance coalition to form a minority government. Labour leader Helen Clark, a former political-science academic and Lange cabinet minister, who in the 1980s opposed in vain the economic reforms initiated by Roger Douglas, came to office with the promise of a 'social-democratic correction' of the institutional reforms of 1984 to 1994. The Clark-Anderton minority administration, which commands 59 out of 120 seats, now forms a tacit *ménage à trois* with the Greens. On

occasions, the government may also draw on the support of other small parties that favour non-market solutions.

In a recent interview, Prime Minister Clark spoke of a reaction to 'neo-liberalism' and declared: 'We're bringing the pendulum back. That doesn't mean that you are anti-business. . .I'm simply saying that, as a Western country with a social democratic government, we want to be mainstream, not out on the edge as a prophet of neo-liberalism.' (Kelly 2000: 19). The new government has, to date, announced or implemented an array of new measures whose common denominator is to signal a much more collectivist and outcome-targeted economic regime:

- There were official declarations that privatisation is finished and that deregulation has been halted. The 'light-handed regulation' of previous governments will become heavier. There are to be more direct interventions by politicians in the daily business of government-owned enterprises, for example in the activities of state-owned media.

- Marginal tax rates on the personal incomes of those above the lower middle class (namely NZ$ 60 000) have been lifted from 33% to 39%. This ends the trend to flatter, lower income taxes and introduces inconsistencies between personal and corporate taxation—invariably an incentive to engage in the economically wasteful pursuit of creative tax planning. The Fringe Benefits Tax has even been raised to 65%. Cigarette taxes were raised by $NZ 1.00 per packet.

- Although Prime Minister Clark has repeatedly spoken in favour of free trade and opposes the protectionist stance of the Alliance Party, she has also reflected publicly on 'fairer trade' along the lines advocated by some American Democrats. Some moves appear to be in the pipeline to protect Kiwi cultural products from foreign competition. Reportedly, there are also moves afoot to bring trans-Tasman shipping again under some control. New Zealand's low residual tariffs, whose elimination was already announced by the previous government, have now been frozen for five years, enabling the customs bureaucracy and compliance costs for importers to stay in place. A decision was made to stop unilateral tariff cuts and to be reticent about entering into future bilateral free trade agreements.

- The new government has begun to intervene directly in specific foreign investment approvals, purportedly 'to protect the national interest'. For a long time, foreign direct investment approvals were delegated to the Reserve Bank. Yet, this authority was revoked by the government shortly before the intended sale of the 'Sealord Fishing Group' to an overseas buyer, and the sale was prohibited. The government also blocked Singapore Airlines' bid for Air New Zealand. These interventions signal a new, activist and politicised stance on foreign investment policy, and this at a time when ventures in small countries are being integrated into the global networks of the future. These interventions also signal to New Zealand investors that their investments enjoy diminished property rights protection and that the government is prepared to reduce the value of people's investments by intervention.

- A new industry-policy authority, *Industry New Zealand*, is to dispense subsidies and export supports to selected, approved industrial ventures. In 2001-02, the amounts spent will be modest (some NZ$100 million). The possibility of greater regulatory activism in competition policy has been canvassed publicly; for example, regarding takeovers and the sharemarket. Some direct interventions in price setting can also be expected.

- In March 2000, the government legislated that all employers must again insure against workplace accidents through a state-owned and state-run monopoly. This has sent out the important institutional signal that the private competitive provision of some key services is no longer the preferred option of the New Zealand parliament. Insurance costs will be levied on typically 1.2% of the wage bill and are, in principle, set according to industry-wide risk averages, not the safety record of individual firms or places of work. However, individual employers' insurance premiums can be adjusted after bureaucratic audits and according to as yet unspecified regulations (Canterbury Employers' Chamber of Commerce 2000: 2).

- As promised in the election campaign, public spending on education, health and welfare is to be raised considerably, although the government hopes to do this without turning budget surpluses into deficits. The private provision of health and education services will not be prohibited, but will in future be overtly discouraged. Tertiary fees have been frozen, and interest on student loans has been abolished.

- The Arts Minister, Ms Clark, announced a substantive one-off handout to the producers of high art, such as the symphony orchestra, the National Museum and local film and television. These subsidies of $NZ 87 million are much higher than promised in the election campaign.

- The government is planning a share of public spending of about 35% of GDP (although, by most measures, the present public sector share is already near 40%).

- In March 2000, the minimum wage was raised to NZ$7.55 an hour for adults and $4.55 for youths; and there is a move afoot to transfer 18- to 20-year olds from the youth to the adult category, raising the cost of employing them by 66%!

- The government's as yet most pervasive initiative to reshape the constitutional ground rules of doing business in New Zealand is the Employment Relations Bill 2000. It will be evaluated later (see pp XX)

- The government is working on a Minimum Code of Employment Rights that will decree minimum wages, penalty rates for holiday work and special categories of statutory paid leave (such as parental leave). It will also create two new agencies within the Department of Labour, the Employment Rights Unit and the Employment Equity Office.

The declared intent of economic policy is to shift New Zealand's economic structure towards knowledge industries and to attract back highly skilled New Zealanders. New Zealand's economic counter-reform is coupled with a shift in foreign and defence policy, as indicated by a further scaling down of the capabilities of New Zealand's small military forces.

One has to conclude that these measures are not simply a technical correction of the existing economic order. They amount to an incisive counter-reform of New Zealand's much-acclaimed liberal economic order. The Clark-Anderton government's reactionary policy stance reveals a fundamentalist scepticism about the merits of spontaneous initiative and the coordination of free private individuals and firms by market competition within the rule of law. They also signal a firm belief that a stronger role for the state and more top-down collective coordination can achieve better outcomes and avoid unforeseen deleterious side effects. Although the official rhetoric tries to convey the impression of a mere correction of past reforms, the actions speak of a fundamental rollback of New Zealand's

liberal economic order. That the present moves are but a correction of New Zealand's liberal economic order may seem plausible to those who take New Zealand's pre-1984 regime as the norm or who consider the social democratic, sclerotic bloc of European economies as the relevant yard stick (James 2000). But New Zealand is a wide-open economy in the Asia Pacific. It competes on its own with locations offering an increasingly dynamic Anglo-Saxon form of capitalism to internationally mobile high skills, capital and enterprises. Many New Zealanders, as well as New Zealand government bodies, are also in direct competition with Singaporean, Taiwanese or other agile institutional innovators in Asia.

There has been a skilful media campaign to convey that this government is not about *laissez faire*, but about taking resolute control of New Zealand's fate. The press and the elites are impressed, as they always are, by the resolute action of the visible hand, and the current upturn in the business cycle makes the overturn of the liberal reforms more easily feasible.

The Prime Minister—though not her deputy—explicitly favours a fairly open economy, fiscal surpluses, an independent and firm monetary policy and a flexible marketplace with strong competition. The 12.5% Goods and Services Tax will be retained because it transfers bountiful tax yields to the government. Even after the rollback of some of the liberal economic rules, New Zealand will thus be left with a freer set of economic rules than prevailed under the statist economic order up to 1984, and a rather freer economy than that of most of the sclerotic European countries. But, as we said, New Zealanders are not competing with their own long-past history. Nor are they competing much with the big, inward-looking European bloc. Given New Zealand's international exposure and still fragile competitive position, it seems rather bold—arguably even foolhardy—for the Clark-Anderton government to go so decidedly and on so many fronts against the prevalent international trend in social philosophy and public policy.

