

Submission

By

**THE
NEW ZEALAND
INITIATIVE**

to the Ministry of Business, Innovation and Employment

on

Designing a Fair Pay Agreements System Discussion Paper

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1 INTRODUCTION AND SUMMARY

- 1.1 This submission in response to the Ministry of Business, Innovation and Employment (**MBIE**) Discussion Paper, *Designing a Fair Pay Agreements System*,¹ is made by The New Zealand Initiative (the **Initiative**), a think tank supported primarily by chief executives of major New Zealand businesses. In combination, our members employ more than 150,000 people. The Initiative undertakes research that contributes to the development of sound public policies in New Zealand and the creation of a competitive, open and dynamic economy and a free, prosperous, fair and cohesive society.
- 1.2 In making this submission, we have drawn on the research and recommendations in our report, *Work in Progress: Why Fair Pay Agreements would be bad for labour* (July 2019) (**our Report**).² A copy of our Report is **appended** to this submission.
- 1.3 Our Report concluded that the Government must reject the recommendations made by former Prime Minister Jim Bolger's Fair Pay Agreement Working Group (**FPAWG**),³ or face harming our economic growth and productivity and the interests of workers, the unemployed and consumers.
- 1.4 In response to the issues raised in the Discussion Paper, we submit that:
- (a) New Zealand's labour markets are performing very well, with high levels of employment, high levels of labour market participation, and one of the highest rates of job growth creation in the OECD. The Government should be very cautious before altering labour market settings that are working very well for workers and overall wellbeing.
 - (b) The economic concerns identified in both the Discussion Paper and the FPAWG Report are either false or are not problems that a system of Fair Pay Agreements (**FPAs**) can solve. This latter conclusion is consistent with advice to Cabinet from Treasury questioning the rationale for introducing FPAs.⁴
 - (c) The evidence and academic literature suggest FPAs would likely harm New Zealand's already fragile productivity growth. Inexplicably – and in contrast to the FPAWG Report – the Discussion Paper omits to cite the 2018 OECD study that cautions that centralised bargaining systems (like FPAs) tend to be associated with lower productivity growth if coverage is high.
 - (d) While FPAs will be good for unions, they will likely harm the interests of everyone else – including workers, the unemployed, consumers, and overall wellbeing.
 - (e) New Zealand's system of regulation already has provisions to protect vulnerable workers. These include our minimum wage laws, along with Part 6A of the *Employment Relations Act 2000* (**ERA**). The ERA, the Holidays Act 2000, and the KiwiSaver Act 2006 also contain a suite of statutory minimum protections that apply to *all* employees. There is simply no need for FPAs. FPAs are a “solution” looking for a “problem”.

¹ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” Discussion Paper (Wellington: New Zealand Government, 2019).

² Ministry of Business, Innovation and Employment, “Fair Pay Agreements: Supporting Workers and Firms to Drive Productivity Growth and Share the Benefits,” Recommendations from the Fair Pay Agreement Working Group (FPAWG Report) (Wellington: New Zealand Government, 2018).

³ Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour” (Wellington: The New Zealand Initiative: 2019).

⁴ Ministry of Business, Innovation and Employment, “Cabinet Paper to Establish the Fair Pay Agreement Working Group” (Wellington: New Zealand Government, 2018), 1.

- (f) Solutions to New Zealand’s poor productivity growth, poor wage growth, and poverty problems require different policy responses, including solving our housing affordability crisis, arresting the declining educational outcomes for school leavers, and fixing other aspects of social and regulatory policy.
- (g) The Government will not achieve its goal of promoting a highly skilled and innovative workforce; an economy that delivers well-paid, decent jobs; and broad-based gains from economic growth and productivity by “fixing” what (the labour market) is not broken.
- (h) If the Government were nevertheless to introduce a framework permitting FPAs, and if FPAs are to have any legitimacy, they must:
 - be introduced incrementally, targeting only industries or occupations where there is evidence of labour markets failing workers and employers;
 - extend only to employees, and not to independent contractors;
 - have a high level of worker and employer support;
 - permit both workers and employers to opt out of the FPA process; and
 - be subject to rigorous ex ante and ex post market impact assessment to ensure they will not have/have not had detrimental effects on either the employment levels in any industry or occupation, or on competition and productivity in any industry or sector (both nationally and regionally).

2 NEW ZEALAND’S LABOUR MARKETS ARE WORKING VERY WELL

- 2.1 Rather than finding systemic problems in New Zealand’s labour market settings that might require a radical reform of the type proposed in the FPAWG Report and the Discussion Paper, our research found that New Zealand’s labour market settings are working very well:
- Unemployment is comparatively low when compared with other OECD countries (4.2% compared with an OECD average of 5.2%);⁵
 - New Zealand has enjoyed the third-highest rate of jobs growth in the OECD in the period since the reforms;⁶
 - At 80.9%, our labour market participation rate is among the highest in the world.⁷ Among developed countries, we are bettered only by Sweden, Switzerland and Iceland. And New Zealand’s position in the front ranks compares extremely well with the EU average (73.6%) and the OECD average (72.1%).⁸
- 2.2 Our current employment record compares favourably with New Zealand’s past employment performance. Before the transformation of our domestic industrial relations under the *Employment Contracts Act 1991 (ECA)*, the predecessor to the ERA, our labour market participation languished at a low 73% and unemployment exceeded 10%.⁹
- 2.3 The 1991 labour market reforms dismantled New Zealand’s national industrial awards system, under which most workers were represented in negotiating their terms and conditions of

⁵ Ibid. 9.

⁶ OECD. Stat, “Economic Outlook 105 – May 2019,” Website.

⁷ OECD, “Labour Force Participation Rate” (Paris: OECD Publishing, 2019).

⁸ Ibid.

⁹ Statistics New Zealand, “Unemployment rate,” Website, http://archive.stats.govt.nz/browse_for_stats/snapshots-of-nz/nz-progress-indicators/home/economic/unemployment-rate.aspx.

employment by unions through a system of collective bargaining. In its place, the ECA permitted individual employment contracts (now individual employment agreements) that are prevalent among workers today.

- 2.4 Since the 1991 reforms, average real hourly wages in New Zealand have increased cumulatively by around 30%.¹⁰ And New Zealand's labour markets are lifting the wages of workers in all deciles. This is at a time when wages for low income workers have been stagnating in some advanced OECD countries for decades.¹¹
- 2.5 It is hardly a surprise that other countries have either emulated – or are looking to emulate – aspects of New Zealand's flexible approach to labour market regulation. Most notably (and recently), France under President Emmanuel Macron introduced “revolutionary” changes to French labour laws in 2017. These changes permit French workers and employers to negotiate at an enterprise level, instead of the formerly compulsory system of sector-wide bargaining.¹²
- 2.6 Consequently, we consider our Government should be very cautious before altering labour market settings that are working very well for labour and where the evidence does not disclose any problems with their operation. Clear evidence of why proposed alternative labour market arrangements would produce superior outcomes for market participants – workers and employers – should be presented before adopting the recommendations of the FPAWG to reintroduce a system of compulsory, industry- or occupation-wide bargaining under FPAs.

3 THE ECONOMIC CONCERNS CITED IN SUPPORT OF FPAs ARE EITHER FALSE OR WILL NOT BE SOLVED BY FPAs

- 3.1 The MBIE Discussion Paper and its accompanying “Message from the Minister” (Workplace Relations and Safety Minister Ian Lees-Galloway)¹³ repeat a number of economic claims in support of FPAs that are untrue. Those assertions include:
 - A false claim that income inequality has been rising since the early 1990s, when New Zealand's labour markets were reformed and both compulsory unionism and the system of industrial awards that had dominated the previous century were abolished.¹⁴ As we demonstrate in our Report, market income inequality under the most cited measure has actually *fallen* since the early 1990s.¹⁵ While income inequality has increased over the past three decades in many countries, it has fallen in New Zealand.
 - A false claim that “incomes at the bottom [have] stagnated” since the 1990s reforms.¹⁶ The FPAWG itself finds that in the decades since the reforms, average hourly wages rose

¹⁰ Statistics New Zealand Infoshare, “Labour Cost Index (Salary and Wage Rates),” Table QEX001AA, Website.

¹¹ See, for example, Drew DeSilver, “For most U.S. workers, real wages have barely budged in decades,” Blog post (Pew Research Center, 7 August 2018), in relation to US wages.

¹² Caroline Mortimer, “Emmanuel Macron signs sweeping new labour law reforms amid union outcry,” *The Independent* UK (22 September 2017), and for an easily digestible summary of the President Macron's labour market reforms, see Nicholas Vinocur, “5 key points from Macron's big labor reform,” *Politico* (31 August 2017).

¹³ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 2–3.

¹⁴ *Ibid.* 2.

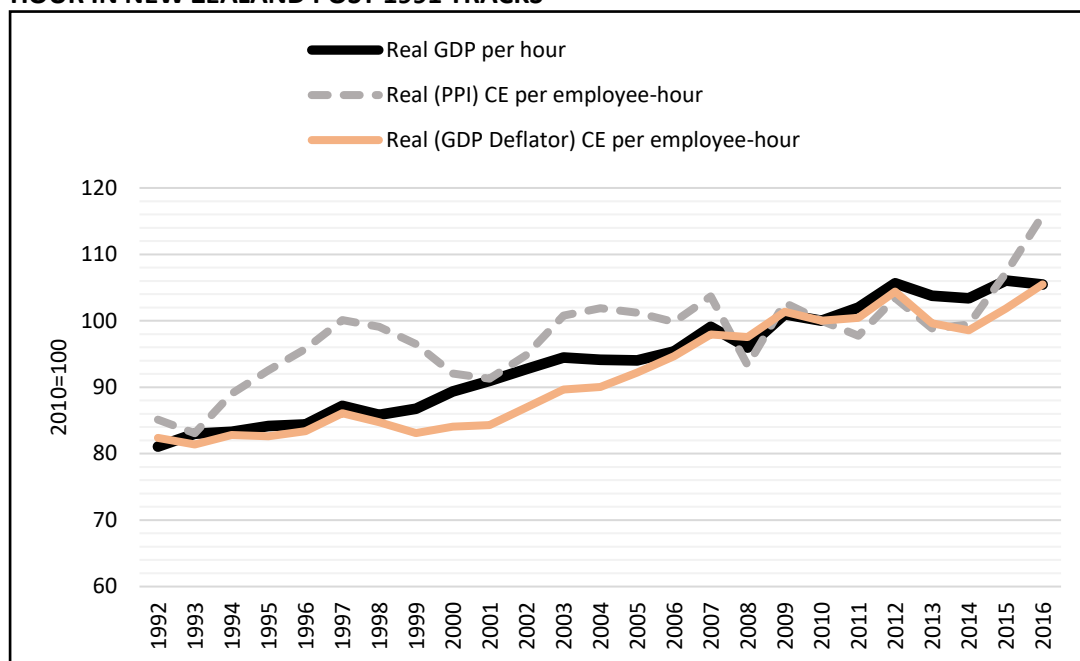
¹⁵ Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. 23–24.

¹⁶ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 2.

materially *in every wage decile*.¹⁷ New Zealand’s experience contrasts with outcomes in some OECD countries where wages have been stagnating for decades.¹⁸

- That a so-called “race to the bottom” problem exists within the New Zealand economy whereby “good” employers are missing out by “bad” employers by driving down workers’ wages.¹⁹ Our research shows real increases in average wages in every one of the industry groups tracked by Statistics New Zealand.²⁰
- A false claim that overall average wage growth in New Zealand is not keeping up with increases in productivity.²¹ As we showed in our Report,²² average real wages are trending upwards in step with New Zealand’s (admittedly low) productivity growth. Indeed, the OECD has recently singled out New Zealand – along with Denmark – as countries where real median wage growth has *closely tracked* productivity growth.²³ This close tracking is readily apparent in Figure 1, reproduced from our research note, “Response to CTU ‘Fact Check’ 10 July 2019”.²⁴

Figure 1: REAL GDP PER HOUR AND TWO MEASURES OF REAL EARNINGS PER EMPLOYEE HOUR IN NEW ZEALAND POST 1991 TRACKS



Source: OECD, “GDP per hour worked,” “Labour compensation per hour worked,” “Producer price indices (PPI),” and “GDP deflator,” Websites.

¹⁷ Ministry of Business, Innovation and Employment “Fair Pay Agreements,” op. cit. Figure 3.

¹⁸ See Drew DeSilver, “For most U.S. workers, real wages have barely budged in decades,” op. cit.

¹⁹ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 2–3.

²⁰ Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. 24–26.

²¹ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 2.

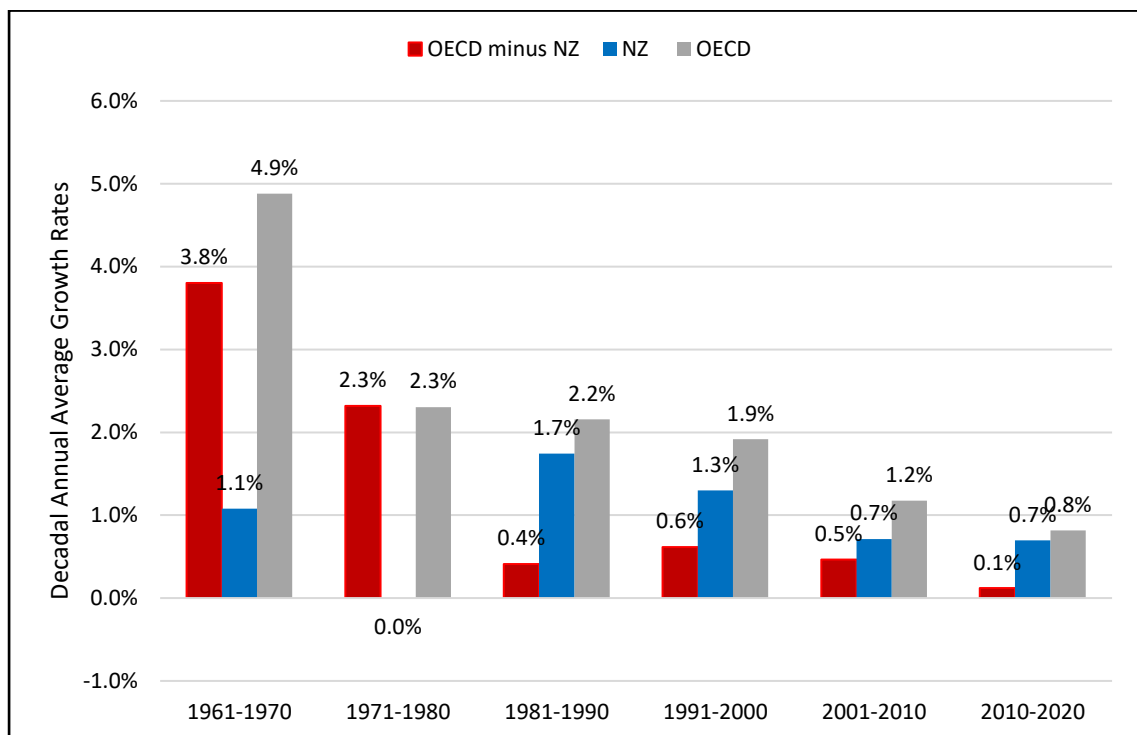
²² Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. Figure 3 and 19–22.

²³ OECD, “Good Jobs for All in a Changing World of Work: The OECD Jobs Strategy,” Meeting of the OECD Council at Ministerial Level (Paris: 30–31 May 2018), 19, www.oecd.org/mcm/documents/C-MIN-2018-7-EN.pdf.

²⁴ Bryce Wilkinson, “Response to CTU ‘Fact Check’ 10 July 2019” (Wellington: The New Zealand Initiative, 2019), 7.

- 3.2 The “Message from the Minister” attached to the Discussion Paper refers to two additional matters in support of FPAs we wish to comment on. The first relates to worrisome levels of poverty, including child poverty. The second is New Zealand’s poor record of productivity growth. However, there are no good explanations indicating that New Zealand’s labour market settings are responsible for either problem – or that introducing FPAs would solve them.
- 3.3 Dealing with the poverty issue first, as noted above, the past 30 years have seen a *decline* in market income inequality.²⁵ In this regard, New Zealand’s experience is quite different from that of many other advanced OECD countries. It is true that low income households in New Zealand have been severely affected by rising housing costs. But the effects of the housing crisis on poverty in New Zealand derive from problems in the *housing market*.²⁶ However, there is no evidence suggesting New Zealand’s poverty statistics stem from problems with the operation of New Zealand’s *labour market*.
- 3.4 Turning to the productivity problem, as we acknowledge in our Report, productivity growth is the Achilles heel of the New Zealand economy.²⁷ But the productivity problem dates back at least two decades *before* the 1991 reforms.²⁸ Since the reforms, New Zealand in the 1990s saw its highest level of productivity growth in nearly half-a-century.²⁹ Furthermore, OECD cross-country data shows a substantial *increase* in New Zealand’s labour productivity relative to the OECD average since the economic reforms of the 1980s and early 1990s (see Figure 2).

Figure 2: NEW ZEALAND’S IMPROVED LABOUR PRODUCTIVITY PERFORMANCE AGAINST OECD AVERAGE (1961–2020)



Source: OECD Economic Outlook Annex Tables (July 2019, forecasts to 2020).

²⁵ Ibid.

²⁶ Bryan Perry, “Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982 to 2017” (Wellington: Ministry of Social Development, 2018), Section F, 121–134.

²⁷ Ibid. 7.

²⁸ Ibid. 27, Figure 10.

²⁹ Ibid.

The evidence of New Zealand’s productivity record simply provides no evidence linking our low productivity growth with the early 1991 labour market reforms.

- 3.5 Treasury has pointed to the lack of links between the problems identified by the Workplace Relations and Safety Minister and his proposals to implement a system of FPAs in its advice to Cabinet in 2018.³⁰ Treasury specifically questioned whether there was evidence suggesting imbalances in bargaining power (which FPAs are designed to address) caused the wage and productivity concerns highlighted in the Cabinet paper.³¹ Even if bargaining power were the problem, Treasury noted that the Cabinet paper does not set out a “strong case that industry- or occupation-level bargaining would be the most effective policy response to address these concerns”, or refer to an evidence base to support the potential impacts of FPAs.³²
- 3.6 Treasury also pointed out that MBIE’s work in support of the recommendations in the Cabinet paper “has not identified an occupation or industry in which the proposed system [of FPAs] would address the highlighted wage and productivity concerns.”³³
- 3.7 Two more claims about productivity made in the Discussion Paper need to be addressed.

Misconceived claims about training and development

- 3.8 The first is the claim that the absence of collective bargaining has caused under-investment by employers in training and development, and that FPAs will lift productivity by increasing the incentives for firms to invest in up-skilling their workforces.³⁴ This claim is not supported by any evidence of the levels of training undertaken by businesses – or of an alleged training “deficit”. It is bad economics and also suggests that firms do not know what is in their best interests and that regulation (in the form of FPAs) is needed to resolve this.
- 3.9 If FPAs are effective in forcing wages above the level that workers’ productivity can justify, firms can be expected to substitute technology for labour or, if otherwise unable to restore competitiveness, cease to operate. (Or, as the Cabinet paper recommending the formation of the FPAWG put it, FPAs will “encourage resources to shift from less productive firms and industries to more productive uses”.³⁵ As we pointed out in our Report, it is speculation that the “resources” – people and capital – will be able to find other, more productive industries to work and invest in.³⁶ If they are unable to, New Zealand’s average labour force productivity may increase. But this will come at the cost of those forced into unemployment. Shutting the least productive workers out of the workforce is not a sensible formula for labour market reform.)

Misrepresentation of OECD cross-country studies

- 3.10 The second matter relates to OECD studies based on cross-country data on the impact of compulsory, industry-wide collective bargaining on productivity. As we note in our Report, an OECD report relied on by the FPAWG warns:³⁷

³⁰ Treasury, “Upcoming Cabinet Paper: Fair Pay Agreements” (Wellington: New Zealand Government, 3 May 2018), paragraph 8.

³¹ Ibid.

³² Ibid. paragraphs 9 and 10.

³³ Ibid. paragraph 10.

³⁴ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 3, 12.

³⁵ Ministry of Business, Innovation and Employment, “Cabinet Paper to Establish the Fair Pay Agreement Working Group,” op. cit. paragraph 43.

³⁶ Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. 28.

³⁷ OECD, “OECD Employment Outlook 2018” (Paris: OECD Publishing, 2018), 95.

... delinking of wages from productivity [as a consequence of centralised collective bargaining] could have potentially important implications for productivity growth. It could reduce incentives for employees to work hard, innovate and move to a better-paid job.

- 3.11 The OECD repeated this warning in June 2019, noting that collective bargaining is a potential impediment to productivity growth rather than a prescription for improving it.³⁸
- 3.12 In response to the OECD research, the FPAWG did note in its report that “the evidence in the research literature suggests wages tend to be less aligned with labour productivity in countries where collective bargaining institutions have a more important role.”³⁹
- 3.13 Unfortunately, such warnings about the adverse effects of a centralised compulsory collective bargaining system like FPAs for productivity are ignored in the Discussion Paper. To the contrary, the Discussion Paper claims the OECD reported that adopting a system of FPAs could lead to “better productivity outcomes”.⁴⁰ This claim is both incorrect and misleading.
- 3.14 The OECD paper cited in the Discussion Paper draws a distinction between “centralised” collective bargaining systems and “organised decentralised” collective bargaining systems.⁴¹ The OECD finds that “[c]entralised bargaining systems tend to be associated with lower productivity growth...”⁴² It finds that “organised decentralised” systems do not have an “adverse effect on productivity” [emphasis added].⁴³ The OECD does *not* find that such systems have “better” productivity outcomes than fully decentralised systems (as we currently have in New Zealand). Indeed, the OECD report finds that the response of wages to productivity is greatest among countries with the least wage coordination and the least collective bargaining coverage.⁴⁴ The claim to the contrary in the Discussion Paper is a misreading of the OECD study.
- 3.15 The claim is also misleading because the system of FPAs proposed by the FPAWG is more akin to a “centralised” system of bargaining than it is to an “organised decentralised” system. That is because the proposed framework of terms and conditions to be covered in an FPA is comprehensive, covering all the key terms governing an employment arrangement, including:
- wages and how pay increases will be determined;
 - terms and conditions, namely working hours, overtime and/or penal rates, leave, redundancy, and flexible working arrangements; and
 - skills and training.

While the proposed “favourability principle” will allow individual employers to offer better terms and conditions than those set out in an FPA, that does not amount to “allow[ing] more detailed terms to be negotiated at the level of specific businesses.”⁴⁵

- 3.16 An accurate reading of the OECD report indicates that a system of FPAs is likely to harm New Zealand’s already poor productivity growth, rather than improve it.

³⁸ OECD, “OECD Economic Surveys: New Zealand: Overview” (Paris: OECD Publishing, 2019), 29.

³⁹ Ministry of Business, Innovation and Employment, “Fair Pay Agreements,” op. cit. 17.

⁴⁰ Ibid.

⁴¹ OECD, “OECD Employment Outlook 2018,” op. cit. 74–75.

⁴² Ibid. 75.

⁴³ Ibid.

⁴⁴ Ibid. 95, panels A and B respectively in Figure 3.9.

⁴⁵ Ministry of Business, Innovation and Employment, “Designing a Fair Pay Agreements System,” op. cit. 9.

4 INDUSTRIAL RELATIONS IN NEW ZEALAND LACK THE NECESSARY PRECONDITIONS FOR SUCCESSFUL HIGH-LEVEL COLLECTIVE BARGAINING

- 4.1 OECD research shows that countries with the most successful forms of high-level collective bargaining have a high level of trust between the negotiating parties, that is, between unions and employers.⁴⁶ This is a feature, in particular, of Northern European industrial relations. Indeed, the OECD sees such trust as necessary (but not sufficient) for good outcomes from such arrangements.⁴⁷
- 4.2 Unfortunately, this trust was not a feature of the fractious, centralised Anglo-Saxon tradition that dominated New Zealand’s industrial relations for most of the 20th century – a period characterised by conflict and distrust.
- 4.3 Indeed, as we pointed out in our “Response to CTU ‘Fact Check’ 10 July 2019”,⁴⁸ the focus in the CTU’s response to our Report on the “income share” going to workers (rather than focusing on growing the pie for the mutual benefit of workers and firms). And claims of an imbalance of power and a “race to the bottom” all lend to a perception that the CTU does not want to build prosperity with business in a mutually beneficial way.⁴⁹
- 4.4 The CTU paper says “each percentage fall in labour’s share represents a \$1,000 less on average per wage or salary earner in their average pay”.⁵⁰ This also signals a combative “them versus us,” zero-sum game view of labour relations. It also suggests a failure to understand that higher real wages would have led to different investment and employment decisions. Higher real wages relative to productivity mean higher unit labour costs. That means a less competitive traded goods sector and greater net international debt.
- 4.5 Related to this is the issue of tone. The CTU disparages reasoned professional debate with political slogans and terms like “outdated thinking”. This is unhelpful. Employees and employers fundamentally want to be part of successful and prospering businesses. Firms cannot expect to be successful for long without willing and motivated workers.
- 4.6 If this is outdated thinking, the OECD study suggests the prospect for mutually beneficial collective pay agreements of the sort envisaged by the FPAWG is slim.

5 WHY A SYSTEM OF FPAs WILL THREATEN NEW ZEALAND’S ALREADY POOR PRODUCTIVITY GROWTH

- 5.1 As we note in section 3, OECD cross-country data discloses that wages tend to be *less* aligned with labour productivity in countries where collective bargaining institutions have a more important role.⁵¹
- 5.2 As we outline in our Report, there are several reasons for this disconnect,⁵² including:

⁴⁶ OECD, “OECD Employment Outlook 2018,” op. cit. 13, 75.

⁴⁷ Ibid. 75. See also, for example, International Labour Organization, “Building Trust in a Changing World of Work,” The Global Deal for Decent Work and Inclusive Growth Flagship Report 2018, Chapter I: “Social Dialogue and Industrial Relations” (ILO, 2018), 31–32.

⁴⁸ Bryce Wilkinson, “Response to CTU ‘Fact Check’ 10 July 2019,” op. cit. 8.

⁴⁹ New Zealand Council of Trade Unions, “Fact Check – Fair Pay Agreements and the ‘New Zealand Initiative’” (Wellington: NZCTU, 2019).

⁵⁰ Ibid. 1.

⁵¹ Ministry of Business, Innovation and Employment, “Fair Pay Agreements,” op. cit. 16–17. See also OECD, “OECD Employment Outlook 2018,” op. cit. 19.

⁵² Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. 29–33.

- (a) **Lack of flexibility:** FPAs are designed to apply across entire industries or occupations. By design, FPAs ignore the needs and circumstances of individual employers and their workers trying to meet the demands of a competitive domestic and international marketplace. The adverse impacts of a system of FPAs will be amplified by disruption from automation and innovation in the future workplace. Consequently, it may never have been more important that labour market regulations operate flexibly. Yet centralised, compulsory collective bargaining of the sort envisaged by a system of FPAs would institutionalise inflexibility. Perhaps the most blunt and inflexible aspect of the proposed system of FPAs is the FPAWG’s recommendation that FPAs apply to *all workers* in an industry or occupation, and not just to *employees*.⁵³ As we said in our Report,⁵⁴ treating contractors as employees would have profound productivity implications for businesses and contractors alike – especially in sectors like transport, where the contractor model is associated with both higher levels of productivity and contractor-income than salaried employment.
- (b) **Cost and complexity:** As we noted in our Report,⁵⁵ experience from overseas suggests compulsory collective bargaining of the sort envisaged by FPAs will add cost and complexity to our labour markets. Complexity will arise from a range of factors, including the need to determine the limits of an “industry” or “occupation” to determine which unions and employers have authority to represent which workers and firms, for consultation between various representative bodies and those they are representing, and so on. These issues will create uncertainty and complexity and will create a field day for lawyers. We give some illustrations from Australia of the types of problems we can expect if a system of FPAs is imposed on workers and employers in New Zealand.⁵⁶
- (c) **Harm to industrial relations:** Instead of workers and their employer discussing their respective wants and needs from their employment relationship, under a system of compulsory, industry- or occupation-wide FPA process, negotiations will take place between remote representatives from unions and employer organisations. The change in dynamic will be profound. This is a matter of acute concern to business. The opportunity for collaborative problem-solving by the people closest to the issues will be lost.

It is little wonder that pre-ECA industrial relations in New Zealand were characterised by the high levels of industrial strife illustrated in our Report.⁵⁷

To mitigate this risk, the FPAWG recommends that workers should be prohibited from taking industrial action in connection with the negotiation of an FPA. However, even without strike action, the consultation process required as part of FPA negotiation will involve extensive workplace disruption.

Of even more concern is the risk of a return to the high levels of industrial action commonly referred to as “second-tier bargaining” we outline in our Report.⁵⁸ The adverse implications for productivity of a return to the type of industrial strife

⁵³ Ministry of Business, Innovation and Employment, “Fair Pay Agreements,” op. cit. 40.

⁵⁴ Roger Partridge and Bryce Wilkinson, “Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour,” op. cit. 30.

⁵⁵ Ibid. 31.

⁵⁶ Ibid. 32.

⁵⁷ Ibid. 12, Figure 1.

⁵⁸ Ibid. 32.

New Zealand experienced prior to the ECA casts a shadow over the FPAWG's recommendations.

- 5.3 The Workplace Relations and Safety Minister recognised the potential harm to productivity from a system of FPAs in his terms of reference to the FPAWG and mandated the working group "where possible" to mitigate the risks.⁵⁹ However, the working group's report pays only lip-service to the risk of slower productivity growth or to mitigating it.

6 FPAs WILL BENEFIT UNIONS – BUT WILL BE BAD FOR WORKERS, THE UNEMPLOYED, CONSUMERS AND OVERALL WELLBEING

- 6.1 FPAs will be good for unions. The FPAWG Report proposes that workers should be compelled to have unions represent them in negotiations for an FPA.⁶⁰ Coupled with the low thresholds proposed for workers to trigger bargaining for an FPA, this means unions would occupy the pivotal role in industrial relations across the economy. This is despite union membership in New Zealand standing at just 17% of the workforce. It is little wonder the CTU has so vocally advocated introducing FPAs.⁶¹

- 6.2 However, FPAs will be bad for everyone else – including workers, the unemployed and consumers. They will also be bad for overall wellbeing. We set out the reasons for these conclusions in Chapter 4 of our Report.⁶² In particular:

- (a) **Workers:** If FPAs lead to increased wage rates that will benefit those who remain employed. But increasing the cost of labour changes will cause job losses in firms unable to recoup the costs of wages from customers. The risk will be the greatest for firms facing international competition. The burden of job losses will likely fall on the least skilled workers. This risk is recognised in the Cabinet paper with euphemistic wording that FPAs may encourage "resources to shift from less productive firms and industries to more productive uses."⁶³ However, what is being discussed here is businesses failing and jobs being lost. Making the least productive workers unemployed is not putting them to more productive use.

FPAs, at least in the form proposed by the FPAWG, will take away workers' freedom to represent themselves in employment negotiations with their employers. Given the choice, most workers prefer not to be represented by unions. FPAs in the form proposed will take away this right to freedom of association. In doing so, they will result in New Zealand breaching its obligations under the International Labour Organization's *Right to Organise and Collective Bargaining Convention 1949*.⁶⁴ This convention enshrines the right of all workers to choose whether to appoint a representative to negotiate the terms of their employment.

- (b) **The unemployed:** Higher wage rates will raise the hurdle for the unemployed to enter the workforce, particularly inexperienced and unskilled workers.

⁵⁹ Ministry of Business, Innovation and Employment, "Terms of Reference for the Fair Pay Agreement Working Group" (Wellington: New Zealand Government), paragraph 6.

⁶⁰ Ibid. 43.

⁶¹ See, for example, New Zealand Council of Trade Unions, "Fair Pay Agreements: A Framework for Fairness" (Wellington: NZCTU, 2019).

⁶² Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour," op. cit. 33–37.

⁶³ Ministry of Business, Innovation and Employment, "Cabinet Paper to Establish the Fair Pay Agreement Working Group," op. cit. 7.

⁶⁴ International Labour Organization, "Right to Organise and Collective Bargaining Convention" (C098) (ILO, 1949).

- (c) **Consumers:** Consumers will also face higher prices as firms must recoup higher wage costs from FPAs to survive. The effect of increased prices will be felt most acutely by the least well-off.
- (d) **Overall wellbeing:** In the absence of productivity gains, FPAs are at best a zero-sum game and at worst a negative-sum game, with the losers including some of the most vulnerable groups in society.

6.3 Both the Cabinet paper proposing the formation of the FPAWG and the Minister’s terms of reference to the working group identified the risks of job losses and increased costs for consumers as a result of FPAs.⁶⁵ Unfortunately, the FPAWG’s recommendations do little or nothing to manage or mitigate these risks.

7 THERE IS NO ROLE FOR FPAs: NEW ZEALAND’S LABOUR MARKET REGULATIONS ALREADY PROTECT VULNERABLE WORKERS

- 7.1 Part 6A of the ERA already contains provisions to protect the interests of specified groups of “vulnerable workers” against “race to the bottom” concerns. The ERA, the Holidays Act 2000, and the KiwiSaver Act 2006 also contain a suite of statutory minimum protections that apply to *all* employees.
- 7.2 In relation to vulnerable workers, Part 6A applies when an employer’s business undergoes restructuring and the vulnerable employee(s)’ work is assigned to a new employer – typically as a result of a contract for services transferring from one service provider to a new service provider.
- 7.3 Under Part 6A, these employees have a right to transfer to the new employer on the same terms and conditions of employment. Part 6A also provides protection for all other employees, by requiring employment agreements to contain employee protection provisions.
- 7.4 Workers covered under Part 6A are listed in Schedule 1A of the Act and include cleaning, catering, caretaking, laundry and orderly services in specified sectors and workplaces.
- 7.5 If the government is concerned there are other groups of employees that have similar characteristics to those covered by Part 6A, or is concerned that the circumstances in which Part 6A applies are too narrow, then it should consider an appropriate extension to Part 6A, rather than creating an unwieldy FPA framework that risks serious harm to the New Zealand economy and the wellbeing of New Zealanders.

8 SOLUTIONS TO NEW ZEALAND’S PRODUCTIVITY AND POVERTY PROBLEMS LIE ELSEWHERE

- 8.1 As we submitted in section 2 (and outlined in our Report), New Zealand’s labour market settings are performing well. Yet, the New Zealand economy faces many challenges. These include poor productivity growth, low wages compared with many of our OECD peers, and concerning levels of poverty.
- 8.2 The government’s stated goal in proposing FPAs is to address these very concerns by creating a highly skilled and innovative workforce, and an economy that delivers well-paid, decent jobs

⁶⁵ Ministry of Business, Innovation and Employment, “Terms of Reference for the Fair Pay Agreement Working Group,” *op. cit.* paragraph 6.1.

and broad-based gains from productivity and economic growth.⁶⁶ This is a laudable goal and is one shared by The Initiative.