New Zealand in 2000 evokes memories of Mitterand's first cabinet in France in the early 1980s. Having long languished in the political wilderness, the French socialists and communists embarked on a decisive, reactionary left turn. The cabinet of Prime Minister Mauroy, which was composed of so many low-ranking intellectuals and school teachers without business experience that it was soon dubbed the 'cabinet of school teachers', adopted paternalistic social reforms, nationalised several banks and other businesses,

increased public spending and embarked on exhilarating regulatory activism. After a brief phase of euphoria, they were confronted with unexpected deficits, job losses, devaluations and the 'flight' of financial and human capital. This could not be stemmed by financial and exchange-rate controls. By 1983, Mitterand was forced into dramatic and programmatic policy reversals. The question is: Will the New Zealand leadership be able to marshal the cognitive, intellectual, constitutional and policy resources to respond as quickly and constructively as President Mitterand, should major damage result from their present socialist pursuits? Will the left policy elite—whose career experience is predominantly in lecturing and union activism and whose incomes are, after all, not dependent on competitiveness and success in markets, but are politically determined—care about a change in New Zealand's international economic fortunes, should such a change emerge? And if the 'realists' in the Labour Party should want to avert material damage to business and middle-class New Zealand when it emerges, will the 'fundamentalists' in the Labour, Alliance and Green parties not press on with the collectivist line while enjoying a measure of *Schadenfreude* at the discomfiture of the 'capitalists'*?*

1984-1999: The birth of a liberal economic constitution

New Zealand's liberal economic order is not deeply entrenched. Between 1984 and 1994, successive governments created what was widely admired as the freest and most straightforward economic constitution in any OECD country (Brash 1996; Evans et al. 1996; Silverstone et al. 1996; Kasper 1996a, ch. 1). New Zealand now has the most open economy of any old industrial country, a freely floating exchange rate and deregulated domestic markets for goods, services and finance. The capital and labour markets have been freed from most government controls, other than to protect safety, health and the environment. Most infrastructure services are now offered on a competitive basis, making for low input costs and helping the international competitiveness of NZ-based exporters[3]. Government

[3] All surveys of international competitiveness and institutional quality rated New Zealand very highly after the second round of economic reforms, i.e. in the mid-1990s. Since then, some ratings of New Zealand's relative position have slipped as other reformers caught up or have overtaken New Zealand. The first such survey published since the broad outlines of the New Zealand reregulation have become apparent is the Swiss *World Competitiveness Yearbook 2000*. According to advance press reports, New Zealand has been downgraded from 8th place in 1995 and 13th place in 1998 to 21st rank in 2000 (*Australian Financial Review* 20-25 April 2000: 9). Now that the full extent of the Clark-

was slimmed down by commercialising and often privatising its former productive functions. Its protective, advisory and regulatory functions were placed on a more transparent basis, preventing political tactical interference, but strengthening the political control over executive strategy. Light-handed regulation was pursued to reduce transaction and compliance costs. Monetary policy was entrusted to an independent central bank and fiscal management reduced the public debt burden to a low 20% of gross national product. There were moderate changes in the traditional redistributive welfare state, but 'welfare for industry' through producer subsidies and the rigging of market outcomes was completely abandoned.

The three central pillars on which the new capitalist economic constitution rests are the Reserve Bank Act of 1989, the Employment Contracts Act of 1991, and the Fiscal Responsibility Act of 1994.

After 1994, the reformatory zeal flagged. Successive conservative-led governments demonstrated by their very behaviour and the opportunistic breach of electoral promises that they no longer believed in free markets, self-reliance and minimal government. The share of public spending crept up again. The main reason for the directionless drifting of successive governments during the 1990s was the new electoral system, which mixed directly elected representatives with party-list nominated parliamentarians. This prevented clear majorities, weakened the voter control of direct election, and favoured political backroom compromises. Opponents of liberalisation, who had lost every argument about the new economic order, understood the interdependence of the economic and the political order and managed to have the political institutions overturned in favour of a regime that would eventually bring a collectivist majority back to power[4].

Anderton counter-reforms are becoming known, competitiveness and freedom rankings can be predicted to plummet further—an ill omen for future international capital flows and economic growth prospects.

[4] Observers of the European parliamentary systems now propose direct, first-past-the-post voting as a partial remedy for controlling rampant political corruption. It is felt that citizens can then better identify with 'their' elected member of parliament and can at least hold individual parliamentarians accountable and throw out those who have neglected to do the electors' will by voting in their party's or their supporters' special interests. For the same reason, many European cities have, over the past decade, adopted the direct election of mayors, and the majority of Australians wanted a directly elected president when polled during the 1998-99 Republic debate, because they do not trust the

In the 1990s, other reforming jurisdictions overtook New Zealand, and renewed net capital outflows reflected New Zealand's lessening attractiveness. Actual economic performance never reached the level that the quality of its economic constitution suggested. If one applies international comparisons to an economic order as highly rated as that of New Zealand, the growth rate should have been some two percentage points higher than what was realised (Kasper 1996c). A part of this shortfall in economic growth was probably a transition problem, the consequence of long-protected capacities still 'dying off' while new world-competitive capacities were 'born' slowly. When the Asian setbacks in 1997 triggered a recession, it cut deep. Unemployment, which had fallen dramatically after the reform of labour markets, went up again. More recently, however, the merits of freed-up labour markets were revealed in the unemployment rate's drop ahead of the cyclical upturn in production. The rate of joblessness now (first quarter of 2000) stands at 6.4%.

Leads and lags

If one is aware of the theory of institutional design and its psychological underpinnings (see pp. xx), one will understand why the economic reforms of 1984-94 were resented by some and why the overturning of the competitive regime now appears attractive to many.

The first Labour-led reforms of 1984-85, which had been inspired and led by Finance Minister Roger Douglas, created urgently needed relief from the economic and financial crisis in the wake of the Muldoon government's 'Think Big' spending spree (Richardson 1995; Prebble 1996). But they introduced major institutional inconsistencies. Labour markets and social welfare were largely exempt from reform, and the Labour Party had inhibitions about outright privatisation. New Zealand's economic institutions were soon out of step with each other. Liberal sub-orders clashed with the interventionist residues of an earlier era. Rising unemployment and a weak currency were the consequence. After the fall-out between Roger Douglas and Prime Minister David Lange and the sharemarket crash of October 1987, the Labour government lost its way as the incoherent economic constitution deprived it of manoeuvring space.

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more anonymous, less directly accountable candidates from party lists. In Italy's ailing electoral democracy, a referendum to abolish mixed member voting is being held in May 2000.

The National Party government of 1991 obeyed the maxim of institutional consistency better, in that they pulled labour markets in line with a liberalised competitive economy, introduced further public-sector and budget-policy reforms, and undertook some steps to address the growing dependency on public welfare. Nonetheless, the maxim of institutional consistency was either not widely understood or it was abandoned by Parliament as too difficult (Kasper 1996b). Subsequent conservative governments lost the intellectual momentum and drifted. Their behaviour demonstrated that they did not believe in the normative superiority of a consistent market order based on economic and social constitution that guarantees sustained success in international markets.

It is also important to note that the changes in New Zealand's economic constitution were shaped and imposed by a small policy elite. What was designed and imposed from above did not necessarily harmonise with the internal institutions of society, its morals, customs, conventions and work practices. After eight decades of state paternalism, it takes time for everyone to learn the *modus operandi* under a free market regime. In New Zealand, the political constitution provides for few checks and balances, so that the rule changes did not have to be explained to the wider public. This means that New Zealand's unicameral parliamentary system, simple majorities—or rather majorities in decisive and selectively staffed committees—can swiftly impose fundamental reforms of the rules. As in Eastern Europe since the fall of the Wall, however, the internal institutions of society evolved sluggishly, and the attitudes of welfare dependency were slow to change, particularly among the elderly. As in Eastern Europe, a political backlash set in once people realised that a competitive order compels everyone to shoulder the costs of competing. But this does not mean that a return in the early 2000s to the old collectivist order, even if it were feasible, would be cost-free. In the meantime, many New Zealanders—the young, the enterprising and new firms in particular—have adjusted to the competitive rules and have built this into their expectations. They will now be disoriented by the new collectivist turn in the rule system.

A litmus test for the 'primacy of politics'

The new parliament's initiatives of 2000 introduce numerous, selective areas of top-down interventionism. The new 'cabinet of union organisers and academics' remains

predominantly committed to fairly light-handed controls of international trade, payments and capital flows, as noted. New Zealand's new socialism is therefore not nationalist. This combination of openness and selective regulation is setting New Zealand up as a fascinating litmus test for the scope of what once used to be touted as the 'primacy of politics' over economic life. Many observers have come to accept that globalisation now exerts an influence over truly open economies which has a force as pervasive as gravity. Others believe that politicians still enjoy considerable sovereignty to intervene selectively. If the former group of observers—to which this author is inclined—is right, then socialism and openness will not be compatible in the long term. One or the other will have to give. Students of the art of political economy will therefore be able to gain valuable empirical insights from New Zealand's experiment in non-nationalist socialism.