8.3 As we said in our Report:⁶⁷

A more productive economy will not just benefit wage-earners but all New Zealanders. Referring to the words of Paul Krugman, our ability to improve our standards of living as a country depends almost entirely on our ability to raise productivity.⁶⁸ Or as two other famous economists said of productivity in less abstract terms, "... nothing contributes more to the reduction of poverty, to increases in leisure, and to the country's ability to finance education, public health, environment and the arts."⁶⁹

8.4 However, if we want higher wages and a more productive economy, introducing industry- or occupation-wide compulsory collective bargaining via a system of FPAs is not the way. The Government will not solve New Zealand's economic problems by "fixing" what is not broken.

8.5 Instead, the answers lie elsewhere – in our policy settings affecting housing affordability, our poorly performing education system, and a raft of social and economic settings outlined in our Report.⁷⁰

9 IF THE GOVERNMENT OPTS FOR FPAs, THEY MUST BE EVIDENCE-BASED, LESS COMPULSORY, MORE DEMOCRATIC, AND SUBJECT TO BOTH EX ANTE AND EX POST MARKET IMPACT ASSESSMENTS

9.1 If, despite the overwhelming case against FPAs (and any need for them), the Government is intent on creating some form of FPA framework, then it should be careful not to undermine the flexible labour market settings that have been working so well for both workers and consumers.

9.2 In particular:

- (a) An FPA process should only be imposed on an industry or occupation under a "public interest" trigger and should only be satisfied where there is evidence of a failure in the labour market in a specific industry or occupation. In other words, where there is evidence that a better outcome could be achieved for employers and employees than from a competitive process of voluntary exchange. A corollary is that it should not be possible to impose an FPA process via a "representative trigger" (whether 10% or higher).
- (b) An FPA process should not extend to contractors. For the reasons outlined in our Report,⁷¹ extending FPAs to contracts for services would have profoundly adverse effects on productivity.

⁶⁶ Ministry of Business, Innovation and Employment, "Terms of Reference for the Fair Pay Agreement Working Group," op. cit. paragraph 2, and Ministry of Business, Innovation and Employment, "Fair Pay Agreements," op. cit. 8.

⁶⁷ Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour," op. cit. 38.

⁶⁸ See Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour," op. cit. Chapter 4, and Paul Krugman, *The Age of Diminished Expectations* (MIT Press, 1997), 13.

⁶⁹ William Baumol and Alan Blinder, *Economics: Principles and Policy* (San Diego: Harcourt Brace Jovanovich, 1993), 778.

⁷⁰ Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour," op. cit. Chapter 4.

⁷¹ Roger Partridge and Bryce Wilkinson, "Work in Progress: Why Fair Pay Agreements Would Be Bad for Labour," op. cit. 29-31.

- (c) An FPA process, commenced via a public interest trigger, should only proceed where a majority of workers and employers (by both firm headcount and number of employed workers) are in favour of it. (The double majority in the case of firms is needed to ensure that the interests of small firms are not swamped by the interests of major employers).
- (d) Both workers and employers should have the option of opting out of the FPA process (something they would be unlikely to do if the evidence demonstrates that a better outcome can be achieved from an FPA process than from voluntary exchange).
- (e) Before implementation, an FPA should be subjected to a market impact assessment to ensure it does not have detrimental effects on competition – and thereby harming the interests of consumers (either nationally or in regional markets).
- (f) Any FPA framework must also include rigorous ex post evaluation mechanisms to ensure FPAs are not having detrimental effects on either:
 - levels of employment for the least skilled and/or in any industry or occupation (nationally or regionally); or
 - competition and productivity in any industry or sector (nationally and regionally).

FPAs should expire in the absence of a successful ex post implementation evaluation, and any successor FPA should incorporate terms to manage or mitigate any adverse effects of a predecessor FPA as a condition for it to come into effect.

9.3 The limitations proposed by these conditions should ensure that FPA processes are limited to where competitive outcomes are suboptimal for both employers and workers, and both employers and workers wish to negotiate terms and conditions of employment via an alternative process to the options currently available under ERA.

9.4 To avoid any doubt, the Cabinet paper, the FPAWG Report, or the Discussion Paper do not provide evidence that could justify triggering an FPA process under the framework suggested above. That is not to suggest no such evidence exists – simply that, to date, it has not been presented as part of the FPA policy development process. In this respect, we are no further advanced than when Treasury observed in its advice to Cabinet that the work undertaken by MBIE in support of the recommendations in the Cabinet paper “has not identified an occupation or industry in which the proposed system [of FPAs] would address the highlighted wage and productivity concerns.”⁷²

The New Zealand Initiative

Wellington

26 November 2019

⁷² Treasury, “Upcoming Cabinet Paper: Fair Pay Agreements,” op. cit. paragraph 10.

WORK IN PROGRESS

Why Fair Pay Agreements
would be bad for labour

Roger Partridge and Bryce Wilkinson
Foreword by Rob Campbell



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About the New Zealand Initiative

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We are developing and contributing bold ideas that will have a profound, positive and long-term impact.

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Foreword



The pros and cons of various pay-fixing structures are not something often subjected to objective analysis. For the participants at least, such structures are typically viewed as creating advantage or disadvantage. The consumers, taxpayers and other non-direct participants are seldom part of the debate, though they are affected by the outcomes. New Zealand is currently amidst one of the occasional pendulum swings, and I suspect I am not alone in feeling unconvinced by either side.

In this report, The New Zealand Initiative makes a case against reintroducing compulsory collective bargaining as proposed by the Fair Pay Agreement Working Group and endorsed by the Coalition Government. They do so in cogent and detailed form, relating the practice of such a pay-fixing structure to economic performance and the record of the more liberal recent structures.

These more liberal structures have not induced or been associated with sustained productivity growth, or with social outcomes regarded by many as acceptable. The latter, in particular, with perceptions of less secure working hours and unreasonably low pay in some occupations, have given rise to the proposed changes.

This report takes the view that an increasingly collective approach to pay-fixing and associated work practices will not solve the issues. From my perspective as a former union official and now a member of several board remuneration committees, I'm not fully convinced. I can see a structure working in larger places of employment reflecting a collaboration between an informed and progressive management and a comparable resourced and motivated union. But in practice

our industry has too few that fit the bill on either side. We have not really taken advantage of the relatively liberal regime on the management part to drive constructive change, inclusion and productivity. On the union side, it has been a struggle for relevance and survival in the private sector and a primarily defensive approach even where union strength has been maintained. Throwing the collective approach at these parties will not change much, at least for some time. So it is hard to see how productivity growth can be an outcome.

Nor can we be much more optimistic about social outcomes. The harsh truth is that the old collective compulsory arbitration system produced rigid relativities which worked against the low paid. Unions that were strong in anything other than revenue were so because they fought against the compulsory structures, not within it. They engaged and activated members to fight the system. Finding a path to accepted social living standards through a collective, arbitrated system is more than long and winding – it is a cul de sac.

Our present system is not perfect but I do not think it is the cause of either defect we observe. The minimum standards issue is best dealt with at the government level. At the firm level the challenge is to find ways, whether with a union in whole or in part, to develop pay structures and working patterns that are more productive and allow for inclusion, diversity and initiative.

Rob Campbell
Professional director
Auckland

Executive Summary

The government's goal of a highly skilled and innovative workforce and an economy that delivers decent, well-paid jobs, along with broad-based gains from economic growth and productivity, is laudable.¹ It is what governments should strive for. It is also a goal shared by The New Zealand Initiative.

However, our research has found that the case for the recommendations of the Fair Pay Agreement Working Group (FPAWG) in pursuit of this goal does not stack up.

The working group recommends reintroducing compulsory, centralised collective bargaining (described in the working group's report as Fair Pay Agreements or FPAs). The FPAWG has done its best to create the appearance of a case for its recommendations. But the case put forward is illusory.

Both the evidence and the academic literature suggest FPAs would likely harm productivity and be contrary to the interests of workers, the unemployed, consumers and overall wellbeing. Rather than advancing the government's vision of a high-wage, high-productivity economy, FPAs would undermine it.

Indeed, New Zealand's labour markets are working very well judging by their results. Unemployment here is comparatively low when measured against the OECD average. Employment growth since 1991 has been the third fastest in the OECD.² Our labour market participation rates are among the highest in the world. Wages are tracking productivity growth. And real wages for all wage deciles have been rising since the labour market reforms of the early 1990s.³

It should therefore be no surprise that other countries – most notably France under President Emmanuel Macron – have looked to emulate aspects of New Zealand's flexible labour market regulation.

The FPAWG's recommendations

The FPAWG proposes replacing New Zealand's existing labour market regulations with so-called FPAs. These agreements would provide a compulsory and prescriptive mechanism for setting minimum terms and conditions of employment across whole industries or occupations. An FPA process would be triggered if either a "public interest" test is met, or if the lower of 1,000 workers or 10% of workers in an industry or occupation favour commencing negotiations.

Union representation in negotiations would be compulsory for all workers. Employers would have to be represented by industry or employer organisations. If agreement cannot be reached in negotiations, a statutory body would determine the outcome for the entire industry or occupation (with only limited, temporary exemptions).

The recommendations would thus permit unions to trigger FPA negotiations across the economy, even if the overwhelming majority of workers in an industry or occupation were opposed to them.

Why the case for FPAs does not stack up

The working group's report outlines four alleged shortcomings in the operation of New Zealand's labour markets to justify introducing FPAs.

However, our research reveals that the concerns are either misconceived or that there is no good reason to believe FPAs will help solve the concerns.

The first concern is that current labour market settings have seen a decline in the share of New Zealand's gross domestic product (GDP) going to workers. In other words, since the liberalisation of labour markets with the passage of the *Employment Contracts Act 1991*, employed workers have been receiving an ever-smaller "share of the pie". This concern is a myth. The share of income going to workers *did* decline in the 1970s and 1980s (at a time when New Zealand had a system of industrial awards similar to the FPA arrangements proposed by the FPAWG). But following the 1991 reforms, the decline in employees' share of GDP has halted and has subsequently trended back up.⁴

The second concern relates to an alleged rise in income inequality and a "hollowing out" of middle-income wages since the 1991 reforms.⁵ This concern is also a myth. Though income inequality has risen *in many other countries* since the early 1990s, income inequality before taxes and transfers has actually *declined* in New Zealand since the 1990s.⁶

The third concern postulates that the current regime sees "good" employers being disadvantaged by "bad" employers by undercutting them in a "race to the bottom".⁷ This concern is another myth. The data shows that average wage rates have risen faster than inflation across *all* income deciles. Workers' wages are simply not being bid down by employers on an ever-decreasing basis.

The final concern relates to New Zealand's comparatively poor productivity growth rates. It is correct that poor productivity growth is the Achilles heel of the New Zealand economy. But this phenomenon dates back to at least two decades *before* the 1991 reforms. And, indeed,

in the aftermath of the reforms, the 1990s saw New Zealand's highest productivity growth for approaching half-a-century. The evidence of New Zealand's productivity performance over the five decades since the late 1970s provides no evidence linking New Zealand's low productivity growth with the early 1991 labour market reforms.

Put simply, the FPAWG's case for dismantling the 1991 reforms and reverting to compulsory collective bargaining is unfounded.

The case against FPAs

Conversely, the grounds for concluding that the FPAWG's recommendations will harm the wellbeing and prosperity of New Zealanders are strong.

First, there is a significant risk of slower productivity growth from FPAs locking in inefficient practices, reducing the flexibility of labour markets, and increasing the cost and complexity of their operation. These problems will be amplified by the disruption from automation and innovation to the future of work. History also suggests FPAs will harm industrial relations, which will in turn hamper productivity.

Second, if the FPA process is successful in forcing up wages, there is a risk FPAs will cause job losses in firms unable to recoup the costs of higher wages from customers. The risk will be particularly acute for firms facing offshore competition. The burden of job losses is likely to fall disproportionately on the unskilled. And higher wage rates will raise the hurdle for the unemployed, particularly inexperienced (i.e. young) and unskilled workers.

Third, the FPAWG's recommendations will take away workers' freedom to choose *not* to be represented by unions in their wage negotiations.

Given a choice, the evidence shows that an overwhelming majority of workers prefer to negotiate directly with their employers. Yet the FPAWG's recommendations will permit a minority of 10% of workers in an industry or occupation (in some cases, far fewer) to impose their wishes on the majority. In this regard, the working group's recommendations are inconsistent with the International Labour Organization's *Right to Organise and Collective Bargaining Convention*, 1949. The FPAWG implicitly acknowledge that the convention presents difficulties for the government in implementing their recommendations.⁸ And yet the FPAWG chooses to ignore the unfair and undemocratic effect of their recommendations on workers.

Finally, consumers face a serious risk of harm from firms increasing prices of goods and services to recoup higher labour costs arising from FPAs. And the effect of increased prices will be felt most acutely by New Zealand's least well-off.

Many of the perils of occupation- or industry-wide compulsory collective bargaining were identified in the Terms of Reference for the FPAWG, which asked the working group, where possible, to make recommendations to manage

or mitigate these risks.⁹ Unfortunately for the government, the working group has completely failed to do this.

A better way

If we want a more productive, higher-wage economy, then introducing compulsory collective bargaining across industries and occupations is not the way to achieve it.

Many factors have been blamed for New Zealand's poor productivity growth, including our small size and geographic isolation.¹⁰ There is little we can do about either factor. But that makes it critical we get our policy settings right in the areas we *can* control. Areas like education, housing and planning, infrastructure, foreign investment, social policy, and regulation and allocating regulatory decision-making powers between local and central government.

If we solve New Zealand's policy problems in these areas, the country can confidently look forward to a more productive, high-wage economy.

Introduction

Judged by the results, we can be proud about how we regulate labour markets in New Zealand.

At 80.9%, our labour market participation rate is among the highest in the world.¹¹ Among developed countries, we are bettered only by Sweden, Switzerland and Iceland. And New Zealand's position in the front ranks compares extremely well with Australia (77.4%), the European Union average (73.6%), and the OECD average (72.1%).¹²

Labour force participation *matters*. The link between work and wellbeing is incontrovertible.¹³ Joblessness is harmful – not just to material wellbeing but also to mental and physical health.¹⁴ If New Zealand's labour force participation rate were the same as the EU average, more than 200,000 additional New Zealanders would suffer the health and wellbeing risks of joblessness.

Employment growth has also been strong. Since 1991, the New Zealand labour market has had the third highest rate of job creation in the OECD.¹⁵ While our high ranking is no doubt influenced by high levels of immigration, New Zealand's employment growth record demonstrates our labour market systems have enabled the economy to absorb high immigration flows.

Matching our high labour force participation and employment growth rates is a relatively low unemployment rate. At the 4.2% level announced in May 2019,¹⁶ our unemployment rate is well below Australia's (5.0%) and compares extremely favourably with the OECD average (5.2%) and the EU average (6.6%).¹⁷

Our current employment rate also compares favourably with New Zealand's past employment performance. Before the transformation of our

domestic industrial relations landscape brought about by the *Employment Contracts Act 1991* (ECA), the predecessor to the *Employment Relations Act 2000* (ERA), our labour market participation languished at a low 73% and unemployment exceeded 10%.¹⁸

The 1991 labour market reforms dismantled New Zealand's national awards system, under which most workers were represented through a system of collective bargaining.¹⁹ In its place, the ECA introduced individual employment *contracts* (now individual employment *agreements*) that are prevalent among workers today.²⁰

Since the 1991 reforms, average real hourly wages in New Zealand have increased cumulatively by around 30%.²¹ As the Fair Pay Agreement Working Group (FPAWG) acknowledges, New Zealand's labour market is lifting average real wage rates in all wage deciles.²² This is at a time when wages for low income workers have been stagnating in some OECD countries for decades.²³ And recently, the OECD singled out New Zealand – along with Denmark – as countries in which real median wage growth has closely tracked productivity growth.²⁴ In other words, notably among other OECD countries, our labour market has increased wages in line with increases in productivity.

Many other countries have either emulated – or are looking to emulate – aspects of New Zealand's flexible approach to labour market regulation. Most notably (and recently) in France, President Emmanuel Macron introduced a revolutionary change to French labour laws in 2017. Macron's reforms now permit workers and employers to negotiate at the enterprise level, instead of (the formerly compulsory) sector-wide collective bargaining.²⁵

Against this background, our coalition government has good reason to be cautious about adopting the FPAWG's recommendations, which were delivered to Workplace Relations and Safety Minister Iain Lees-Galloway in December last year.²⁶ The FPAWG recommends New Zealand revert to compulsory, industry- or occupation-wide bargaining under Fair Pay Agreements (FPAs).

The FPAWG recommendations follow proposals fleshed out in a 2018 Cabinet paper from Minister Lees-Galloway (the Cabinet paper).²⁷ The Cabinet paper also recommended introducing a system of FPAs to set minimum employment terms and conditions across industries and occupations. Such a system, the Minister argued, "... could lift industries out of a low wage, low productivity cycle by giving firms greater incentives to invest in physical and human capital."²⁸ He also proposed forming a working group to advise on the scope and design of the FPA system.²⁹

In the Cabinet paper, the Minister outlined four underlying concerns about the operation of New Zealand's labour markets which a system of FPAs would address:

1. An apparent decline in the share of New Zealand's GDP going to workers;³⁰
2. An alleged "hollowing out" of wages for middle-income workers not keeping pace with labour productivity increases. This, in turn, is said to have resulted in increased income inequality;³¹
3. A concern about a "race to the bottom", whereby some employers undercut others by reducing costs through lower wages;³² and
4. New Zealand's poor record of productivity growth.³³

One of these concerns – New Zealand's low levels of productivity growth – is well-known. The others – including the suggestion that workers' share of GDP has declined since the

reform of New Zealand's labour markets in the early 1990s – are more contentious.

Even if each of the concerns were well-founded, the link between the concerns and the desirability of introducing industry- or occupation-wide collective bargaining under a system of FPAs is far from clear. Collective bargaining is certainly less prevalent in New Zealand than in many OECD countries.³⁴ But it is not obvious that the absence of widespread collective bargaining has *caused or contributed to*, for example, low levels of productivity growth in New Zealand.

Indeed, the government's advice from Treasury on the Cabinet Paper (Treasury's advice) questioned whether imbalances in bargaining power – which FPAs are designed to address – are the cause of the wage and productivity concerns highlighted in the Cabinet paper.³⁵ Even if bargaining power were the problem, Treasury noted that the Cabinet paper does not set out a "strong case that industry- or occupation-level bargaining would be the most effective policy response to address these concerns", or refer to an evidence-base to support the potential impacts of FPAs.³⁶

Treasury also pointed out that the work undertaken by the Ministry of Business, Innovation & Employment (MBIE) in support of the recommendations in the Cabinet paper "has not identified an occupation or industry in which the proposed system [of FPAs] would address the highlighted wage and productivity concerns."³⁷

As well as cautioning that FPAs might not be the right solution to the perceived problems, Treasury's advice also warned against the possible negative effects of introducing a system of fair pay agreements.³⁸ These risks include:

- Reducing the employers' incentives to hire workers on permanent contracts, thereby harming the interests of low-skilled workers;³⁹

- Creating minimum wages or conditions that are unsustainable for small or new employers, or which embed inefficient business models;⁴⁰ and
- Introducing inefficiencies in the operation of the labour market.⁴¹

Treasury’s advice also warned that the proposed working group would need “to make complex policy judgments with only a high-level diagnosis of the problem and limited guidance from Cabinet...”⁴² Treasury therefore recommended:⁴³

... further departmental policy analysis [should be carried out] before Cabinet considers the [Cabinet] paper’s recommendations. The proposed changes are significant and still in early stages of development. Extending the policy process would better position the policy to achieve its objective of supporting productivity and wage growth, while managing risks that the policy could exacerbate existing labour market issues.

Neither Minister Lees-Galloway nor Cabinet accepted Treasury’s advice, and the Minister announced the formation of the FPAWG on 5 June 2018.⁴⁴

In the announcement, Lees-Galloway outlined the government’s vision for “a highly skilled and innovative economy that delivers good jobs, decent conditions and fair wages, while supporting economic growth and productivity.”⁴⁵ This vision is laudable. And one shared by The New Zealand Initiative. Whether a system of FPAs will help achieve this vision is another matter.

Recognising this, the Minister’s Terms of Reference for the working group identified many of the perils of compulsory, collective occupation- or industry-wide bargaining. They also directed the FPAWG, where possible, to make recommendations that managed or mitigated these risks.⁴⁶

The FPAWG delivered its recommendations to the Minister on 18 December 2018.

On 31 January 2019, the Minister made the working group’s report publicly available and announced that the government would take time to consider the recommendations.⁴⁷

To assist with the government’s deliberations, this report evaluates the FPAWG’s recommendations, including the extent to which they could succeed or fail in managing or mitigating the perils of a centralised, compulsory collective bargaining system.

The report has the following structure:

- Chapter 1 sets out a brief history of labour market regulation in New Zealand;
- Chapter 2 outlines the recommendations of the FPAWG and explains some of their practical implications;
- Chapter 3 evaluates each of the four economic concerns FPAs are intended to address, and assesses whether the concern is well-founded and, if so, whether there are good reasons to believe introducing FPAs will help resolve the concern;
- Chapter 4 examines potential adverse effects for workers, would-be workers, consumers, and the wider economy if the FPAWG’s recommendations are enacted; and
- Chapter 5 points to some alternative policy reforms that will help achieve the government’s stated objectives of promoting a highly skilled and innovative workforce, and an economy that delivers well-paid, decent jobs, and broad-based gains from economic growth and productivity.⁴⁸

CHAPTER 1

A brief history of labour market regulation in New Zealand

For most of the past hundred years New Zealand's labour markets were regulated by a system of compulsory centralised bargaining covering entire industries or occupations. With the passage of the *Industrial Conciliation and Arbitration Act 1894* (the IC&A Act),⁴⁹ a majority of workers had their wages fixed by conciliation or, if this was unsuccessful, by the Court of Arbitration.⁵⁰ Employers were represented in this process by employer associations, and workers by unions.

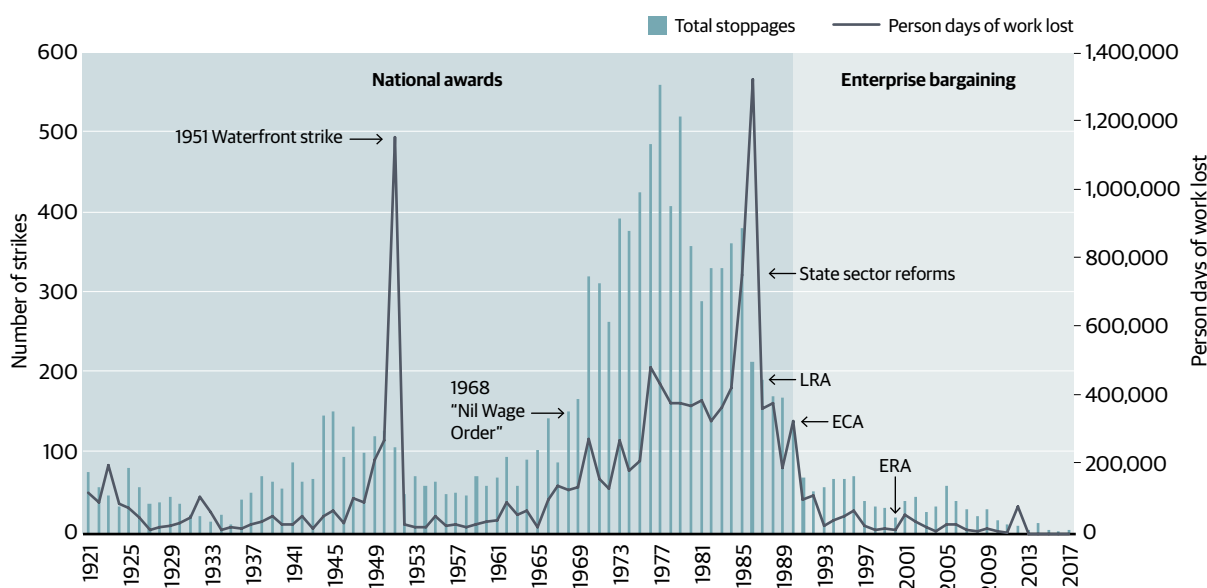
The outcome of centralised bargaining (or arbitration) was an “award”. Awards set out legally enforceable terms and conditions of employment. And awards extended to all employers and workers in a designated industry or occupation, regardless of whether they were

formally represented in the bargaining process or any resulting arbitration.⁵¹ From 1922, the Court of Arbitration had the power to issue General Wage Orders, thereby increasing wages under all awards in one go. From 1935 to 1991, union membership was compulsory.

By the 1960s, cracks began emerging in the awards system. It was proving insufficiently flexible to cope with changes occurring in the New Zealand economy. As Gordon Anderson, author of leading employment law textbook, *Labour Law in New Zealand*, explains:⁵²

In the post-war period a combination of short-term economic shocks and longer term structural changes in the New Zealand economy led to the gradual demise of the

Figure 1: Industrial action in New Zealand since 1921



Source: Business New Zealand, “Comments on the Report of the Fair Pay Agreements Working Group” (March 2017), 1.

arbitration system. Over time it became clear that the structure of fixing wages and employment conditions that lay at the heart of the system was increasingly unsustainable...

Workers were also victims of the awards system. Perhaps the most notorious example of the system's adverse impacts on workers was the "nil general wage order" of 1968: The Court of Arbitration ordered wage levels to remain unchanged from the previous year despite high inflation and rising prices.⁵³

Industrial awards were also infamously inflexible – to the point of preventing workers in an enterprise and their employer implementing agreements reached between them

Unsurprisingly, the three decades from the 1960s to 1980s were characterised by extraordinary levels of industrial unrest (Figure 1).

Aside from the disruption caused by industrial strife, the national awards system was also characterised by high levels of cost, complexity and inflexibility.

The complexity is best illustrated by studying just one occupation: clerical workers. By the late 1980s, occupational and geographical differences meant clerical workers were covered not by one award but more than 200. Different awards covered such diverse clerical occupations and industries as airways, banks, chartered accountancy, freezing works, hotels, insurance companies, librarians and their assistants, local authorities, nurse receptionists, rental car companies, shipping companies, stock and station agents, taxi telephonists, timber supervisors, the TAB, and "general".⁵⁴ This was in pre-1990s New Zealand – well before the internet and the gig economy added layers of complexity to the make-up of the workforce.

The need for awards (collective agreements by another name) to cater for occupational

or geographical differences also had another dimension: demarcation disputes. Which union should represent which workers? Wellington's BNZ Centre strike (involving the construction of what is now known as the State Insurance Building) became perhaps the most notorious example of industrial disputes about which the employer could do nothing. Construction of the BNZ Centre began in 1973, but was disrupted for six years by the boilermakers' union claiming exclusive rights to weld steel. The dispute effectively deterred architects from using structural steel on a large scale in buildings in New Zealand for decades.

Industrial awards were also infamously inflexible – to the point of preventing workers in an enterprise and their employer implementing agreements reached between them. For example:

- Changes in shift conditions agreed between the employer and workers at an Auckland engineering factory were disallowed by the Labour Court;⁵⁵
- Attempts by meat workers at a new works in Otaki to negotiate directly with their employer were blocked by the national union;⁵⁶ and
- The initiative by a Wellington metal fabricating plant to introduce a 4-hour evening shift, which would have suited married women wanting part-time work, was blocked by the union as undermining the 9-hour work day.⁵⁷

Each of these cases demonstrates the inflexibility of New Zealand's labour laws at the time. In the Auckland and Wellington factory examples, employers and their workers were trying to agree on working hours that suited their workplaces better than prescribed by the applicable award. In the Otaki meat works example, workers were trying to escape the productivity and industrial relations problems plaguing the New Zealand meat industry.

Against this background, reforms to labour market regulation were inevitable. Regulatory reform in the early 1980s abolished compulsory arbitration. In 1987, the IC&A Act was repealed and replaced by the *Labour Relations Act 1987* (the LRA). Under the LRA, compulsory collective bargaining replaced conciliation. However, the LRA retained the system of national awards. Consequently, most workers continued to be represented through collective bargaining, with their wages and other terms and conditions of employment covered by an industrial award.

After a decade of stagnant wages,⁵⁸ and unemployment that had grown to 7.3% by 1989,⁵⁹ the OECD Economic Survey of New Zealand that year recommended that “further changes [to labour market regulation] would assist better labour market outcomes.”⁶⁰

More fundamental reform came in the form of the *Employment Contracts Act 1991*. The ECA abolished the system of national awards and compulsory unionism. The Act’s fundamental presumption was that individual workers should be permitted to negotiate the terms and conditions of their employment with their employer. The outcome was that only very strongly organised workers were able to bargain collectively.⁶¹ The majority of workers previously covered by national awards were left to bargain individually with their employers.

By the time the ECA was introduced in 1991, unemployment in New Zealand exceeded 10%.⁶² Many economists predicted it would rise further as a result of the 1991 budget spending cuts.⁶³ Contrary to expectations, unemployment steadily fell.⁶⁴ In the decade immediately following the ECA, New Zealand enjoyed the most rapid increase in productivity growth in the last half-century (see Chapter 3).⁶⁵

However, the ECA was relatively short-lived. Nine years after its passage, the Act was repealed by the fifth Labour government and replaced by the *Employment Relations Act 2000* (ERA). The ERA did not return New Zealand’s labour market regulation to the pre-ECA system of national awards. Instead, it modified the regulatory framework of the ECA by introducing the concept of good faith bargaining and increasing the legal recognition of unions.

The ERA has been subject to repeated amendment and re-amendment since its enactment. Yet its fundamental architecture remains more or less as it was when it was enacted in 2000. Within a decade of the ERA’s enactment, union membership increased from a post-ECA low of 17% of the workforce to approximately 30%.⁶⁶ However, following international trends, union membership fell back to around 17% by 2017 (which is also the OECD average).⁶⁷

Compared with the wage stagnation in the decade or so before the ECA,⁶⁸ the nearly three decades since abolishing industrial awards have been good for the wages of New Zealand workers. Average hourly real wages in New Zealand have increased cumulatively by around 30% since 1991.⁶⁹ Both labour market participation rates and unemployment are at levels that are the envy of most OECD countries (see Introduction).

Against this background, Chapter 2 will examine the changes now proposed by the FPAWG.

CHAPTER 2

What are Fair Pay Agreements and how will they work?

With the government taking time to consider the FPAWG's recommendations, there has been little commentary on them since their public release on 30 January 2019.

Perhaps the lack of attention is partly because a "fair pay agreement" sounds like something everyone should want. After all, no employee wants to work for unfair pay. And it is hardly a sustainable proposition for an employer to offer "unfair" pay – especially at a time of low levels of unemployment and skills shortages.

However, the FPAWG's recommendations extend far beyond creating a framework for an employer and an employee to reach agreement on a fair level of remuneration.

Indeed, the term "agreement" is a misnomer. The working group's recommendations propose a system for determining wages and other terms and conditions of work that are both compulsory and prescriptive. The recommended system:⁷⁰

- is compulsory for both employers and employees if specified thresholds are met;⁷¹
- applies to entire occupations and whole industry sectors (even CEO salaries could be covered by FPAs);⁷²
- requires FPAs to specify minimum employment standards, including wages (and how pay increases will be determined), working hours, overtime and penal rates, leave, skills and training, and redundancy;⁷³
- requires all workers in the sector or occupation to be represented by unions and their employers to be represented by incorporated representative bodies;⁷⁴

- contains a mechanism for a statutory body to make determinations if agreement cannot be reached after facilitated negotiation and mediation, with no appeals process;⁷⁵
- extends to all "workers" in an occupation or industry, including contractors (i.e. not just to employees) unless proposed statutory exemptions apply;⁷⁶
- is one-sided in that it can be initiated only by workers or unions and not by employers;⁷⁷
- has a low threshold for the initiation of bargaining by workers (the lower of 1,000 workers or 10% of workers in the nominated occupation or industry);⁷⁸
- can also be initiated when it is deemed to be in the public interest;⁷⁹ and
- prohibits industrial action in connection with the fair pay agreement "bargaining" process, but not in relation to matters outside the scope of the FPA.⁸⁰

The FPAWG's recommendations are, nevertheless, permissive in four respects. First, FPAs will set the *minimum conditions* for employment in an occupation or sector. The working group recommends that employers and employees should still be permitted to "agree [to] an enterprise level collective agreement" – provided the terms and conditions of any such agreement equal or exceed the terms of the relevant FPA.⁸¹ The FPAWG calls this "the principle of favourability".⁸² However, as the report stands, the favourability principle applies only to collective agreements for the enterprise, not to individual employment agreements.

Second, FPAs will be permitted to include provisions for regional differences in their terms and conditions within sectors or occupations. This flexibility is “to recognise labour markets can vary significantly across New Zealand”.⁸³

The FPAWG’s recommendations will recreate and, in many respects, enhance the system of national awards that existed in New Zealand before the ECA was enacted in 1991

Third, the working group recommends that “exemptions” should be available to firms that may be forced out of business by higher labour costs brought about by FPAs.⁸⁴ However, the working group recommends such exemptions only be “temporary” and subject to approval by an “administrative procedure”.⁸⁵

Fourth, FPAs will be permitted to include other matters beyond the specified minimum employment standards, such as “other productivity-related enhancements or actions”.⁸⁶

Despite these permissive aspects of the proposed regime, the FPAWG’s recommendations will recreate and, in many respects, enhance the system of national awards that existed in New Zealand before the ECA was enacted in 1991. According to Business New Zealand, FPAs will be “awards on steroids”.⁸⁷

Indeed, in several key respects, the wage-setting system outlined in the FPAWG report extends well beyond New Zealand’s former system of industrial awards. In particular, the former national awards system did not purport:

- to extend beyond a *specific occupation* to an *entire industry or sector*; or
- extend beyond employees to workers with non-employee status as *independent contractors* (like many couriers or taxi drivers).

Several features of the FPAWG’s recommendations warrant further comment.

a. Scope and speed of roll-out:

The Prime Minister is on record saying there will be “no more than one or two” fair pay agreements concluded by the next election.⁸⁸ This may have created the impression that it is possible to constrain the roll-out of FPAs. However, the FPAWG’s recommendations include two routes for triggering a compulsory FPA process: a “public interest trigger” and a “representativeness trigger”.⁸⁹ While the government might control the number of FPA processes initiated via the public interest trigger, it would have no control over the number of FPAs triggered by the proposed representative trigger. And the very low threshold for the representativeness trigger means compulsory FPA processes would not be limited to perceived “problem sectors”. The proposals would facilitate a rapid increase in the coverage of collective agreements.

b. Individual firms and employees will be side-lined:

The FPA system will transform the conduct of industrial relations in New Zealand. Businesses in an industry, or with employees in an occupation, covered by an FPA process will be precluded from directly negotiating the default terms and conditions of employment with their employees. Unless they are union representatives, the affected employees will likewise be barred from negotiating their own pay. Instead, business organisations like the Employers and Manufacturers Association (EMA) or specific industry bodies (like the New Zealand Bankers’ Association) will represent relevant businesses in employment negotiations for a specific occupation or industry. Unions will represent employees (whether the employees are members of a union or not). The working group suggests that umbrella bodies like Business New Zealand and the New Zealand

Council of Trade Unions will play a role in coordinating negotiating parties.⁹⁰ All organisations – particularly industry bodies – would need to “resource up” to cope with their new responsibilities.