The question of positive knowledge about globalisation is overshadowed by a normative problem: Is it morally defensible that properly elected, sovereign parliaments and governments are subjected to the daily verdicts of international finance and multinationals? Those who are outraged about this tend to forget what public choice economics has taught us: most parliamentarians, once elected, pursue their own self-interest and the interests of organised groups of their supporters, rather than the common good of the electorate (Kasper-Streit 1998: 285-340). Open capital markets and the free flow of information frequently compel self-seeking bureaucrats and legislators to pursue policies which dictate self-constraint and empower the citizens. Openness forces them to abandon measures that discriminate in favour of well-connected interest groups. History has shown time and again that economic openness promotes transparent rule, i.e. the rule of law, secure property rights, genuine competition, and general individual freedom (Jones 1982, 1987; Rosenberg-Birdzell 1986; Kasper-Streit 1998: 383-389). When one hears moralising about the disciplines now imposed by globalisation, one should therefore carefully analyse whose interests motivate the professed moral outrage!

Likely consequences of the reregulation of labour

On the principles of institutional design and reform

When trying to evaluate what is currently happening and when making forecasts, one has to draw on the modern theory of economic growth. It is now increasingly accepted that capital formation, both human and physical, resource mobilisation from domestic and overseas sources, rapid technical innovation, and structural adaptability to new conditions and opportunities are only the proximate causes of economic growth. They in turn depend on deeper causes, namely the underlying, enforceable rules that motivate and coordinate human action (Kasper-Streit 1998: ch. 1). These are called 'institutions'[5].

If a community's institutions form a non-contradictory whole, then they will order economic, civil and political action effectively and people will cooperate and innovate with confidence. A trust-based economy with effective institutions enjoys low transaction costs and will grow. By contrast, people who are subjected to complicated, arbitrary, and outcome-specific interventions tend to cooperate on the basis of personal relations, a more costly—though sometimes more enjoyable—way of coordinating activity. In a complex modern economy, the costs of cultivating relations are high, which means that transaction costs are high. When the rules are hard to know or poorly enforced, people become confused and often lack the motivation to explore economic improvements. Entrepreneurial energies are then diverted from cultivating commercial and technical prowess and wealth creation to sports, lobbying, redistribution, war and other non-productive pursuits (Baumol 1990). Taken to extremes, a complicated coercive rule system produces lethargy, as observed under Soviet socialism, but also under New Zealand's pre-1984 rule set. Such economies therefore

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[5] A note on terminology that we shall be using: *internal institutions* evolve from human experience and tend to be enforced spontaneously, informally and cheaply. Examples are ethical norms, work practices, conventions and customs (Kasper 1998: 44-49). They contrast with *external institutions*, such as legislation and administrative regulations, which are designed and imposed on society by political agents, however legitimated. They are enforced by formal means and rely on coercion; they tend to cause high agency and compliance costs (*ibid*: 49-50). They are often not very effective as political agents. A German study has estimated, for example, that the government can at best enforce 3% to 7% of the many rules which Parliament has decreed, if citizens do not comply voluntarily and spontaneously (Kimminich 1990: 100). Effective coordination therefore requires that external rules do not replace internal rules, but only support and complement them, and that they remain in harmony with the internal rules.

It will be most instructive to observe how this problem will be solved in the case of New Zealand's new labour-market regime that relies so heavily on external rules!

tend to perform poorly. The central importance of institutions to prosperity is often overlooked by academics and regulators. They forget all too easily that the complexity of economic life requires simple, consistent and stable rules that give citizens freedom and self-responsibility (Epstein 1995).

Underlying these observations is the fact that individuals, who want to invest their time and money in commercial, technical or organisational innovations for the sake of hoped-for but uncertain future profits, are easily overtaxed when the rules change or when the rule books are complicated. An individual is simply unable to assess all the consequences of institutional changes and fears being surprised by unexpected, deleterious side effects. In a complex and dynamic economy, changes in the tax regime or in labour-market regulations therefore work as major destroyers of confidence and as obstacles to innovation.

It is now widely accepted in law and economics that for rule systems to be effective, they need to be universal in character. People can only understand and obey rules when they are general and abstract, when they remain stable and are therefore perceived as certain, and when existing rules are open, in the sense that present rules will apply to unknown future circumstances (Kasper 1998: 51-56). New Zealand's stop-go approach to its fundamental economic rules and its increased interventionist proclivity will detract greatly from the principle of universality. This leads me to predict losses in the effectiveness of coordinating work and business. In the medium term, it will be reflected in what economists call poor 'third factor growth', namely relatively poor returns on capital and labour.

This applies *a fortiori* to modern knowledge industries, which thrive on continuing innovation and are exposed to fickle international competition. In the knowledge industries and the service enterprises of the 'new economy', a very large share of all costs are transaction costs, which depend critically on simple and expedient rules (Kasper 1998: ch. 2, 3; Kasper-Streit 1998: 95-98, 125-129, 221-228). The 'new economy' therefore requires a rule-based and steady style of public policy. Whereas traditional agriculture or manufacturing with their low-skill production routines, technological rigidities and mass-product markets provided a degree of continuity and stability, the rapidly growing 'new economy' and its tailor-made services depend on stable rules and the predictable, constitutionally bound evolution of those rules. Some New Zealand observers, who have dismissed reformers such

as Roger Douglas and Ruth Richardson as 'purists', fail to understand this fundamental fact. And policymakers, whose ideology and mentality were shaped in an earlier agricultural or industrial era, are likely to frustrate the new knowledge economy.

One aspect of New Zealand's institutional rollback of the early 2000s is that it shifts many concerns of normal private interaction from the sphere of private law, trust-based interaction and civil society to public law, supervision, relation-based interaction and hierarchical political society. When the occasional unavoidable conflict arises among citizens, they normally seek recourse to the familiar processes of private law. Private litigation is among equals and is constrained not only by considerations of private risk and private cost, but also by the realisation that the two parties have to continue doing business with each other. When legislators usurp matters of private interaction and convert them to matters of public law or quasi-public law, as now happens with private work contracts, this can easily end up in a muddled mix of responsibilities. The level of intervention, litigation and arbitration then rises and transaction costs go up. One reason for this is that third parties frequently have incentives to postpone conflict resolution and to drive conflicts to formal arbitration or litigation. After all, one woman's arbitration or litigation costs are another man's income! International experience has shown that the unclear mix of public and private law and the proliferation of intermediaries tend to make economic coordination more costly and less effective (Epstein 1996).

Another principle of constitutional economics of relevance to New Zealand is that institutions improve with age. New rules impose adjustment costs. People have to learn the new rules and alter their arrangements. As they become more familiar, rules are obeyed better and more reliably, so that everyone can operate with more confidence and lower transaction costs. There is much truth in the conservative saying that 'old rules are good rules'. But as circumstances change, the rules have to evolve accordingly (Hayek [1960] 1992).

When there is a hierarchy of rules, the existence of accepted higher-ranking and more abstract rules of constitutional quality makes it possible to adapt the lower-ranking, specific rules in predictable and orderly ways (Kasper-Streit 1998: 134-141, 381-409). This facilitates economic progress, social stability and harmony, whereas revolutionary reversals of the

fundamental rule system destroy confidence, wealth and social peace. Constitutional turnarounds simply overtax the capacity of human cognition. Naturally, people have accidents when the traffic rules tell them to drive on the right-hand side one day, and on the left the next!