- c. **Unions will be centre-stage:** The requirement that all workers in an industry or occupation are represented by unions, coupled with the low thresholds for workers to trigger bargaining for an FPA, means unions would occupy the pivotal role in industrial relations across the economy. This despite union membership in New Zealand standing at just 17% of the workforce.⁹¹
- d. **Changes to terms and conditions of employment:** FPAs would result in the standardisation of terms and conditions of employment. This would inevitably lead to changes to the terms and conditions of employment for many workers. Among the likely changes would be:
- more industry or occupational allowances, rather than enterprise-based ones;
 - more service-based pay increases, rather than performance-based ones;
 - minimum entitlements to redundancy pay (this is one of the mandatory terms and conditions for FPAs recommended by the working group);
 - standardisation of ordinary working hours, shift hours, overtime hours, and penal hours, each attracting different industry- or occupation-wide rates; and
 - industry- or occupation-wide minimum requirements for training and development.
- e. **Minority rule:** The very low proposed threshold for the representativeness trigger is undemocratic and creates a risk of minority capture. The working group’s recommended threshold for activating the representativeness trigger is the lower of 1,000 workers or 10% of workers in the nominated occupation or industry. Appendix 2 of the working group’s report lists 97 sectors or occupations. Of

- these, 77 have more than 10,000 workers, meaning fewer than 10% of the workforce could trigger an FPA process in a majority of occupations. Forty sectors or occupations have more than 20,000 workers, meaning the trigger could be activated by less than 5% of the workforce. The largest occupations have more than 100,000 workers, meaning a tiny minority of less than 1% of the workforce could impose their wishes on the remaining 99%. The working group’s recommendations would give a small minority of workers in an occupation or sector enormous power. They would be able to change the approach to industrial relations for a whole sector, regardless of the wishes of the majority.
- f. **A multiplicity of awards:** The number of FPAs will likely exceed the 97 occupations listed in Appendix 2 of the FPAWG report – and by a large multiple. Under the awards system in place before the ECA, regional differences in market conditions led to multiple FPAs for different geographic regions. As we saw in Chapter 1 in relation to clerical workers, different terms and conditions were needed for workers in the same occupation working in different sectors.⁹² Similar variations are likely needed, for example, for the 107,000 “Sales Assistants and Salespersons” listed in the FPAWG’s report.⁹³ A salesperson in a retail clothing store performs a very different role from a salesperson selling complex technology. Business New Zealand estimates that the number of awards in place in 1990 exceeded 1,900 – more than 20 times the number of occupations listed in Appendix 2. In the more complex 21st century economy, we can expect a one-size-fits-all approach to collective bargaining will be even more unworkable than it was in the last century.
- g. **Judges in the hot seat:** The proposals create considerable scope for judicial intervention. Where parties are unable to agree on the terms of an FPA, judicial bodies would need to make decisions affecting the economic

outcomes for entire industrial sectors or occupations. Long before final agreement (or judicial determination) on the terms of an FPA, there would be scope for judicial intervention over meeting the triggers for initiating the FPA process, demarcation issues, etc. These issues will likely include determining what jobs are covered by an “occupation”, what businesses are in an applicable “sector”, and which unions and employer organisations are mandated to represent which workers.

- h. **Employment terms and conditions will be imposed on the self-employed:** The proposal that FPAs apply to “workers” rather than “employees” means occupational FPAs would apply to self-employed contractors (e.g. “drivers” or “security guards”).⁹⁴ They would also cover workers engaged through labour-hire agencies. The FPAWG acknowledges the need for exemptions as long as they are “limited and typically time bound (e.g. up to 12 months)”.⁹⁵

If implemented, the FPAWG’s recommendations would radically rewrite New Zealand’s labour market rulebook. But are the reforms needed? And will they benefit workers and the wider economy? We explore these questions in the chapters that follow.

CHAPTER 3

The case for Fair Pay Agreements: Does it stack up?

The proposal to introduce a system of FPAs rests on four concerns said to have emerged since New Zealand retreated from collective bargaining following the enactment of the ECA in 1991. The concerns are:

1. the decline in the share of New Zealand's GDP going to workers;⁹⁶
2. an alleged “hollowing out” of wages as a result of wages for middle-income workers not keeping pace with labour productivity increases. This, in turn, is said to have resulted in increased income inequality;⁹⁷
3. a so-called “race to the bottom” whereby some employers undercut others by reducing costs through lower wages;⁹⁸ and
4. New Zealand's poor record of productivity growth.⁹⁹

This chapter will consider each of these concerns and address two questions:

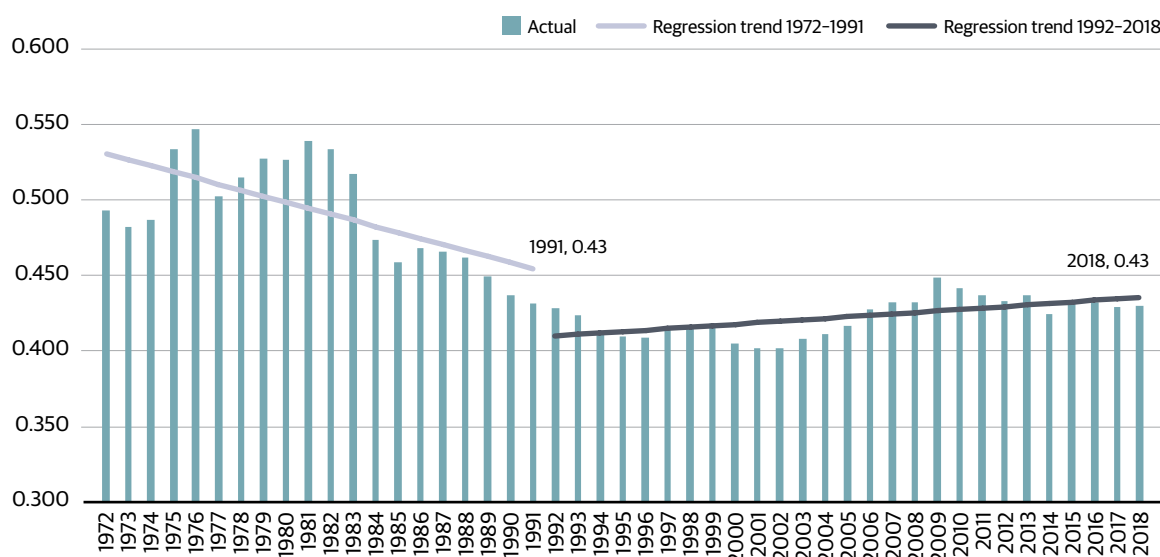
1. Is the concern well-founded?
2. If so, will introducing FPAs help resolve the concern?

As the FPAWG report itself discusses some of these concerns, we will comment on those observations in the report where appropriate.

A declining share of the pie?

Has the share of GDP attributable to workers declined since the introduction of the ECA in 1991? The answer can be found in data published by Statistics New Zealand disclosing employees'

Figure 2: Compensation of employees/GDP (P)



Source: Statistics New Zealand (years ended March). Authors' calculations.

share of GDP going back to 1972. As Figure 2 shows, the share of GDP attributed to employees *has* declined over the past half-century.

However, the period of significant decline *pre-dates* the labour market reforms introduced by the ECA in 1991 (Figure 2). The share of GDP attributed to labour fell from a high of just under 55% in 1976 to around 43% in 1991. Of course, during this pre-1991 period, industrial relations in New Zealand were dominated by collective bargaining.

However, as Figure 2 shows, in the nearly three decades since the ECA was enacted, the decline has been arrested and, indeed, has trended back up. The share of GDP going to employees has fluctuated between a high of 45% in 2009 and a low of 40% in 2001 (at the end of the first term of the Fifth Labour government). In the year ended 31 March 2018 it was 43%. Since the introduction of the ECA, the trendline for employees' share of GDP has been significantly *positive*.¹⁰⁰

How, then, do we reconcile these numbers with the gloomy picture painted in the FPAWG

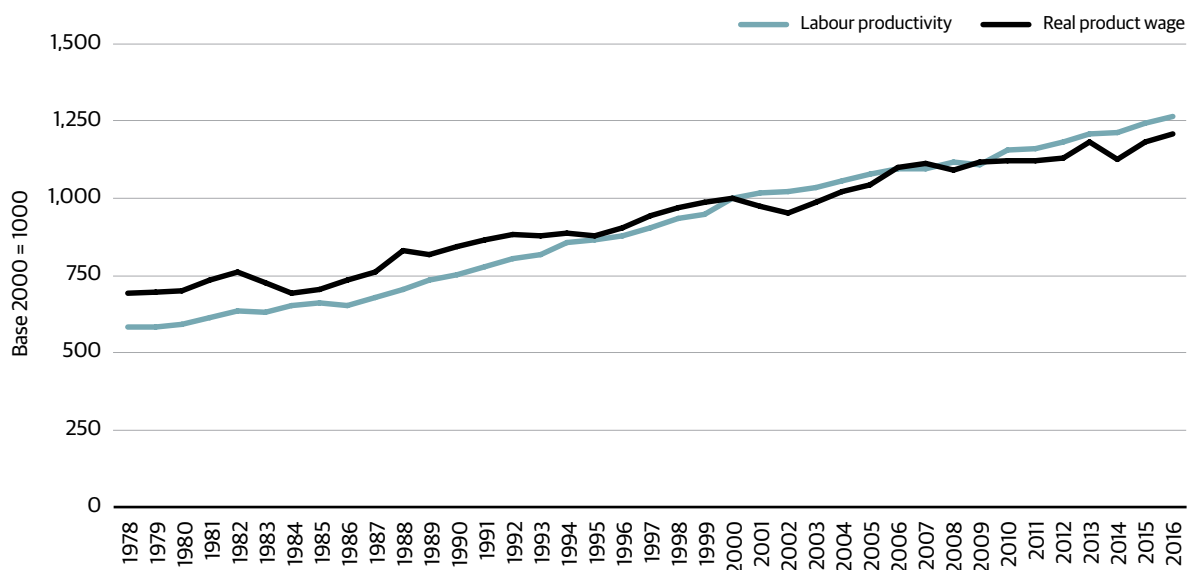
report? Figure 2 of the working group's report suggests that since 1978, growth in real wages in New Zealand has consistently lagged labour productivity.¹⁰¹ Growth in wages allegedly lagging the value of output has resulted in an ongoing decline in labour's share of GDP.¹⁰²

The answer to this apparent paradox lies in "lies, damn lies, and statistics". Figure 2 in the working group's report takes 1978 as the base year for "equality" (of labour productivity and wages). However, this creates a distorted view of the relationship between wages and productivity.

The underlying statistics used by the working group came from the Productivity Commission,¹⁰³ which used March 2000 as the base year for the value of wages and labour productivity. Figure 3 shows the Productivity Commission's original statistics.

Rather than suggesting an ever-widening gap between wages and productivity, Figure 3 invites the conclusion that real wages markedly *exceeded* labour productivity in the late 1970s, with productivity catching up around the mid-1990s.

Figure 3: Labour productivity and real product wage base 2000=1000



Source: New Zealand Productivity Commission (years ended March).

And that since then, the two have been largely tracking each other, with minor ups and downs along the way.

The share of GDP going to employees did fall significantly, but the fall started in the 1980s before the ECA. And their share of GDP has trended upwards since then, broadly in line with increases in productivity

The proposition that real wages exceeded labour productivity in the 1970s is consistent with Figure 2 showing employees’ share of GDP declining significantly from the early 1970s to the early 1990s. That picture is also consistent with New Zealand’s real-world experience in the 1970s and mid-1980s, with high labour costs contributing to an uncompetitive export sector and the ballooning balance of payments deficits (see Figure 4).¹⁰⁴

The working group’s portrayal of a progressively widening gap between wages and productivity since 1978 invites readers to infer that wage costs and labour productivity were in a sustainable

configuration during the year ended March 1978, and that subsequent adjustments reflect some form of “malaise” attributable to the 1991 labour market reforms. Figures 2 and 3 show that this narrative is simply incorrect. The share of GDP going to employees did fall significantly, but the fall started in the 1980s before the ECA. And their share of GDP has since trended upwards, broadly in line with increases in productivity.

Indeed, the OECD has recently singled out New Zealand – along with Denmark – as countries where real median wage growth has *closely tracked* productivity growth, adding that both countries have also generally done well on job quantity and inclusiveness.¹⁰⁵

To be fair, the FPAWG report goes *some way* towards acknowledging the trends identified here. The working group states that a falling share of income going to labour since the 1970s has been observed “in many other countries worldwide”.¹⁰⁶ The working group also acknowledges that since 2004, the change in New Zealand’s labour-capital income share has been “flatter” than in other countries.¹⁰⁷

Figure 4: New Zealand’s external trade balance (1972-2018)



Source: Statistics New Zealand (years ended March).

However, employees' share of income in New Zealand has not simply been "flatter" than other countries. It has risen. And not simply since 2004. Employed workers' share of GDP has trended upwards over the nearly three decades since the ECA (Figure 2).

A hollowing out?

Wage inequality is a different matter from trends in labour productivity and wage rates. But a closer examination shows that the concern about a "hollowing out" of middle-income wages is also flawed.

Of course, wage rate inequality among workers is inevitable. Wages reflect skills, work effort, and other factors, including changing demand for particular skills.

But the contention advanced in the working group's report is that existing labour market arrangements have contributed, over time, to the rise in mid-decile wage rates lagging the

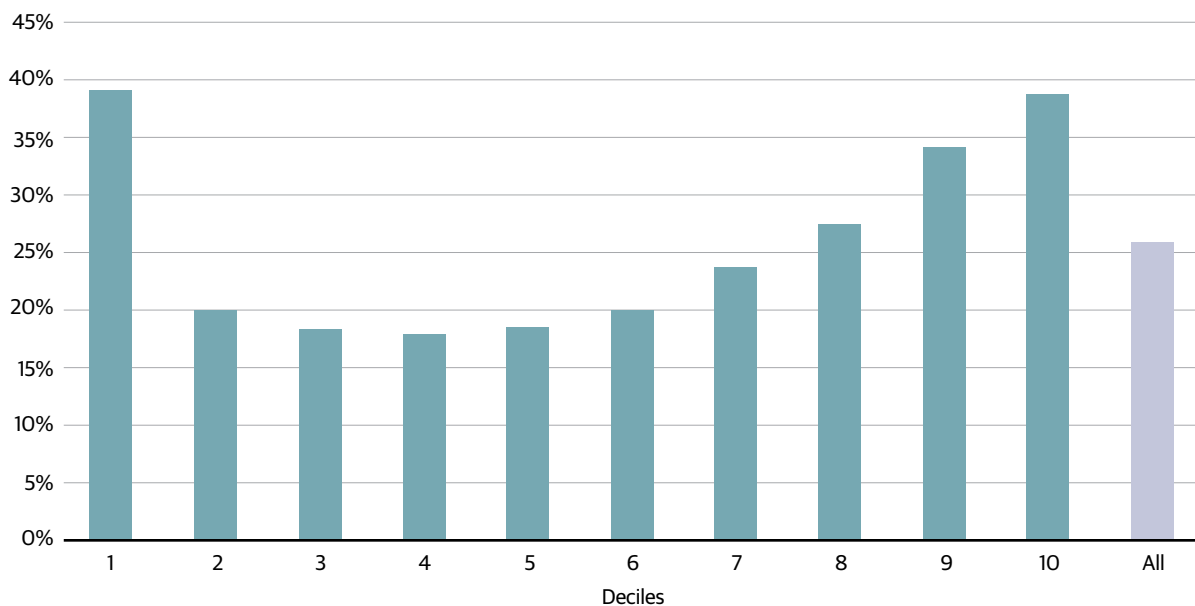
rises at the top and bottom. The contention is illustrated in Figure 3 in the working group's report. It is reproduced for ease of reference as Figure 5 below.¹⁰⁸

Figure 5 shows substantial real hourly wage increases between 1998 and 2015 across all wage-earning deciles – in an almost "U" shape – with the highest cumulative increases for deciles 1 and 10 (39%), the lowest increase for decile 4 (18%), and deciles 2–6 in the 18–20% range.

A first (and obvious) observation is that Figure 5 shows average hourly wage rates have risen materially in every decile. Oddly, this point is not made in the FPAWG report – even though this fact may be both contrary to popular belief, and contrary to outcomes in other economies with different labour market arrangements than those we enjoy in New Zealand.¹⁰⁹

Instead, the report asserts simply that the chart shows a "hollowing out" of the wage-scale. However, this claim is contrived. The first decile shown in the chart includes wage earners on

Figure 5: Real increase in average hourly wage in each decile for employees (1998-2015)



Source: Ministry of Business, Innovation & Employment, "Fair Pay Agreements: Supporting Workers and Firms to Drive Productivity Growth and Share the Benefits," Recommendations from the Fair Pay Agreement Working Group (Wellington: New Zealand Government, 2018), Figure 3.

the minimum wage. This wage is regulated in New Zealand by the *Minimum Wage Act 1983*. Hikes in the minimum wage lift wage rates in this decile regardless of labour market arrangements. At around 60% of median wage, New Zealand has one of the highest relative minimum wage rates among OECD countries.¹¹⁰ The downwards slope on the left of the FPAWG's Figure 3 – the “U” shape – is attributable to government intervention by forcing the minimum wage upwards. It has nothing to do with either the ECA (or, rather, its successor, the ERA) or with the functioning of the labour market.