There is now ample empirical and theoretical evidence to support the insight that the fundamental, overriding rules of economic coordination—a community's economic constitution—are crucial to economic prosperity. Ground rules that ensure people use their assets to compete; that suppress parliament-provided privileges for well-organised groups; that secure property rights, the rule of law, stable money and small government will typically encourage the fast growth of productivity and incomes, high employment and social optimism. Numerous international comparisons now underpin this fundamental point (Sachs-Warner 1996; Gwartney-Lawson 1997, 2000; Kasper-Streit 1998, ch. 14; Beach-O'Driscoll 2000; Barro 2000). Those who are not impressed by international surveys and correlations may instead wish to consider the track record in job creation, innovation and productivity growth in the more regulated welfare states of the European Union as compared to less regulated capitalist regimes, such as in the US, Britain, Australia and the Netherlands[6]. Stagflation in the United States gave way to ten years of vigorous inflation-free growth once a firm monetary policy, wide-ranging deregulation (under Reagan and Clinton but not Bush), flatter income taxes and growing international openness had laid down a new, liberal economic rule system.

The outcome of the great philosophical contest of the 20th century—between collectivist, coercive socialism and individualist, voluntary, competitive capitalism—can therefore be in no doubt. Economic freedom is the approach to ordering economic life which serves ordinary citizens best, and progress is driven by deregulation and self-responsibility. Dramatic institutional reversals, reregulation and 'political class' politicking are reactionary hallmarks and harbingers of poor performance further down the track.

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[6] As of early 2000, the US unemployment rate stood at 4%, the EU's average unemployment at 9%. As of 1998, the job participation rate in the working-age population was 74% in the US, and only 62% in the EU.

Simple, free and stable institutions therefore have to be considered as more important than items of physical capital, natural resources or practical skills. We are therefore justified to speak of 'constitutional capital'. Its importance is now increasingly realised around the world. A freedom- and prosperity-supporting rule set—the constitution of capitalism—is now being discovered by more and more jurisdictions and appreciated as a most valuable and worthwhile shared possession, despite the acknowledged fact that it imposes some costs and diminishes the influence of some elites.

A matter of basic philosophy

When politicians conduct ideologically driven stop-go experiments with the constitutional economic framework—as, for example, in Britain during the late 1940s, 1950s and 1960s—this can be costly in terms of growth, people's life opportunities and social optimism.

One ideological approach to governance is based on trust in responsible self-reliant individuals, who interact in civil society as equals, freely and spontanously. Private actions are then guided predominantly by the internal institutions of society and the disciplining force of free competition, but there is also reliance on private law. Operators who act in bad faith or who act maliciously, fraudulently or deceptively are soon found out and shunned; they lose their reputation and often their business. In such an institutional system, one needs the costly, coercive and often clumsy intervention of the visible hand in only relatively few cases. Governments act only as the ultimate guarantors of trust and security by protecting the key rules, but abstain from engineering specific outcomes.

The alternative concept of society and governance is to rely much more heavily on hierarchical relationships and prescriptive top-down coordination by the visible hand of government – under the motto, as Lenin put it, that 'control is better!'. Since the demise of coercive Soviet socialism, the protagonists of the collectivist approach have been careful to hide their intentions behind sugar-coated notions of communitarianism and the 'Third Way'. However, collectivist solutions always require a measure of control and coercion as people naturally try to shirk contributions and make excessive claims on public services when give

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Average capital productivity in Germany in 1998 was one-third less than in the US, and in France more than one-quarter less ('European Business Survey', *The Economist*, 29 April-5 May 2000: 4-5).

and take is subject to public choice[7]. The collectivist approach distrusts the disciplining force of spontaneous civil interaction and competition in markets[8] and introduces public law elements into many private interactions. Often, the free interaction of citizens is even proscribed as, for example, in Soviet foreign trade, and in future employment bargaining in New Zealand. In these circumstances, coordination of economic activities depends much more on the wisdom and honesty of the rulers, on centrally designed and formally imposed legislation and regulation, as well as the collective control and ownership of resources.

The practical problems with the collectivist, top-down approach have become evident in many countries. Because government authorities have limited cognitive powers and a limited capacity to regulate the complex diversity of real life, they group everyone into pseudo-homogeneous classes—industries, the working class, skill categories, average consumers—and suppress diversity. And because top-down coordination relies on hard-to-change rules, collective action often fails to cope well with dynamic evolution and change (just remember the Soviet Union!).

The main reason why top-down legislation and regulation are advocated despite their stultifying effects and the mismatch with the complex, dynamic and open-ended evolution of the modern world, is rent seeking. Interventionism allocates power and income to an influential 'political class' of regulators and guardians who believe that ordinary citizens cannot be trusted to know what is good for them. When they regulate normal human interaction, they also find it easier to extract 'tribute' (protection money, compulsory membership fees, taxes and the like). The made order also enables them to allot material privileges (rents) to well-connected groups, which in turn perpetuate the political power of the controllers (Olson 1982). However, the world is becoming more diverse, open and

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[7] In private choice, the *quid pro quo* is direct: I only sell a product, if you pay me. Transactions are voluntary and among equals. In public choice, the trade-offs are indirect: I benefit twice, by having to pay tax and by the consequences of public spending. Or I may claim public services without offering anything in exchange. So why pay a contribution? Why not free ride? This makes allocation by collective choice coercive and turns interacting parties into unequals within a hierarchy (Kasper-Streit 1998: 287-290).

[8] In a recent survey in the United States, people were asked whether Americans know enough about issues to form wise opinions what should be done: 47% of Congress, 77% of Presidential appointees and 81% of civil servants said no (Crane 2000: 10).

dynamic, and citizens are much better informed, skilled and enterprising. The levelling, deadening influence of the kleptocratic, visible hand is therefore increasingly resented. In most Western democracies, this is reflected in proliferating protest movements and growing popular contempt for parliamentarians and government officials.

The conclusion is inevitable: prescriptive, detailed interventions and stop-go changes to the economic constitution (in the sense of a regime of ground rules) lead to a weak and vulnerable economic constitution (in the sense of economic performance). There is indeed good reason for the double meaning of 'constitution': a business- and competition-friendly economic rule set makes for a robust, resilient, flexible, fast-growing and optimistic economy[9].

A lacking constitutional consensus

Fundamental and disorienting changes to the economic ground rules—such as New Zealand's zig-zag approach to its economic constitution since 1980—are normally prevented by steadying and confidence-inspiring checks and balances in the political constitution. Normally, communities operate by a hierarchy of more specific lower-level rules and more abstract higher-ranking rules of a constitutional character. These overriding constitutional rules cannot be changed easily by simple parliamentary majorities and are typically enshrined in fundamental human rights or constitutional preambles (Kasper-Streit 1998: 134-142; see also Ratnapala 1999-2000). They create a stable framework for the orderly, predictable change of the more specific rules; hence they underpin confidence in the underlying order of rules and ensure continuity along the path of institutional evolution.

In New Zealand, the overriding constitutional rules are, by and large, implicit and weak. New Zealanders have lived by the time-tested rules of the British way of life, and there has probably been little need to spell out and analyse the more fundamental shared beliefs, understandings and institutions. This informal and implicit set-up works well when it is firmly anchored in informal and shared rules of behaviour, but only if the population is fairly homogeneous in composition, worldview and material interest, and if circumstances remain

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[9]4 These fundamental insights have given rise to the dynamic new discipline of 'constitutional economics' (Voigt 1997).

fairly static. When fundamentally new solutions to problems have to be explored, and a dramatic shift in circumstances challenges the old consensus, then constitutional weaknesses are likely to be costly.

The onslaught of globalisation from the 1980s onwards made a re-examination of New Zealand's constitutional rule system necessary. The traditional rules and regulations quite obviously no longer equipped New Zealanders well to cope with the new world economy. Numerous specific rules were adapted after 1984, but little attention was paid to analysing the more abstract constitutional underpinnings. That intellectual work is still largely left undone, and has certainly not affected popular conscience. When one adds stark ideological divisions to such a transition, disorienting disruptions seem inevitable.

New Zealand has only one chamber of Parliament. No provision is made for the review of new legislation. And there is no written constitution. In practice, a small resolute group can reshape the rules of constitutional quality. If that group gains influence in key parliamentary committees it can probably determine how a parliamentary majority of 50.5% on the day rewrites the fundamental rules of social and economic interaction. This constellation enabled the Lange-Douglas and the Bolger-Richardson waves of reform to overturn the old interventionist-welfarist rule set with surprising ease. Now it is enabling another majority—or rather the minority government—to overturn the liberal economic constitution.