In any case, New Zealand has not experienced a *general* rising trend for market income inequality since the reforms to New Zealand's labour market regulations in 1991.¹¹¹ Inequality is most commonly measured by the Gini coefficient, a statistical measure of income distribution developed by Italian statistician Corrado Gini in 1912.¹¹² A 2015 paper by Treasury's Christopher Ball and Victoria University economist John Creedy found a rise in market income inequality

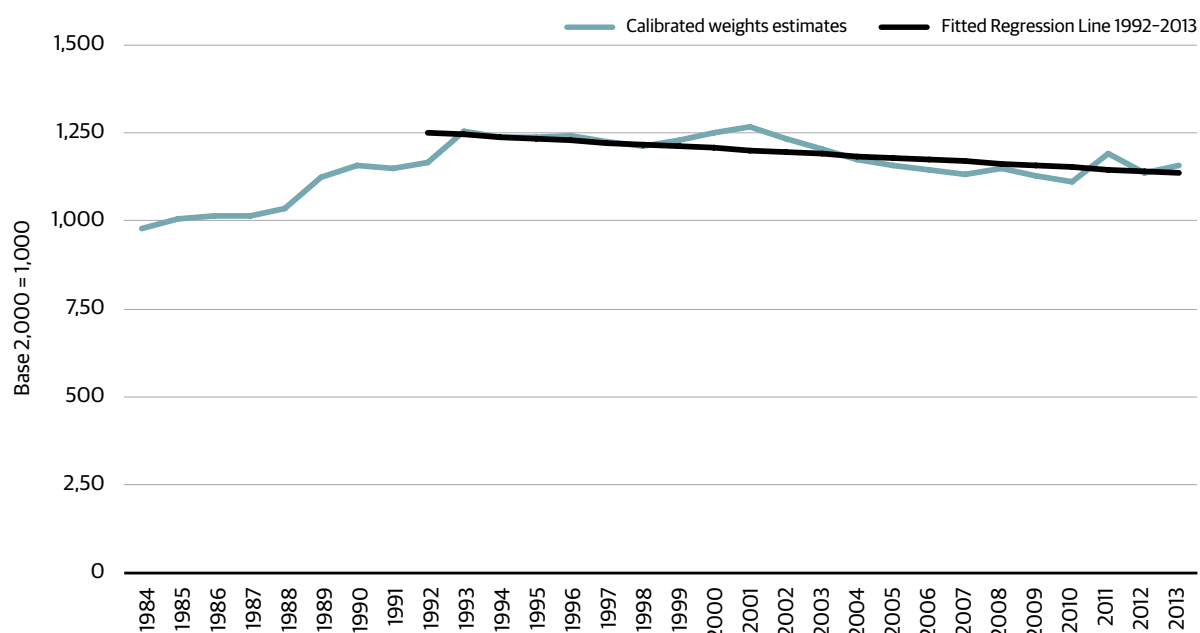
in the late 1980s.¹¹³ But the study found no rising trend for household market inequality after the early 1990s (when the ECA was passed).

Contrary to the impression created by the working group's report – and by Figure 3 in particular (Figure 5 above) – Ball and Creedy's estimates indicate that New Zealand experienced a *decline* in inequality on this measure from the 1990s to 2013.¹¹⁴ This decline is illustrated in Figure 6 below.

Claims of an ongoing rise in income inequality after labour markets were reformed in 1991 are also rebutted in the annual reports on household income inequality from the Ministry of Social Development (MSD). The 2018 report by MSD analyst Bryan Perry calculates New Zealand's Gini coefficient for market income at 40.3 in 2015, compared with 42.4 in 1991.

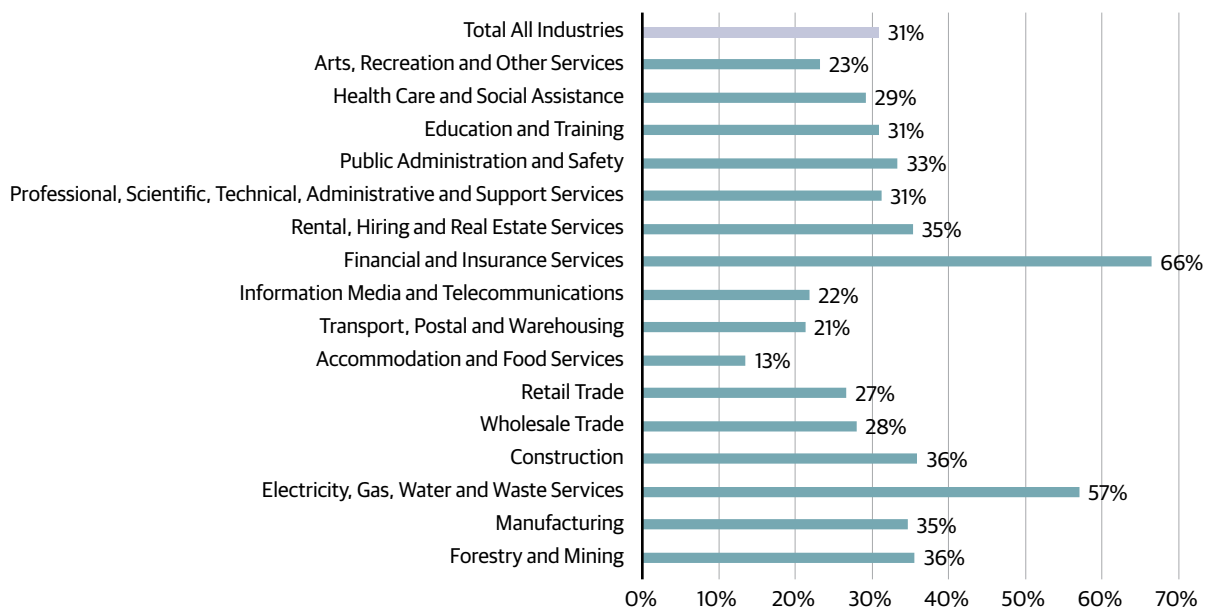
It is puzzling that the working group report ignores the academic research showing that market income inequality has declined in New Zealand. Instead, it embeds its

Figure 6: Market income inequality in New Zealand (1983/84 to 2012/13)



Source: Christopher Ball and John Creedy, “Inequality in New Zealand 1983/84 to 2012/13,” *New Zealand Economic Papers* 50:3 (2016), 323–342.

Figure 7: Percent increase in real ordinary time average hourly wage rates 1991(1) to 2019(1)



Source: Statistics New Zealand Infoshare, “Labour Cost Index (Salary and Wage Rates),” Table QEX001AA (Statistics New Zealand, New Zealand Government), downloaded 30 May 2019. Authors’ calculations.

“hollowing out” claims in text that refers to income inequality “rising in many developed countries”, as if this were also the case in New Zealand.¹¹⁵ It is not. And to the extent the working group suggests otherwise, its report is misleading. In any event, it provides no basis for the FPAWG’s proposed heavy-handed re-regulation of New Zealand’s labour markets.

A race to the bottom?

The concern that “good” employers are being disadvantaged by “bad” employers by undercutting them with lower costs by paying lower wages is repeated in the Cabinet paper,¹¹⁶ the Terms of Reference,¹¹⁷ and in the Minister’s media statement.¹¹⁸ It is also repeatedly asserted in the FPAWG report.¹¹⁹

This so-called “race to the bottom” argument is predicated on the view that the absence of industry-wide collective agreements or awards permits New Zealand employers to undercut their competitors by choosing to pay lower wages.

No matter how sincere this “race to the bottom” concern may be, it is not borne in the data.

First, the working group report’s Figure 3 (reproduced as Figure 5 above)¹²⁰ shows that average wage rates have risen substantially faster than inflation since 1998 across *all* income deciles. This refutes the suggestion that workers have suffered from employers bidding down their wage rates on an ever-decreasing basis. To the contrary, average real hourly rates *increased* by a minimum of 18% across all deciles over the period. Between 1991 and 2019, average real hourly wages increased by 31%.¹²¹

A second approach is to examine wages on a sector-by-sector basis. Figure 7 shows changes in the real ordinary time hourly wage rates in the 16-industry breakdown published by Statistics New Zealand since 1991 (when the ECA was passed).

Figure 7 shows no evidence that workers have suffered falling wages in any of these 16 sectors.

Statistics New Zealand also provides a more disaggregated 31-industry breakdown of labour’s

**Figure 8: Change in compensation of employee trend share in 25 years (1992-2017):
31-industry breakdown**



Source: Statistics New Zealand. Authors' calculations.

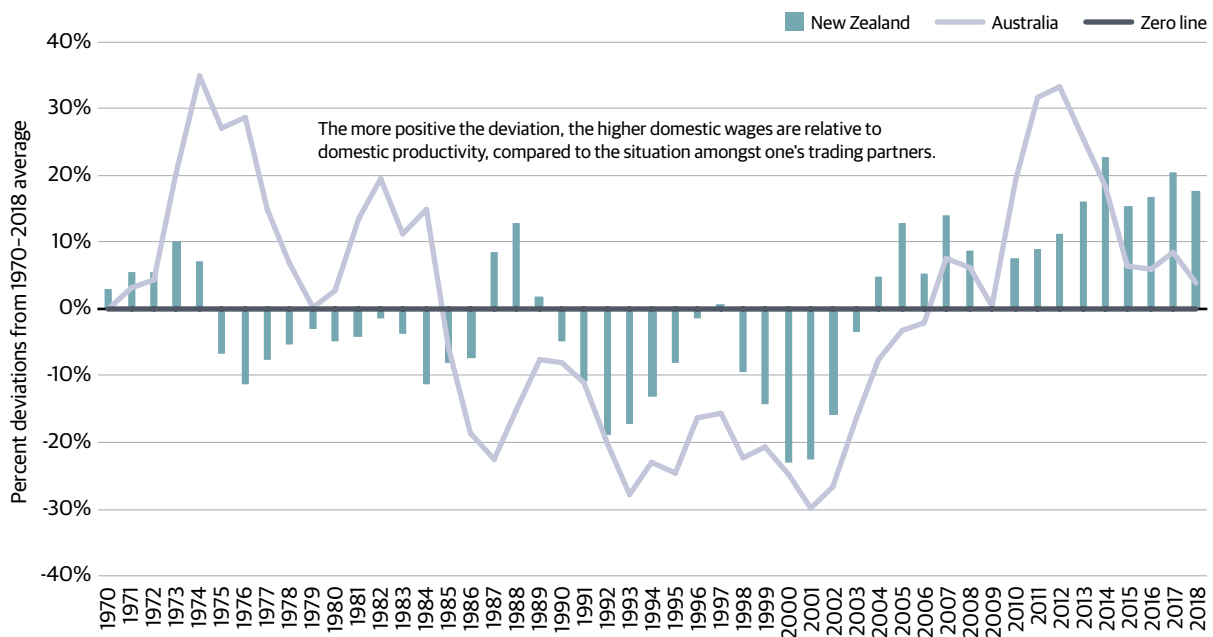
income shares. If wages were being driven down relative to productivity in any of these industries, it should be apparent in a declining income share in one or more of these 31 industries. Figure 8 shows the results of regression trend lines since the ECA was passed for labour's income share for each of the 31 industry groups that collectively produce economy-wide GDP.

Figure 8 shows a rising trend for employee compensation relative to operating surplus for 21 of the 31 industries. The rises are modest for a handful of industries, making them statistically

insignificant. The same is true for some of the 10 industry groups showing a modest trend decline.

Not surprisingly, labour share has declined most markedly in the financial and insurance services industry group. Over the past two decades, the banking and insurance sectors have seen a rapid adoption of technology, including ATMs and online banking. These changes have caused a significant reduction in the number of bank branches and staff. At the same time, average hourly wage rates since 1991 have risen more in this industry group than in any other major

Figure 9: OECD: Relative unit labour costs (1970 to 2018)



Source: OECD Database: Country Statistics. Authors' calculations.

industry group (see Figure 7). Consequently, changes to the delivery of banking and insurance services to customers are a more likely explanation for the declining income share of workers in financial services than a hypothetical “race to the bottom” among bank bosses.

Nor is it plausible that labour’s declining income share in Furniture and Other Manufacturing, Local Government Administration, or Education and Training reflects any “race to the bottom” (Figures 7 and 8).

It is informative to compare New Zealand’s average wage rates in the traded goods sector relative to productivity with one of our closest peers, Australia. Figure 9 shows a time series of unit labour costs for New Zealand and Australia, relative to unit labour costs among their respective trading partners.

If New Zealand suffers from a “race to the bottom”, it does not show in Figure 9. There has been no comparative reduction in unit labour costs and therefore no comparative gain in competitiveness as “bad” New Zealand

employers undercut good ones, driving down labour costs. Indeed, the past five years show a rise in New Zealand’s comparative labour costs compared with Australia’s.

The notion of a race to the bottom is also bad economics. It assumes workers are simply price-takers regarding their wages. This assumption is fallacious. In a competitive labour market, the price of labour (wages) is set by supply and demand. An employer who tries to undercut the market by offering lower wages will quickly find workers taking their labour elsewhere.

Fears about “bad” employers triggering a race to the bottom are misplaced – in fact and in theory. They provide no basis for supporting a return to compulsory collective bargaining.

New Zealand's poor productivity growth

The last concern identified in support of a return to compulsory collective bargaining is a real one. New Zealand *has* suffered from poor productivity growth in recent decades.

Indeed, poor productivity growth has been the New Zealand economy's Achilles heel.

But this is not a new worry. As the FPAWG acknowledges in its report, New Zealand's GDP-per-hour worked has been declining compared with high-income earning countries in the OECD since at least the 1970s. Yet for nearly half this period, the New Zealand labour market was characterised by high levels of coverage by collective agreements.¹²²

Since productivity growth is cyclical, Statistics New Zealand calculates average growth rates during periods it determines to be complete growth cycles. Figure 10 reproduces these growth cycle statistics since 1978.

As we can see, productivity growth averaged just 1.0% over the half-century between 1978 and 2018. Against this benchmark, productivity growth was extraordinarily high in the two growth cycles that *followed* the passing of the ECA in 1991. It was not nearly so high following the repeal and replacement of the ECA with the ERA in 2000.

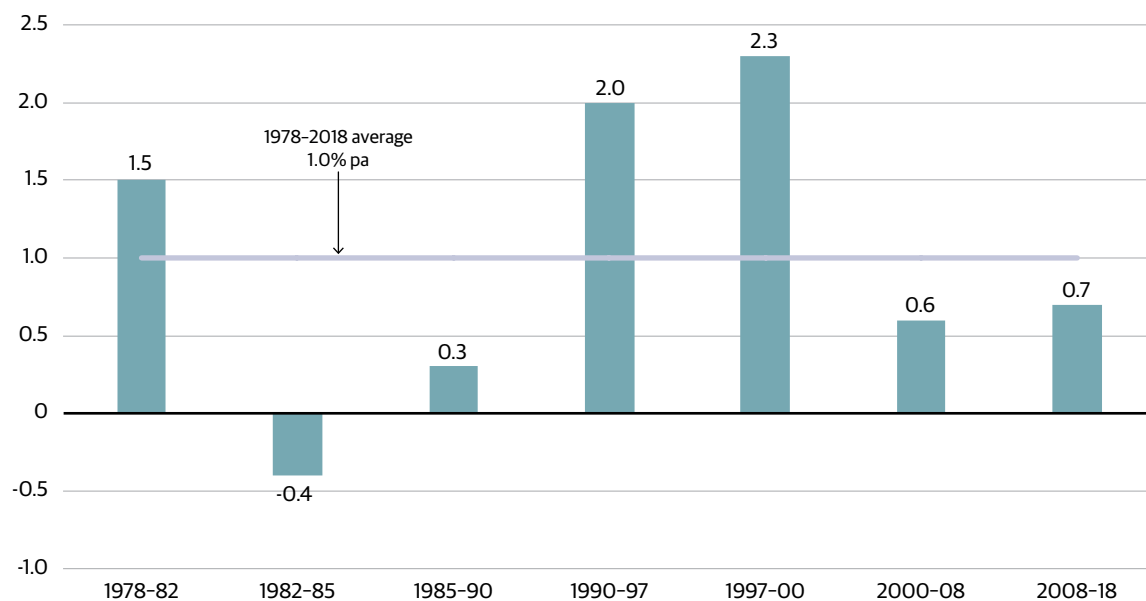
Of course, Figure 10 does not establish that the fast growth from 1990 to 2000 was primarily due to the ECA. Nor does it establish that the slow growth from 2000 was due to the passage of the ERA. But the figure provides more information about productivity growth in relation to these events than the FPAWG report. Moreover, Figure 10 suggests no reasons for thinking the ECA had an *adverse* effect on productivity growth in New Zealand.

Collective bargaining is a potential impediment to productivity growth rather than a prescription for improving it

Nor does the working group present any evidence for believing that returning to a comprehensive system of compulsory collective bargaining under FPAs will lift New Zealand's rate of productivity growth.

Indeed, the FPAWG notes in its report that "the evidence in the research literature suggests wages tend to be less aligned with labour productivity in countries where collective bargaining institutions have a more important

Figure 10: Multi-factor productivity growth cycles



Source: Statistics New Zealand, former measured sector (1978–2018) (years ended March).

role.¹²³ This is not surprising. As noted in the research literature relied on by the FPAWG (an OECD report):¹²⁴

... such delinking of wages from productivity [as a consequence of centralised collective bargaining] could have potentially important implications for productivity growth. It could reduce incentives for employees to work hard, innovate and move to a better-paid job.