Such constitutional stop-go is easier in common law regimes without written constitutions, without constitutional courts committed to constitutional continuity (the Westminster system) and with an overwhelming dominance of political parties. In the United Kingdom, the confusing stop-go of the late 1940s, 1950s and 1960s was rightly blamed for the country's subsequent moral and economic decline. The Thatcher reforms, however, established a new consensus on constitutional character, which Blair's Labour Party has obviously embraced in the interest of international competitiveness and continued high economic performance.

In New Zealand's unanchored constitutional framework, there is little need to explain changes and to win allies among the wider public, so as to ensure that the belief systems,

attitudes and internal institutions are adapted. This saves on the transaction costs of reform, but hampers fundamental attitude changes and public recognition of the importance of external rule changes. Over time, basic attitudes will, of course, adapt. New internal rules will be tried out. During the transition, this inevitably creates inconsistencies between slow and fast learners and hence a fairly unstable array of partly contradictory internal and external rules. This was the underlying reason for New Zealand's relatively poor initial growth response when world-class liberalisation was imposed from above (Kasper 1996c). It will now facilitate a new series of experiments whose impacts few are able to comprehend and many dread.

Growth, jobs and income distribution in the wake of the reforms

In order to evaluate the reactionary constitutional shifts of 2000, it is necessary to assess the effects of the liberal reforms on economic performance. A good reference point for this is Mancur Olson's well-known hypothesis that the de-politicisation of economic life, the constitutional constraint of rent-seeking lobbies and the enhancement of economic liberties lead to accelerated growth, less unemployment and reduced income disparities (Olson 1982, 1996). New Zealand's institutional reforms of 1984 to 1994 have, it would seem, clearly fulfilled the first two expectations; but there is room for argument about the third.

In the 1960s, 1970s and 1980s New Zealand had a slow-growth economy. In the 1960s, New Zealand had still had an average per-capita income a third above the OECD average. By 1993, it stood at 89% of the OECD average. I estimate that the 'natural rate of economic growth'—i.e. the medium-term growth rate beyond the cycle and beyond the unsettling effects of institutional transition—was at least doubled by the institutional improvements of the early 1990s, say from a growth potential of about 1.5% to 2% p.a. to one at least 4%[10]. This means that, with a steady rule set, the productivity and measured living standards of average New Zealanders would have grown by half every 11 or 12 years, instead of 20-22 years, as previously. It also means that New Zealand's income shortfall vis-à-vis its

[10] One must not lose sight of the fact that New Zealand remains one of the poorer OECD countries, its 1999 per-capita income if valued at purchase power parities ranks somewhere between Portugal's and Spain's. New Zealanders have an average living standard of only less than three-quarters of the income of that average Australians enjoy (New Zealand Treasury 1999)

competitors such as Australia would not have widened any further. Numerous teams of international observers—for example from OECD, the WTO, the IMF, international rating agencies and the World Economic Forum—regularly implied substantive improvements in New Zealand's growth capacity in their reports and comments.

It is also apparent that the ECA, by abolishing the old centralist-interventionist awards system, introduced new flexibility in New Zealand labour markets. Like competition in any walk of life, labour-market competition acted as a standing invitation to employers and employees to incur the transaction costs of exploring and trying out improvements (Kasper 1998: 76-95; Kasper-Streit 1998: 221-234). Competing imposes some stress and costs, but the benefits are better job security, new career opportunities, and the growth of productivity and incomes. When as many participants in the economic game as possible are engaged in exploring and testing knowledge, there is a net gain: better competitiveness, faster economic growth and job creation. When competition among the suppliers of labour is administratively hobbled, as will be the case under the ERB, there may be less stress, but this will be at the expense of job security and income growth; and some will have to cope with the stresses of unemployment. On the basis of employment, wage and productivity data in the mid-1990s (Kasper 1996a: 47-54) and judging by international comparisons, I estimate that New Zealand's 'natural rate of unemployment' was reduced to about 5% by the mid-1990s. As of 2001, enforceable union rights, a higher degree of union monopoly and a return to the notion that unions 'own the job' will inevitably raise the underlying unemployment rate.

Measured income distribution is inevitably affected when the economic constitution changes. Transitions to more competitive institutions are typically associated with uneven adjustment speeds and, consequently, with changes in relative income positions. Naturally, alert people with high skills benefit promptly and reap 'pioneer rents' from moving into promising new areas. However, the New Zealand evidence does not bear out the old Marxist slogan that 'the rich are getting richer and the poor are getting poorer'. According to a 1999 study by Statistics New Zealand, income distribution in the first wave of reform became less equal, as one would expect from the uneven impact of liberalisation. The unwillingness of the Lange government to tackle labour-market regulation drove up unemployment and ensured that the middle income groups lost income shares whilst highly skilled people and

professionals made absolute and relative gains. The disposable incomes of the poorest 20% fell marginally (Kerr 1999). As a result, measured income distribution became somewhat less even.

In the wake of more a even spread of market rules, followed by the Employment Contracts Act (ECA), tax and other reforms by the National government, income distribution stayed stable. More importantly, the specific unemployment rates of groups often labelled as 'disadvantaged' dropped by more than the average (Kasper 1996a, ch. 3), as expected despite the discouraging effects of welfare hand-outs[11]. Under the ECA, low-skilled and inexperienced workers, workers with specific job requirements, and workers with disabilities were able to demand lower wages in order to gain a foothold in the job market.

However, relative income distribution is probably not an adequate measure of the social impact of reforms. What really matters is the incidence of poverty. Overall, the poorest households kept pace with income growth. If one defines households at 50% of median disposable income or less as poor, then their share has not gone up during the reform period overall (Kerr 1999: 4). Many had predicted before social welfare was tightened and labour markets were deregulated in 1991 that the poor would suffer badly. In reality, the average real incomes of the bottom 20% dropped only marginally (1.75% from 1991 to 1996).

It should also be kept in mind that real spending was more evenly distributed than incomes (as it always is) and that people drop in and out of relative poverty, whether with age, change in employment or by private choice. Thus, half of those on public welfare in June 1992 were off the list a year later, and a quarter of those taxpayers in the lowest 20% of income mover to a higher bracket within a year (Kerr 1999: 7).

As always, questions of income distribution are intricate and contentious, with causes and effects of institutional change taking a considerable time to settle. This is not the place for an exhaustive discussion of the issue. In any event, the full effects of labour-market deregulation on relative incomes will now not be allowed to work themselves out.

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[11] In New Zealand 'Newspeak', welfare recipients who are kept in poverty traps are oddly enough called 'beneficiaries'.

In summary, New Zealand's deregulation produced the beneficial results that Mancur Olson would have predicted. One can now, by inverse reasoning, predict that economic reregulation by the Clark-Anderton government will slow down growth, increase unemployment and eventually lead to a less even income distribution. The future medium-term record should be assessed against the benchmarks of 4% annual growth, an unemployment rate of 5%, and the income distribution of the mid- to late 1990s.

An evaluation of the Employment Relations Bill

Specific provisions

Good faith: The major justification for introducing the ERB appears to be that the legislator wants to ensure the prevalence of good faith in employment relations. This term is not precisely defined in the Bill but is to be given substance by a new tripartite committee that is to develop a new 'good faith code'. The official attempt to decree good faith is surprising. After all, the time-tested legal principle of good faith dealing—the prohibition of misleading and deceptive action—has been an integral and fundamental part of contract law since Roman times (*uberrima fides*). Unless the general principle of good faith and trust-based interaction is not part and parcel of New Zealand contract law, it can hardly be accepted as a reason for an employment-specific, elaborate 200-page piece of new legislation. Nor can it justify the creation of a complicated array of new organisations, commissars and commissions!

In any event, good faith is a sensible mode of behaviour in any open-ended ongoing relationship, such as a relational work contract. Self-interest dictates good faith and reliance based on mutual trust. Those who do not act in good faith tend to lose their good reputation and their business. Open-ended work contracts can only lay down certain general principles, which enable the contracting parties to address new circumstances peaceably and constructively (Epstein 1996). It is the very function of a relational contract, such as a work contract, to establish mutual trust and confidence and reduce the transaction costs of necessary adaptations to new circumstances. If employers break good faith at times of high employment, they lose skilled staff and with it much firm-specific implicit knowledge. This is why the cooperation of people under the law—precisely the conditions facilitated by the

Employment Contracts Act—cultivates mutual trust and good faith. Only in rare instances will acts of bad faith therefore be committed. One can then rely on general contract law to compel malfaisants to behave properly and to remedy torts.

The ERB is based on the assumption that bad faith in employment relations is the norm and that an apparatus of third parties and agents is needed to ensure certainty. But experience shows that third parties and detailed interventions lead to costly relations-based interaction and, indeed, induces distrust. At best, this drives up transaction costs and detracts from the competitiveness of jobs that are managed in this way. At worst, it leads to the arrogation of power by the intermediaries, as well as corruption, arbitrary discrimination and discontent.

In the ERB, the general principle of good faith is interpreted in narrower and more specific terms. On the one hand, the ERB stipulates commonsense rules, which do not need legal prescription in other countries, such as the requirement to set up a bargaining process, to meet and to respond to proposals. On the other hand, the ERB seems to understand good faith as is, for example, done in insurance law, where contracting parties are obligated to disclose all relevant conditions that may pertain to the contract, even if potentially problematic conditions cannot be specified *a priori*. The ERB thus obligates employers to share their strategic business plans, financial forecasts, possible plans for selling the business, and their information on sub-contracting and reorganisation with union representatives if this information can 'reasonably' be expected to be 'relevant'—two terms which will be a source of considerable legal uncertainty. Employers will have to consult with union officials on an ongoing basis. This will create uncertainties, apart from being a major new cost factor.

One can readily imagine nightmare scenarios under the 'good faith' provisions. If a firm is accused by a union representative of not having properly consulted with them on subcontracting work—an increasingly frequent event given the progressing division of labour—the ERA will be called in and may issue an injunction against the management's decision to subcontract work. Likewise, the sale of a business may be halted by the ERA if a breach of good faith is alleged; and it is not clear whether owners will be able to claim compensation for losses from such hold-ups, and if so, from whom.

Promotion of unions: After the introduction of the ECA, there were numerous reports that individual workers appreciated the freedom from shop steward control and benefited from the direct human contact with management (Kasper, 1996a). Does the ERB now intend to test the workers' commitment to workplace freedom? If the freedom of the ECA is still widely perceived as an improvement on the pre-1994 order, the ERB will be very hard to enforce, and workers will opt for in-house unions. There is provision for the formation of new unions, which might go some way to facilitate spontaneous, small-group negotiation and to obtain plant-level agreements without union interference. However, the ERB requires the licensing of unions by the official Registrar of Unions and indicates a high fixed cost of forming a new union. Employers are explicitly prohibited from having a hand in firm-level union formation. The formalism of registration and procedure prescribed in the ERB, and the possibility that some workers in a firm may demand union coverage, will make it hard for a company's workers to organise themselves collectively without the patronage of an established union. What the freedom to form a new union will therefore mean in practice remains uncertain at this stage.

Another explicit aim of the ERB is to promote trade unionism. The parliament will give unions privileges which other non-government associations do not enjoy. When a government uses its legislative and executive powers to promote membership of a specific private organisation, it violates the principle of equality before the law (discrimination). Indeed, the ERB's provisions boil down to blatant preference mongering that would be unacceptable to most Western parliaments. To prohibit direct communication between employers and their employees during bargaining erodes freedom of speech and would undoubtedly be unconstitutional in countries with a clearer awareness of fundamental constitutional principles.

As only unions will be licensed to strike and bargain for the new collective agreements, and given that all new employees must be employed initially on collective agreement conditions, the ERB contains strong elements of compulsion. The wide access of union leaders to workplaces, the compulsory collection of union dues by employers and the provision of paid leave for stop-work meetings make trade union membership almost obligatory again. Even where individuals bargain with employers, there are provisions for the intervention of mediators and the new Employment Relations Authority. The ERB also

requires employers to advertise union and government material to employees. Employers must, for example, bear the costs of informing new employees of collective employment conditions, inform employees if a union wishes to cover the workplace, and distribute bureaucratic material such as the Second Schedule of the ERB that explains how dismissal and other problems are to be resolved.

Union membership and union influence will also be promoted by the ERB provision that sub-contractors, if mainly controlled by one employer, will be treated as employees and will in all likelihood be subjected to collective coverage. A considerable part of the workforce, among them many of the most enterprising and independent people, will thus be subjected to inflexible, summary work conditions and 'capture' by the union organisation. The economic consequences of this can be gleaned from the difficulties into which the project to produce a large part of a 'Lord of the Rings' movie trilogy has run. The project, which was budgeted to attract $155 million in foreign earnings to the New Zealand movie industry, is in the middle of production. However, it is reported that the intending producers of the movie, along with the New Zealand producers and directors organisation, SPADA, have told ministers that the project is now at risk should the ERB go ahead. Under the ERB extras and casual support staff would *de facto* become employees and potential union members. They would probably be covered by conditions of employment that have to be negotiated with unions, and their work would be carried out under union supervision and with the consent of shop stewards and the Labour Inspectorate.

Under such institutional circumstances, great care will need to be taken to ensure that union privileges do not result in proliferating political rent-creation and protection at the expense of the common good, as defined by improving material welfare, peace, justice, freedom and security for everyone. New Zealanders have a well-earned reputation for personal honesty, but they should beware the lesson that the palm of the visible hand has to be greased often. *Dirigisme* the world over creates continual temptations for corruption.

Several of the ERB's provisions make the formal commitment to the freedom of association look hollow. Admittedly, the ERB allows the formation of new unions in a workplace, in order to facilitate competition among unions. In practice, however, it is likely that the requirements for formal union registration and other administrative-regulatory

barriers to setting up new unions will guarantee hard-to-contest market niches to existing unions. It is not clear to this observer to what extent established unions will in practice be exposed to challenges for coverage by other unions and, therefore, what the likelihood of demarcation disputes will be in future.

The high fixed cost of negotiating a bargain under the ERB is likely to promote a trend towards multi-employer or even industry-wide settlements. Once the visible hand has reduced competition, individual firms will be inclined to eliminate competition for labour and will be satisfied with knowing that their competitors pay as much for labour and are just as hampered in their pursuit of as they are. The proposed legislation eliminates many incentives for an employer and his employees to share competitive advantages by negotiating firm- and market-specific agreements. The new legislation will thus not only weaken competition among employees, but also the competition among employers and suppliers in product markets. This is bound to work against the government's declared intention to enhance product-market competition.

As compared to free labour markets with firm-level work agreements, compulsory union participation, the reliance on mediation and third-party activists, and the formalism of the ERB promise increasing rigidity. If circumstances change, New Zealand businesses will find it hard to vary work practices and remuneration quickly to retain or win market shares. Often such attempts would only risk a strike. Once this is fully realised by company managers, they will sacrifice business opportunities rather than risk new negotiations with union and government officials. Worse still, the strange rule forbidding employers to communicate directly with their employees during union bargaining may well mean that workers will in future lose their jobs without ever knowing that they could have helped to avoid this calamity by accepting concessions in working conditions.

The ERB is explicitly based on International Labour Organisation (ILO) conventions, which were framed a generation ago, long before globalisation changed the rules of the game. The ILO, a United Nations body which several countries have left because of its growing anti-employer biases, has meanwhile created much case law through its Committee of Experts, and has established the right to strike against a government's economic and

social policies and the right to secondary boycotts and strikes. These provisions may well create disputation and strikes of a kind as yet unfamiliar to new Zealanders.

Confidentiality of business information: The ERB also creates new business risks, in particular multi-employer bargaining with a union. Internal and confidential business information, secrets and commercial-in-confidence material are likely to become public. Only an academic, a union organiser or a rookie journalist could overlook the impact of this provision on the attractiveness of doing business in New Zealand. The ERB does not address the resulting problem of confidentiality. It will therefore be up to trials and errors in costly, drawn-out negotiations and legal proceedings to clarify whether binding and enforceable confidentiality agreements between an employer and union officials are feasible when union officials access business information under their new powers.