The OECD repeated this warning in June 2019, noting that collective bargaining is a potential impediment to productivity growth rather than a prescription for improving it.¹²⁵

The claim that FPAs may increase productivity is based on *conjecture*, not *evidence*. The most succinct summary of this conjecture is set out in the Cabinet paper. It is that collective bargaining will result in higher wages, and that higher wages “could” in turn:

- a. encourage firms to invest in training, capital and innovation to protect their profitability;
- b. encourage resources to shift from less productive firms and industries; and
- c. lead to better engagement from workers.¹²⁶

However, each of these claims is spurious. In a competitive marketplace, if firms could improve their profitability through greater investment in training, capital and innovation, they would have already done so. Proposition (a) above suggests firms do not know what is in their best interests.

Yet the working group presents no evidence for this claim.

The premise behind the claim in proposition (b) above is even more astonishing. It is that New Zealand’s productivity will improve by driving firms who cannot afford the higher wages fixed under FPAs out of business. It is a heroic assumption that the “resources” – people and capital – will be able to find other, more productive industries to work and invest in. If they are unable to, New Zealand’s remaining labour force may be more productive. But it will come at the cost of those forced into unemployment. Shutting the least productive workers out of the workforce is not a sensible formula for labour market reform.

Finally, proposition (c) above claims that higher wages will lead to better engagement and higher productivity. But industrial relations in New Zealand’s recent past have been characterised by high levels of compulsory collective bargaining (see Chapter 1). Yet it was also a period of serious industrial strife. The evidence from the past suggests that reintroducing compulsory collective bargaining will lead to higher levels of industrial strife, rather than higher levels of worker engagement.

Chapter 4 will explore this and other potentially adverse consequences of introducing a framework for compulsory collective bargaining. In the meantime, this chapter has shown that the stated case for introducing FPAs does not stack up.

CHAPTER 4

The case against FPAs

There are many reasons to be cautious about returning to a comprehensive system of compulsory collective bargaining. Indeed, the working group's Terms of Reference themselves acknowledge some of the risks.¹²⁷ These include:

- slower productivity growth if FPAs lock in inefficient business models;
- unreasonable price rises for consumers if increased labour costs are not offset by productivity gains; and
- job losses, particularly in industries exposed to international competition that are unable to pass on higher labour costs to consumers.

Recognising these risks, the Terms of Reference record that it will be important to ensure that the working group's recommendations "manage and where possible mitigate" these risks.

The risks identified in the Terms of Reference are concerning. But the possible adverse consequences of FPAs go far beyond those set out in the Terms of Reference. Most critical is the risk that workers themselves will be casualties through lower wages from slower productivity growth.

In this chapter, we examine the potential adverse consequences of a compulsory, comprehensive system of collective bargaining and evaluate the extent to which the recommendations of the FPAWG "manage or mitigate" these risks.

The risk to productivity growth

As economist Paul Krugman put it, "Productivity isn't everything, but in the long run it is almost everything. A country's ability to

improve its standard of living over time depends almost entirely on its ability to raise its output per worker."¹²⁸ Krugman's insight serves as a warning to policymakers: gamble with productivity at your peril.

In this context, the FPAWG's observation based on the OECD's *Employment Outlook* 2018 noted in Chapter 3 above is a concern.¹²⁹ This is that wages tend to be *less* aligned with labour productivity in countries where collective bargaining institutions have a more important role.¹³⁰ There are several reasons for this disconnect – the most significant of which in relation to the FPAWG's recommendations are discussed below.

Lack of flexibility

Collective bargaining of the sort contemplated by the FPAWG lacks flexibility. FPAs are intended to be applied across industries and across occupations. Consequently, by design, they ignore the needs and circumstances of individual employers and their workers trying to meet the demands of a competitive domestic and international marketplace.

How likely is it that an FPA will:

- permit bespoke changes to shift arrangements desired by one innovative firm in an industry, but not by others; or
- permit changes to terms and conditions unanimously agreed to by the workforce of a specific employer but which make different trade-offs – and therefore infringe the "favourability principle"?

Furthermore, union officials in the centralised bargaining structure envisaged by the FPAWG

cannot hope to be informed about – or take account of – the varying needs and circumstances of each and every employer of the workers they are mandated to represent. Nor can the statutory body whose task it is to adjudicate if agreement cannot be reached by representatives tasked with negotiating an FPA.

Collective bargaining of the sort contemplated by the FPAWG lacks flexibility

This lack of flexibility with sector- or occupation-wide collective bargaining will be exacerbated by the FPAWG's proposed prohibition on employers – individually or collectively – from initiating changes to collective bargaining arrangements.¹³¹

The adverse impacts of a system of FPAs will be amplified by disruption from automation and innovation to the future workplace. Drawing on research from the McKinsey Global Institute, the report *A Future that Works* from the Prime Minister's Business Advisory Council predicts that New Zealand workplaces face technological disruption at 10 times the pace of the Industrial Revolution.¹³² The report notes that automation holds enormous potential for New Zealand through increased productivity. However, the report concludes that the extent of the benefits will depend on the speed of automation adoption relative to international competition.¹³³

Consequently, it may never have been more important that our labour market regulations operate flexibly to enable individual firms to make timely changes to the terms and conditions of employment to meet the rapidly changing needs of a competitive marketplace. Yet centralised, compulsory collective bargaining of the sort envisaged by the FPAWG would institutionalise inflexibility. Rather than permit individual firms to respond nimbly to the opportunities presented by automation and innovation, firms will be straddled with terms and conditions that are fixed across entire

industries or occupations. FPAs will be no prescription for the challenges to the future of work. Rather, they will present an obstacle to businesses trying to meet those challenges.

Perhaps the most blunt and inflexible aspect of the FPAWG's recommendations is the proposal to extend the terms and conditions of FPAs to *all workers* in an occupation, including contractors.¹³⁴ Treating contractors as employees would have profound implications for businesses and contractors alike – especially in sectors like transport, where market-based outcomes have led to many businesses using fleets owned and operated by contractors.¹³⁵

Feedback from businesses interviewed in the course of our research indicated alarm at the adverse implications for productivity from treating owner-operator drivers as employees.¹³⁶ Recognising the impracticality of its recommendation, the working group acknowledges the view that “contractors operate under a business model, rather than [an] employment model”, and that its recommendation raised “broader issues” that the government may want to address “by other means”.¹³⁷

Even if FPAs do *not* extend to contractors, the FPAWG's recommendations will significantly reduce the flexibility of New Zealand's labour markets for reasons outlined above.

Poor incentives

FPAs may also reduce incentives for workers to innovate and work hard. That is the conclusion of the OECD in its *Employment Outlook 2018* report.¹³⁸ The OECD's conclusion relies on findings in several recent European studies that decentralised wage-setting is associated more with higher productivity than the centralised wage-setting recommended by the FPAWG.¹³⁹

The OECD conclusion is also consistent with New Zealand's experience of comparatively rapid increases in multi-factor productivity in the

1990s following the ECA reforms. As we saw in Chapter 3, this sustained period of productivity growth followed a long period of moribund productivity growth under New Zealand's former system of industrial awards.¹⁴⁰

While the OECD also notes the *potential* for centralised collective bargaining to increase aggregate productivity by setting higher wage floors, forcing unproductive firms to exit the market,¹⁴¹ this means firms failing and jobs being lost. As noted earlier, this is hardly a sensible strategy for labour market reform in New Zealand.¹⁴²

Cost and complexity

Experience from overseas suggests the centralised, compulsory collective bargaining framework envisaged by the FPAWG will introduce higher cost and complexity to the operation of our labour markets.

Complexity will arise from, among other matters, the need:

- to determine the limits on an “industry” or “occupation”, including whether a particular business falls within a specific “industry” or whether a particular role falls within a specific “occupation”;
- to determine whether the thresholds for triggering or initiating an FPA process have been met;
- to determine which unions and employer organisations are mandated and entitled to represent which workers and businesses. As noted in Chapter 1, so-called “demarcation” disputes between unions (of which there are 135 in New Zealand) were a common phenomenon under New Zealand's former awards system;
- for consultations between the various representative bodies on the above issues and on the terms and conditions to be decided and being negotiated (in itself an immensely complicated issue when

the recommendations envisage negotiations across whole industries or occupations); and

- to determine outcomes judicially if agreement cannot be reached between employee and employer representatives.

These matters may seem simple. In practice, they will create uncertainty and complexity in the operation of the labour market. And they will create a field day for lawyers.

Experience from overseas suggests the centralised, compulsory collective bargaining framework envisaged by the FPAWG will introduce higher cost and complexity to the operation of our labour markets

Box 1 provides some examples from Australia of the types of complications expected to arise from the working group's recommendations. They are outlined in more detail by John Slater in *Industrial Relations in Australia: A Handbrake on Prosperity*.¹⁴³

A reduction in the dynamism and fluidity of labour markets will adversely affect economic growth and productivity. Unfortunately, the FPAWG report shows few signs of understanding either the risks its recommendations will create, or the adverse consequences for wages, workers and welfare.

Harm to industrial relations

Compulsory industry- or occupation-wide collective bargaining in the form of FPAs also risks taking the “relations” out of industrial relations. Instead of a firm and its workers sitting around a table and discussing their respective wants and needs – and the trade-offs each is willing to make in the interests of a harmonious and productive workplace – negotiations will take place between remote representatives from one or more unions and business organisations.

The change in dynamics will be profound, even for New Zealand's larger businesses. As one

Box 1: Australia's costly collective bargaining system

The aim of Australia's Fair Work Act was to provide a simplified safety net for the terms and conditions of employment. The reality is quite different. John Slater describes Australia's system of industrial relations as unwieldy, expensive and painstakingly complex.¹⁴³

In *Industrial Relations in Australia: A Handbrake on Prosperity*, Slater gives examples like a small Melbourne design firm that was unable to work out which award (or "FPA" in terms of the FPAWG recommendations) applied to its workers. The roles and duties of its workers did not clearly fit within any of the categories prescribed. The firm was found to have made the wrong decision by the Australian Fair Work Ombudsman and was issued with a notice for back pay for AU\$700,000. The notice was eventually withdrawn, but only after several costly months of lawyers and hearings.¹⁴⁴

Another example identifies the inevitably arbitrary lines that have to be drawn between different categories of occupations under a centralised wage bargaining system. As Slater explains:

... awards comprehensively set out unique pay rates, classes of workers, penalty rates and other loadings, all tailored to different occupations and industries... These rates and conditions are sometimes arbitrary at best, and often lead to distortions and pay differences that make little sense economically or practically.¹⁴⁵

Slater also gives the example of fast food and hospitality workers – with the latter having 25% higher penalty rates in their award – even though businesses in these industries often directly compete with each other. Consequently, a cashier in a fish and chip shop could be taking home AU\$35 less on a Sunday than a worker performing substantially the same job in the café next door.

As Slater concludes, "... the award pay rate setting function of the Fair Work Commission is better thought of as a quasi-legalistic line-drawing function than a rigorous analysis of the commercial needs of a given sector and its corresponding workforce."¹⁴⁶

employer put it to us, "[Under FPAs] I will stop being an *employer* of labour and become a *user*."¹⁴⁸ Another noted, "Together with the unions we have invested heavily in processes both within and outside bargaining that promote collaborative problem-solving by 'the people closest to the problem' with real success. That will be lost with negotiations undertaken by strangers with strangers."¹⁴⁹

It is little wonder that pre-ECA industrial relations in New Zealand were characterised by industrial strife (well-illustrated by Figure 1).

To mitigate this risk under a system of compulsory FPAs, the FPAWG recommends that workers should be prohibited from taking industrial action in connection with the

FPA process. However, even without strike action, the representative role envisaged for unions will be a significant logistical exercise, requiring multiple stop-work meetings to enable consultation with workers across entire industries or occupations. Consultation will be needed for initiation, the course of negotiations, and ratifying the final terms of FPAs. Consequently, the FPA process will involve extensive industrial disruption, even when industrial action is not taking place.

Of more concern, perhaps, is the risk of a return to industrial action commonly described as "second-tier bargaining". The history of New Zealand's pre-ECA industrial relations suggests the FPA process risks raising workers' expectations for high wage increases. To enable

less-profitable employers to cope with award outcomes, the 1960s and 1970s saw some conservative awards that did not meet workers' expectations (the most notorious of which was the "nil" wage order of 1968 referred to in Chapter 1). Workers subsequently put pressure on individual employers to negotiate "above award" settlements. This "second-tier bargaining" contributed to New Zealand's historically high levels of strikes and lockouts during the 1970s and 1980s.¹⁵⁰

The adverse implications for productivity of a return to the industrial strife experienced in New Zealand's recent past casts a shadow over the FPAWG's recommendations to return to compulsory sector-wide collective bargaining.

Mitigation

As noted at the beginning of this chapter, the Terms of Reference for the FPAWG acknowledge the risk of slower productivity growth if FPAs lock in inefficient and costly practices or structures.¹⁵¹ And they mandated the working group to mitigate this risk "where possible".¹⁵² However, the working group's report pays only lip service to the risk of slower productivity growth from FPAs, or to mitigating it.

Two sentences in the covering letter from the working group's chair to Minister Lees-Galloway succinctly encapsulate the FPAWG's approach.¹⁵³

Fair Pay Agreements could also be useful where workers and employers identify scope to improve outcomes across a sector or occupation. In particular, workers and employers will need to work together to find innovative ways to lift productivity.

No evidence is presented in the report for the hoped-for outcome in the first sentence.

Short of permitting the representatives of employers and workers to discuss matters beyond those mandated for inclusion in an FPA,¹⁵⁴

no mechanism is incorporated into the design of FPAs to encourage productivity-enhancing outcomes of FPA negotiations. Of course, if firms could improve their productivity and profitability through negotiations with their employees, they would already be doing so. FPAs will provide no new opportunity (Chapter 3).¹⁵⁵

Harming the unemployed (current and future)

If an FPA leads to increased wages and improved terms and conditions for workers, that will benefit those who remain employed in industries or occupations covered by the FPA. But increasing the price of labour will change the incentives for firms to hire the marginal worker. If hiring an *additional* worker becomes uneconomic because of the higher cost, firms will choose not to hire the worker. And if the higher wages make firms' *existing labour costs* uneconomic, firms may shed workers, reduce workers' hours, or perhaps substitute capital (e.g. technology) for more expensive workers.

The adverse effects of centralised bargaining systems will be felt most harshly during downturns. Indeed, standard economics predicts that by preventing wages to adjust downwards during economic downturns, centralised bargaining institutions are likely to hamper the smooth functioning of labour markets and to amplify the impact of shocks on levels of employment.¹⁵⁶

The enhanced terms and conditions from centralised bargaining arrangements like FPAs may be good for those workers who retain their jobs, but those who are priced out of the labour market because of them will suffer.

In the subsections that follow, we identify the groups most at risk, and the extent to which the FPAWG's recommendation mitigates the risks faced by these groups.

Young or unskilled workers and the long-term unemployed

To the extent FPAs increase the costs of labour, we can expect FPAs to harm the unemployed, especially unskilled school-leavers and the long-term unemployed. Employers will only hire workers if their value (productivity) exceeds their cost (wages). Lifting wages through compulsory collective bargaining will simply increase the hurdles unskilled or inexperienced workers have to overcome to enter the labour market.

In times of comparatively low unemployment like New Zealand is currently enjoying, the risk of low-skilled workers being locked out of employment by higher minimum wage rates might seem academic. But these concerns are real. Based on OECD-wide research, the OECD's latest country survey of New Zealand reports that a 7% rise in the minimum wage might reduce GDP per capita by 1.8% in time, particularly at the cost of the employment rates of young people and women.¹⁵⁷

At the time of writing, the latest labour market statistics for the March 2019 quarter show the number of New Zealand 15- to 24-year-olds not in education, training or employment (NEETs) has increased over the past two years, despite a fall in the overall unemployment rate.¹⁵⁸

In March 2019, New Zealand's unemployment rate was down to 4.2%, compared with 4.9% in March 2017.¹⁵⁹ Yet over the same period, seasonally adjusted youth NEETs increased from 12.7% to 13.2%.¹⁶⁰ This rise reflected 2,000 more NEET youth compared with two years ago, despite the fall in the overall unemployment rate.¹⁶¹ Indeed, the percentage of NEETs was at the highest level in a March quarter since March 2012 – when the overall unemployment rate was much higher, at 6.7%.¹⁶²

There may be several reasons for the increase in 15- to 24-year-old unemployment. And Statistics New Zealand recommends caution in relation to

this data.¹⁶³ However, it may be no coincidence that the comparative rise in youth unemployment has coincided with a period of rapid growth in minimum wages,¹⁶⁴ pricing young and inexperienced workers out of the labour market.

Consequently, while the concern about pricing the marginal worker out of the labour market may sound academic, it is hardly so in practice. This is not just a matter of economics but also livelihoods and wellbeing.

Workers employed by firms facing international competition

In an open economy like New Zealand's, artificially lifting labour costs through compulsory processes like FPAs risks New Zealand "exporting jobs" to overseas firms.

Firms facing competition from importers will find themselves at a comparative cost disadvantage to their international competitors. As consumers substitute cheaper imports, the ultimate "cost" will be to the jobs of workers at firms whose products have been rendered uneconomic by FPAs.

The same risk affects workers in export industries facing competition from overseas producers. If their employers are at risk, so are their jobs.