Proletarians or citizens?: The ERB is based on the assumption of an inherent imbalance between employee and employer in the work relationship. This is surprising. There are no longer masses of unskilled proletarian day labourers queuing for any job. There is no abundance of low-skilled factory workers. The world of early industrialisation 150 years ago that Karl Marx observed and Charles Dickens misrepresented is no more! Nowadays, employees are typically well educated, well-informed citizens with scarce skills. After they have worked in a business for a while, they possess much valuable implicit knowledge that will be essential for their firm's profitability. With high employment, which can be reached if labour markets are free of restrictive regulations and monopolies, unfairly treated workers are able to move to another job. This is a most effective and spontaneous discipline on employers. The labour market is thus not a confrontation between an employer cartel and desperately competing workers, but rather a market where there is competition among employers for good workers, and among workers for good jobs—in other words, a situation perfectly suited to time-tested contract law.

There is another reason why the New Zealand legislators' vision of short-sighted bosses and masses of powerless workers seems badly out of date.

The dynamic, diverse, complex industrial reality of today requires self-assured and responsible employees. Increasingly, work is no longer concerned with standardised mass

production and repetitive processes. In manufacturing and the services, the individual employee or small teams are nowadays expected to respond immediately to diverse demands by different clients. Employees have the responsibility to tailor-make the product within broad guidelines laid down by management. In manufacturing, we have now moved to 'mass customisation' thanks to information technology and, in many services, each product is tailored to the customer's requirements. In these circumstances, the hierarchical approach to employment and management is out, and the cultivation of responsible, self-managed, enterprising employees is in. This makes for partnership and not subordination (Kasper-Streit 1998: 263-282). Knowledge workers certainly do not want to work within rigid, centrally framed union rules. And they will not want self-appointed agents, who are distant from the workplace, to speak on their behalf. The transformation of the intrinsic character of work, together with a growing division of labour, is the real reason for the worldwide secular decline in union membership, including in New Zealand[12]. Knowledge workers are simply not the type of employees to whom the old socialists' view of the work relationship can ever apply!

Redistribution of incomes: One of the ERB's express goals is to redistribute income and ensure more favourable employment conditions for employees. This goal seems misconceived. If compulsory legislative means are used to shift incomes from profits to wages, and if regulatory complications hinder productivity growth, higher wages cannot be earned in the longer run. Interventions to change this will only reduce employment and efforts to explore new sources of productivity. The legislators can arrogate to themselves the power to allot a larger share of the national income cake to poorer and less skilled workers, but when they do, they ensure that the cake will grow more slowly. New Zealand voters have the choice between a bigger employee share in a slow-growing cake, or the fast growth of the cake, which sooner or later makes their real incomes grow fast.

Proliferation of intermediaries: In daily life, intermediaries are often not the solution but the cause of problems. Human experience has shown that the reliance on direct face-to-face conflict resolution and internal rules, such as work practices that evolve on the shop floor and their spontaneous enforcement, are effective and cheap. Imposed external rules and third-party

[12] Exceptions from the secular downward trend in union membership are Sweden and some other

meddling typically result in high agency and compliance costs; inconsistent, arbitrary application; and cumbersome delays. Moreover, third parties often have a bureaucratic self-interest in inflating conflicts and delaying conflict resolution. After all, what looks like high transaction costs to the business and the workers is the intermediaries' income and their *raison d'être*. The formalism and coercive content of the ERB, and the proliferation of official agencies that are to speak on behalf of workers, threatens a takeover by the intermediaries and agents of public law by elbowing aside those directly concerned, namely the employers and the workers. Naïve and good-natured observers may still hope that common good will and common decency will suffice to prevent abuses of the ERB's provisions by officials and union activists, and that organised interest groups and opportunistic intermediaries will not 'capture' the rule making process for their selfish advantage. Public choice theory and international experience suggest otherwise: it is dangerous to govern the unions by law made by the unions for the unions.

At the very least, the ERB contains numerous mechanisms with the potential to annoy job providers. In some instances, the ERB creates major new risks for those providing employment. For example, the personal liability of company directors and managers for wages and holiday pay (and possibly redundancy pay) makes employing people personally highly risky. This provision amounts to a revolutionary overturn of the time-tested institutions of limited liability which have, since the 19th century, been crucial to the rise of capitalism and the exploitation of new knowledge (Rosenberg-Birdzell 1986: 197-199, 216-238). Limited liability enabled enterprising people to develop and test promising ideas without having to fear personal financial annihilation. By curtailing this traditional risk protection, the ERB has the potential to take New Zealand back to pre-modern conditions of industrial stagnation.

Observers who are acutely aware of the fundamental shifts in global economic and technological circumstances and who understand the effects of (re)regulation on transaction costs, must conclude that the changes in New Zealand's employment regime will reduce the competitiveness of New Zealand jobs in world markets. The proposed counter-reform of the underlying economic constitution therefore seems very risky.

NW European countries.

Winners and losers

Who will be the major winners and losers from the change in labour-market regime?

The activist interventionism of the ERB will certainly create one class of major winners, namely the 'political class' of intermediaries—union organisers, inspectors, judges, bureaucrats, employer representatives, lobbyists, committee organisers, clerks, industrial-relations researchers, advocates and other agents. Agents on both sides of the work relationship and organisers of collective action will again be able to justify each others' existence. This in turn will justify the growing interventionism of parliamentarians, who will often neglect the common good and respond to demands for interventions by organised interests. Party fundraisers can therefore also be expected among the big winners. To observers with an understanding of public choice—the economics of politics, or the analysis of tribute and kleptocracy—the New Zealand counter-reform looks like a manoeuvre by well-organised interest groups to capture rule making; in this case, organised labour, the bureaucracy and parliamentarians who cater to collectivist sentiment.

The conversion of individual work relationships into the collective organisation of industrial relations will be at the expense of normal, commonsense, face-to-face attempts to solve the inevitable small daily problems and conflicts. The spontaneous ordering amongst those who are directly involved and who are therefore well informed will again be replaced by a made order (the visible hand) and the intervention of less informed outsiders. Soon, it will again be hard for most people to imagine that society can do without the efforts of guardians and other such third parties. Only when one benchmarks a collectivist-regulatory order against a spontaneous order and the conflict-solving capacity of free markets, are the intermediaries perceived as a parasitic imposition.

Much entrepreneurial energy will in future be diverted from technical and commercial innovation to rent-seeking and politicking—from positive- to zero-sum games. The major losers are likely to be small enterprises and those people with ideas, ambition and some resources whom a regulatory state discourages from trying out their ideas and starting new ventures. A regulated labour market and a prescriptive state are the kiss of death for the

Silicon-Valley style dynamism and the creative diversity that drives what is now called the 'new economy'. In the longer run, economic growth will therefore be the loser.

Major losers will also be those employees who appreciated the dignity of representing themselves in their dealings with their employers. They are likely to feel disenfranchised by an intermediary-ridden regime of work that is altogether less humane. A depersonalised work atmosphere—where one constantly looks over the shoulder what the Inspector or the Sex Discrimination Investigator might say—will not appeal to that majority of workers. For them, work is an important part of their social life and good work performance is a source of personal satisfaction, apart from being a source of income (Sloan 1999).

It has to be kept in mind that New Zealand's is a wide open labour market and that the young have a great propensity to move from Auckland to Sydney or London. They form a key asset of any small, knowledge and enterprise driven economy. And it is of concern that the net immigration of the 1990s has turned, again, into net out-migration. Many workers are already voting on the ERB in the most meaningful way—with their feet.

When reading through the Bill, one cannot help but gain the impression that normal bilateral employment relationships are perceived by the ERB's authors as having become dysfunctional, in constant need of intervening mediators—as if every marriage had to be enhanced by the presence of counsellors and divorce lawyers! Whereas the ECA confines itself to addressing rare breakdown, the ERB will turn collective agents and mediators into an integral and central part of the relationship.

The most serious concern with the ERB from the point of view of institutional design is that it turns the work-life segment of civil society and the freedom of association into losers. Free trade unions are essential to justice, security and equity, just as other free associations are. After all, most individuals do not function effectively in isolation, and free associations—such as churches, clubs and unions—help most people to learn, to coordinate activities, and to feel appreciated. Freedom of association is therefore an essential human right. But membership in free associations must be voluntary; the freedom to associate includes the freedom not to associate, or to exit. The 'exit option' is essential to ensure that the officers of the association do the bidding of the members, instead of becoming a law

onto themselves and acting as the bosses. The New Zealand legislature is now reducing the genuine freedom of equals to associate by licensing 'clubs' that have a right to strike and negotiate work conditions for people in a given workplace, even non-members. The legislature will also coerce third parties, namely employers, to distribute information and collect membership fees on behalf of licensed unions.

The New Zealand parliament is supposed to act in the common interest of all citizens. But it now intends to adopt legislation originally drafted by the central trade-union organisation in order to engineer targeted rates of union membership. Will there be more resolute interventions later if workers resist joining a union and official unionisation targets are not met?

Parliamentary privileges for licensed unions, as well as the intervention of government agents with coercive powers and the rise of public welfare, diminish the freedom and the self-responsibility of citizens to associate as they please. They detract from a free civil society. One hundred years ago, one might have been ignorant of the consequences of such interference. But the state takeovers of civil society by socialist regimes in the 20th century, under Lenin, Stalin, Hitler, Mussolini and Mao Zedong, has taught us the important lesson that collective takeovers of parts of civil society inflict great harm to freedom and prosperity. Admittedly, the ERB is only a mild step in the direction of emaciating civil society and individual liberty. However, institutional regimes are now being reshaped around the globe to ensure that civil society is better protected from coercive meddling by governments and parliament-privileged groups. This is now setting stricter standards for the freedom of association than were common when, for example, the ILO was founded over a generation ago. The intention of New Zealand legislators to go against the historic global trend will force New Zealand citizens to test the veracity of the verdict that 'those who refuse to learn the lessons of history are condemned to repeat them.'

The shift from the ECA to the ERB will have one final and major consequence. At present, employers and employees are challenged to compete. This means they must continually expend effort to search for improvements and creative responses to new opportunities. Such competition, though not always comfortable, is deeply satisfying to many. Once competing becomes a casualty of regulation, the overall outcome will be less

interest and stimulation, and New Zealand will again be a sullen and less attractive place for enterprising people.

Conclusion: from a spontaneous to an imposed order

The abolition of the ECA by parliament, in conjunction with the other selective shifts to collective and coercive interventionism, marks a far-reaching reversal of New Zealand's current economic constitution. Seen in isolation, most individual changes may seem small and justifiable. But the cumulation of new interventions amounts to a risky gamble with New Zealand's fragile economic resurgence. Some leaders in politics and industry are now resigned to a sweeping deliberalisation of the economic ground rules, and live in hope that a future National Party victory will again promote wide-ranging deregulation. But such a constitutional stop-go only serves to confuse investors. It is one matter to slow reforms to a snail's pace but still proceed in the same direction (as the New Zealand parliament did in the late 1990s). But it is quite another to reverse the direction of institutional change. If a community switches from traffic rules that mandate driving on the right-hand side of the road to the left, accidents are bound to happen and the flow of traffic is bound to slow down. The zig-zag approach to institutional change therefore raises transaction costs and augments the risks for those considering productive long-term engagements in New Zealand. Fundamental institutional turnarounds like that of 2000 thus constitute a distinct and durable drawback for the international competitiveness of those working in 'location New Zealand'. The lack of stabilising anchors for the country's underlying order will prove a serious handicap to economic progress and personal freedom, once the current cyclical upswing and the current political euphoria have petered out.

If one comprehends the central importance of free and stable institutions to prosperity, justice and freedom, then one is likely to watch the destruction of 'constitutional capital' by the present New Zealand government in disbelief. Do New Zealand voters really want a return to union monopolies, strikes and shop-steward meddling on the shop floor? Do they really believe that the grab for power of the intermediating 'political class' elites will improve their lives?

To observers who believe that progress is automatic, it may come as a surprise that communities at times discard technological and institutional knowledge which has proven widely advantageous. Famous examples are the abolition of the seemingly superior alphabetic writing system in Korea, which King Sejong had introduced in the 15th century, and the abolition of guns in Togukawa Japan[13]. Many Europeans, of course, also disliked guns and canons, but could not suppress them without risking being overrun by better-armed neighbours (Diamond 1997: 257-258). The upshot of all known episodes of rejection of useful knowledge is that elites in closed societies are sometimes able to suppress technologies and institutions which are useful to the population at large, but not to the interests of a reactionary elite. In open societies it is not possible to suppress or reject productive knowledge. The 'political class' elites who are now discarding many of the key elements of the New Zealand constitution of capitalism seem to believe that they can act like reactionary Mandarins in the Hermit Kingdom or like the warlords of insular Japan. But New Zealand's 'splendid isolation' is gone! Consequently, New Zealand citizens and firms will again have to cope with the risks and tribulations of being overtaken economically.

It is the government's declared hope to 'promote an increase in workplace productivity through improved workplace relationships' (Lingard 2000: 4). This hope seems misplaced. The complications of the rule system, the intervention of government agencies with coercive powers and unions with state-sanctioned privileges, together with the regulatory formalism of the ERB, will add greatly to the transaction and compliance costs of employing people. Many natural, evolutionary productivity improvements will no longer seem worthwhile. Many evolutionary improvements in the free institutional order can now no longer happen. All this will be at the expense of ordinary workers and those who have not yet found access to work.

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[13] The Korean alphabetic script, which is once again in use in Korea, simplified literacy and access to knowledge, thus weakening the power of the Mandarins. They eventually managed to return Korea to the archaic way of writing with Chinese characters, which gave them kudos and exclusive power.—Japan had produced many excellent guns after their introduction by the Portuguese in 1543. But guns did not suit the *samurai* elite, and their abolition, even as hunting rifles, allowed the elite to carry on warfare and slaughter by sword.—The rejection of useful knowledge in both these cases came to an end when the respective societies were opened to the world.

The ERB, in conjunction with the forthcoming Minimum Code of Employment Rights, is legislation by the unions for the unions. It creates huge new legal uncertainties for enterprises. Many of the intricate new prescriptions will have to be tested and interpreted in courts since the new institutions come with a hard bite: sanctions, injunctions, compliance orders, penalties and damages claims. One can also expect that employers will try to circumvent costly new workplace regulations by searching for creative and legally sustainable counter-strategies, not a cost-free exercise. Some of them will probably be contested by the unions and one of the government agencies—again, a source of legal uncertainty and higher transaction costs for those providing jobs in years to come.

The ERB imposes the additional compliance and transaction costs of public law and third-party intervention. Big corporations will, of course, be able to build up their legal and industrial-relations departments to cope, but this will affect their asset values over the longer term, and hence the wealth of New Zealand shareholders. Small firms and start-up enterprises will be diverted from concentrating on commercial and production tasks, and will frequently make the rational choice to remain ignorant. Given the coercive and employer-annoying nature of many of the ERB's provisions, they will, in that case, be running high risks. Administrators and academics frequently assume that 'regulatees' will learn new rules eagerly and with dedication. But limits of human cognition and the many pressures of daily business life, particularly in small firms, mean that most simply have to live in 'rational ignorance' of the rules. They resent the nagging feeling that they are not abiding by the rules. But what can they do? Many will give the game away.

The institutional set-ups, which underpin success stories of good economic performance, resemble each other. But economic failures differ widely. This is an application of the *Anna Karenina principle*[14]. New Zealand policymakers struggled to shape the constitutional conditions for success in the open global economy. And popular belief systems and attitudes have gradually, though imperfectly, begun to fall into line. The sharp left turn of 2000 is now

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[4] This concept of social science is inspired by Tolstoy's opening sentence in *Anna Karenina*: 'Happy families are all alike; every unhappy family is unhappy in its own way.'

disrupting the process and is paving the way for New Zealand's very own path to economic underperformance.

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