Of course, not all importers or exporters are likely to fail if wage costs increase because of FPAs. But at the margin, an artificial increase in wage costs that is not matched by an increase in labour productivity will harm both firms and the employment prospects of their employees (and prospective employees).

Workers whose firms are only marginally profitable

This risk is obvious. For firms that are only marginally productive, an enforced increase in labour costs that is unmatched by an increase in labour productivity may be the difference between continuing in business and bankruptcy.

This risk is recognised in the Cabinet paper with euphemistic wording noting that FPAs may encourage “resources to shift from less productive firms and industries to more productive uses.”¹⁶⁵ However, what is being discussed here is businesses failing and jobs being lost. Making the least productive workers unemployed is not putting them to more productive use. This is hardly a pro-employee prescription.

As Treasury noted in its advice to the Minister,¹⁶⁶ research on the effects of the global financial crisis suggests that compared with firm-level bargaining, centralised wage bargaining restricts the ability of firms to maintain competitiveness, increasing the incidence of staff layoffs.¹⁶⁷

The analysis in this and the previous subsection focuses on *existing* firms in an industry. But it is equally applicable to potential *new entrants* who may be dissuaded from entering a market in New Zealand because of higher labour costs brought about by FPAs.

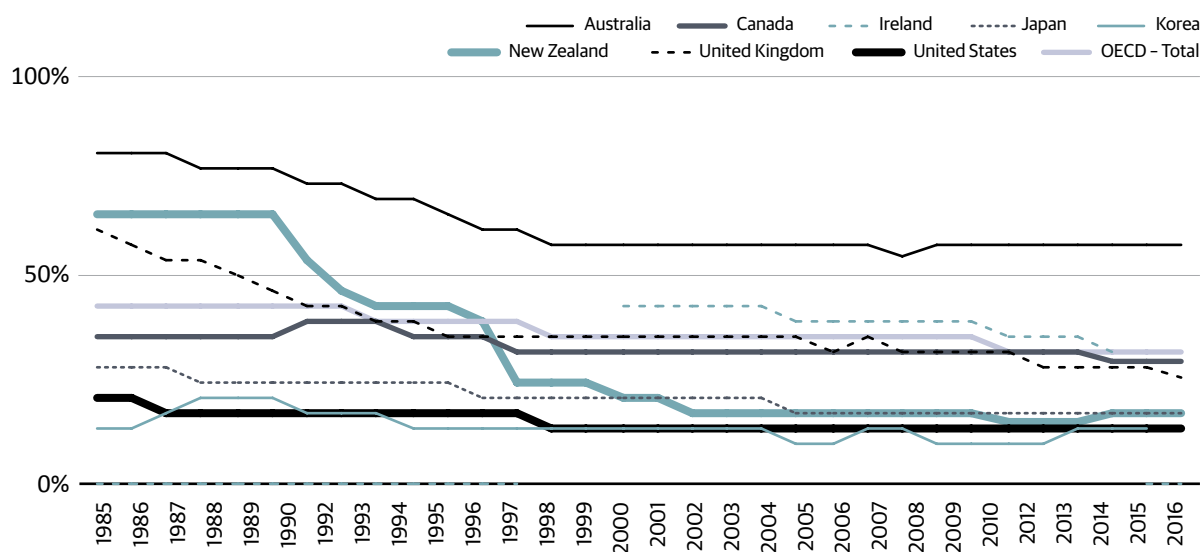
Mitigation

The FPAWG’s recommendations do little to mitigate these risks. As noted in Chapter 2,¹⁶⁸ the working group’s recommendations allow for flexibility within an FPA for *regional differences* within sectors or occupations and for *temporary exemptions* where the additional costs imposed by an FPA may jeopardise a business’s financial viability.¹⁶⁹

However, there is no provision for flexibility based on the extent to which the firm is exposed to offshore competition. The temporary exemption process envisaged in the report not only creates the spectre of complexity but also of uncertainty. Neither is likely to be conducive to long-term investment commitments by business owners or potential new entrants.

Consequently, FPAs may have profound adverse implications for the employment decisions of businesses throughout the economy – hence, on their employees and prospective employees.

Figure 11: Percentage of workers covered by collective agreements



Source: Ministry of Business, Innovation & Employment, “Fair Pay Agreements: Supporting Workers and Firms to Drive Productivity Growth and Share the Benefits,” Recommendations from the Fair Pay Agreement Working Group (Wellington: New Zealand Government, 2018), Figure 11.

The cost to personal freedom

The recommendations of the FPAWG will take away an important freedom currently enjoyed by all workers.

Given a choice, most workers *choose not* to have unions represent them in their wage negotiations (and not to seek coverage under a collective agreement). The evidence demonstrates they prefer to negotiate directly with their employers. We can see this in the decline in union membership in New Zealand, from around 46% when compulsory union membership was abolished with the passage of the ECA, to around 17% in 2017.¹⁷⁰ This decline has been matched by a similar downwards trend in the percentage of workers covered by collective agreements in New Zealand. As the FPAWG report notes, as of 2016, New Zealand's collective bargaining coverage stood at 15.9%, down from a peak of 45% in 1985 (see Figure 11).

If the working group's recommendations are implemented, workers will see an end to choice and a return to compulsion

There are good reasons workers may prefer to negotiate their own terms and conditions and not be bound by the terms of a union-negotiated industry- or occupation-wide collective agreement of the sort contemplated by the FPAWG. For example:

- a. Workers may prefer to retain a more direct relationship with their own employer for various reasons, including enabling the negotiation to be imbued with their own employer's culture and values (and their own) and ensuring that the negotiations focus on issues relevant to their particular needs, and their particular work environment;
- b. Workers may prefer to negotiate their own pay rises – or at least for their individual employer to retain flexibility about pay rises for themselves and their

co-workers. The alternative (under an FPA) may be to determine their pay rates (and pay increases) in a manner not of their choosing and not in their interests (for example, by the lock-step approach faced by teachers under the teachers' collective agreements);¹⁷¹ and

- c. Workers may prefer not to become subject to the types of industrial action that can be associated with collective bargaining (for example, second-tier strikes, stop-work meetings, working to rule, and so on).

In this context, the FPAWG's recommendations are particularly worrisome because they recommend extraordinarily low thresholds for triggering a compulsory FPA negotiation. As noted in Chapter 2,¹⁷² the working group recommends that a small minority of only 10% of the workers in an occupation or industry should be able to trigger a compulsory collective bargaining process. This is regardless of the views of the remaining 90%. As we saw in Chapter 2, in larger industries or occupations with more than 10,000 workers, the alternative "1,000 workers" threshold could mean less than 10% of workers have the ability to change the approach to industrial relations for all other workers in the occupation or industry. At the very least, the FPAWG's recommendations are undemocratic.

The recommendations are also inconsistent with New Zealand's international treaty obligations. The right of workers to choose whether to appoint a representative to negotiate their terms and conditions of employment is enshrined in the International Labour Organization's *Right to Organise and Collective Bargaining Convention, 1949*.¹⁷³ New Zealand ratified the convention only in 2003,¹⁷⁴ more than half-a-century after the convention. For most of that period, New Zealand's labour market regulations (compulsory unionism – and compulsory collective bargaining) were inconsistent with the fundamental freedoms protected by the

convention and enjoyed by workers in other countries around the world.

If the working group's recommendations are implemented, workers will see an end to choice and a return to compulsion.

Cost to consumers

If implemented, the FPAWG recommendations may adversely affect consumers in the form of higher prices for goods and services not subject to competition from imports. Inevitably, the effect of any increased prices will be felt most acutely by the least well-off – who are also likely to be most at risk of remaining or becoming unemployed because of the FPAWG recommendations.

Remarkably, the recommendations from the FPAWG ignore the interests of consumers. Despite the Terms of Reference requiring the working group to manage and mitigate the risk of price rises for consumers if increased labour costs are not offset by productivity gains, the report contains only two references to “consumers”. The first is on page 35, referring to the mandate from the government to consider consumer interests. The second is in Appendix 1 annexing the Terms of Reference. A solitary paragraph addresses the potential for higher wage costs to be passed on through product price increases.¹⁷⁵ And there, the working group's

best offer is to invite the government to consider how existing competition law mechanisms might be adapted to address this risk.¹⁷⁶ In fact, competition policy has *nothing* to do with businesses passing on cost increases where market conditions permit them to do so.

The working group's failure to address these concerns must be disappointing for the Minister. This is especially so when, for the reasons explained above, the Minister can have no confidence that wage increases will be matched by improvements in productivity.

Impact on overall prosperity and wellbeing

As we have seen, the economic literature suggests compulsory centralised collective bargaining arrangements like the FPA arrangements proposed by the FPAWG are more likely to *reduce* productivity than *increase* it.

In the absence of productivity gains, FPAs are a zero-sum game at best and at worst a negative-sum game, with the losers including some of the most vulnerable groups in society. Among them are the young and unskilled or low-skilled, the unemployed, and less well-off consumers.

Overall, the evidence and analysis presented in this chapter provides a compelling case against introducing FPAs.

CHAPTER 5

A better way?

The government's goal of building a highly skilled and innovative workforce, and an economy that delivers well-paid, decent jobs and broad-based gains from economic growth and productivity, is a laudable aim.¹⁷⁷ It is what governments should strive for. It is also a goal shared by The New Zealand Initiative.

A more productive economy will not just benefit wage-earners but *all New Zealanders*. Referring to the words of Paul Krugman, our ability to improve our standards of living as a country depends almost entirely on our ability to raise productivity.¹⁷⁸ Or as two other famous economists said of productivity in less abstract terms, "... nothing contributes more to the reduction of poverty, to increases in leisure, and to the country's ability to finance education, public health, environment and the arts."¹⁷⁹

Both the government in the Cabinet paper and the FPAWG in its report rightly note New Zealand's poor productivity growth.¹⁸⁰ Other than a bright spot in the 1990s, productivity growth has languished for nearly two decades – as it did in the two or three decades prior to the 1990s.¹⁸¹

Consequently, productivity in New Zealand wallows at nearly 30% below the OECD average.¹⁸² Other small, advanced economies like Denmark, Belgium and The Netherlands enjoy GDP-per-hour-worked that is more than 50% higher than New Zealand's.¹⁸³

If we want higher wages and a more productive economy, introducing industry- or occupation-wide collective bargaining is not the way. There is no evidence that the problems with New Zealand's poor productivity record lie with

the functioning of the labour market (Chapter 3). Productivity growth is more likely to be the victim of centralised collective bargaining than be liberated by it (Chapter 4).

Many factors have been blamed for New Zealand's poor productivity performance. In its 2016 research paper, the Productivity Commission pointed to the small size of our domestic markets and our geographic isolation – about which little can be done.¹⁸⁴

But that makes it all the more important to get the policy settings right in areas that matter to productivity which we *can* do something about: education, housing and planning laws, infrastructure, foreign investment, social policy, and regulation, among others.

The New Zealand Initiative outlined a policy prescription for the incoming government in our *Manifesto 2017: What the next New Zealand government should do*.¹⁸⁵ High on the list for achieving more productivity were reforms aimed at:

- **Education:** Improving educational outcomes for New Zealand's school students. A well-educated workforce is a prerequisite for productivity. Yet our education system does a poor job of spreading attainment across ethnic and socioeconomic groups – a phenomenon described as the "long tail of educational underachievement". At the same time, we are suffering declining performance in international rankings for literacy, numeracy and science. Solutions are needed to these long-term trends.¹⁸⁶
- **Housing affordability:** Restoring housing affordability to reduce inequality, facilitate

labour mobility, and remove investment distortions. This will require changes to planning laws and changes to the way we incentivise and fund local councils.¹⁸⁷

- **Investment:** Making New Zealand more attractive for domestic and overseas investors, whose capital investment is needed to assist in lifting productivity.¹⁸⁸
- **Regulation and decision-making:** Strengthening our regulatory framework to reduce wasteful spending by government and unnecessary costs on the productive sector, and shifting decision-making on local issues from central government to local bodies with local knowledge, and incentivising them to make better, productivity and growth-enhancing decisions.¹⁸⁹
- **Social policy:** Improving the quality and outcomes of government spending on social policy.¹⁹⁰

Government initiatives show promising signs on some of these issues, especially housing affordability and education.¹⁹¹

But in other areas, the government faces many diversions and distractions (such as the recommendations of the FPAWG) from achieving its goal of a high-wage, high-productivity economy. We can only hope common-sense will prevail.

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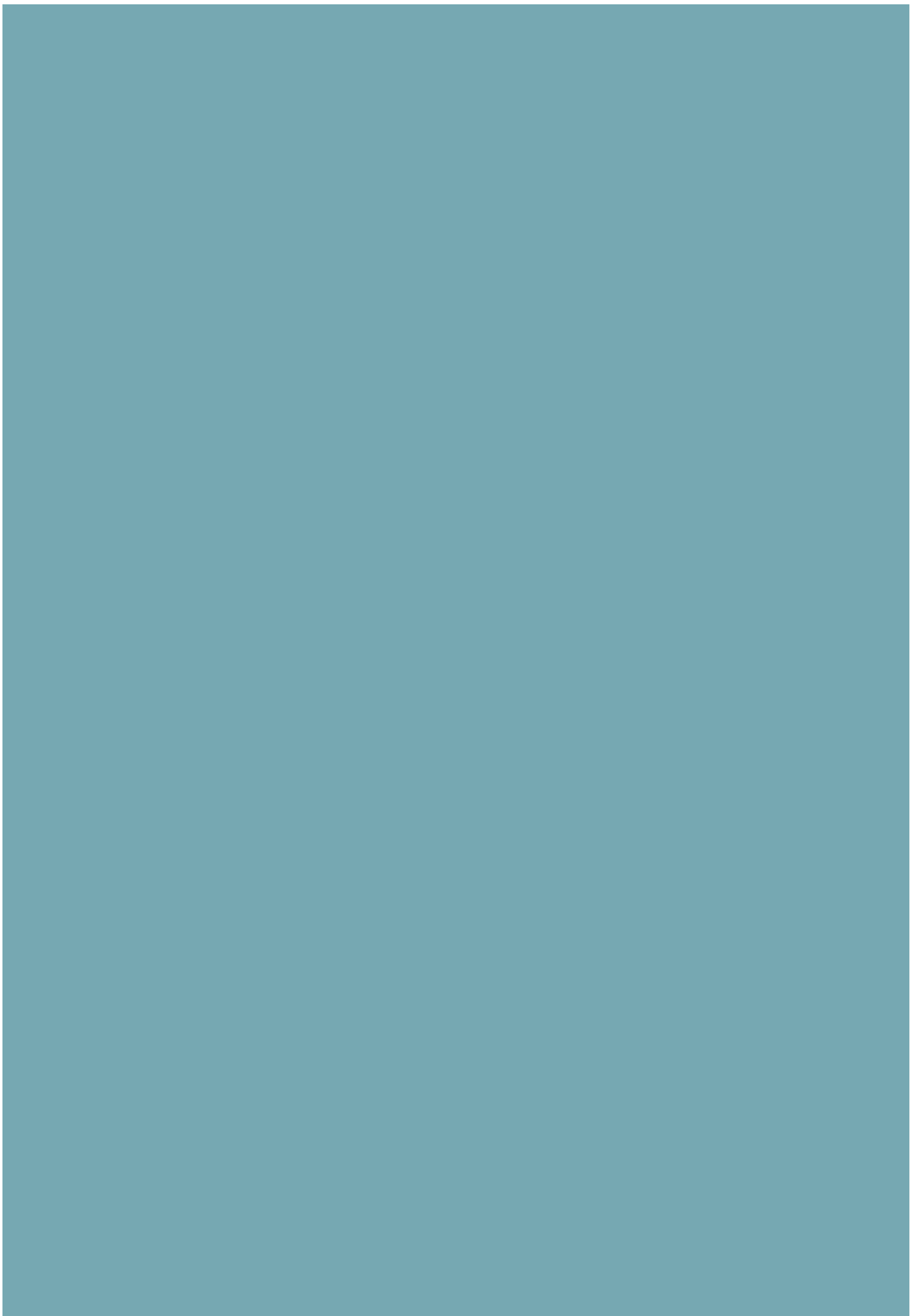
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The government's vision of an economy that delivers well-paid, decent jobs and broad-based gains from economic growth and productivity is laudable. It is a vision shared by The New Zealand Initiative.

However, our research finds that the recommendations of the Fair Pay Agreement Working Group will hinder, rather than help, the government realising its vision.

In this report, we demonstrate that the working group's recommendations to introduce compulsory, centralised collective bargaining covering entire industries and occupations (described in the report as a system of Fair Pay Agreements or FPAs) are based on a misrepresentation of New Zealand's labour market record. And we show that the recommendations are contradicted by both the empirical evidence and international trends towards greater labour market flexibility.

Judging by their results, we find that New Zealand's flexible labour-market settings are working very well. Unemployment is comparatively low when measured against our OECD peers. Labour market participation rates are among the highest in the world. Wages are tracking productivity growth. And real wages for all wage-deciles have been rising since the labour market reforms in 1991, abolishing New Zealand's then system of industrial awards.

It should therefore be no surprise that other countries – most notable France under President Emmanuel Macron – have looked to emulate aspects of New Zealand's flexible labour market regulation.

We conclude that Fair Pay Agreements would be contrary to the interests of workers, the unemployed and consumers, and likely to harm productivity and overall well-being. Rather than advance the government's vision of a high-wage, high-productivity economy, Fair Pay Agreements would undermine it.

We end the report with recommendations for an alternative policy prescription to improve productivity, economic growth, wages and overall well-being.

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