NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the Employment Relations (Probationary Employment) Amendment Bill

May 2006

Executive Summary

- The New Zealand Business Roundtable supports the proposed introduction of a 90-day probationary period for new employees.

- There are strong arguments in favour of the proposed reform. The key one is that it will have a positive impact on labour market outcomes for vulnerable workers because it would allow employers to 'take a chance' on individuals who might pose a 'risk' and a potential personal grievance if the job does not work out. This is particularly important given that groups such as youth and Maori continue to experience poor labour market outcomes. In 2005, the unemployment rate for Maori aged 15-24 was nearly 18 percent.

- The introduction of a 90-day probationary period would bring New Zealand more into line with provisions in most other OECD countries, including Australia. It would also provide a better environment for business by reducing needless compliance costs and encourage innovation.

- Several arguments have been raised by opponents of the reform – that there is already scope for probationary periods and that employers can use fixed-term contracts/casual work as a means of 'trialling' new employees. None of these stands up to scrutiny.

- Ideally, the provisions governing dismissals would be removed from the Employment Relations Act and become a matter of free negotiation. However, the proposed 90-day probationary period represents a useful and important step in limiting the adverse effects of mandatory provisions. For that reason we support the Bill and believe it should proceed.

- If the proposal in the Bill is not accepted, we suggest that alternatives be considered, including exempting 'small' employers from unfair dismissal laws, a loosening of the rules to allow employers to use fixed-term agreements as *de facto* trial periods, and the introduction of a salary limit on access to personal grievance provisions.

1. Introduction

1.1 This submission on the Employment Relations (Probationary Employment) Amendment Bill (the Bill) is made by the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

2. Proposed Changes

2.1 The Bill seeks to introduce a 90-day probationary period for new employees. During this 90-day period (or a lesser period if the employment is terminated early):

- either party may terminate the employment at any time during or at the end of the probationary period;
- neither party has recourse to dispute settlement under the Act, whether personal grievance procedures, mediation services or any other dispute settlement, in relation to probationary employment;
- employees retain their rights under the Human Rights Act 1993 in the event they suffer discrimination on the various grounds covered by that Act, or action for breach of contract in relation to probationary employment which could extend, for example, to recovery of wages;
- the parties may agree to a longer period of probationary employment, but in that event (as in the case of the existing law) the law relating to unjustifiable dismissal may continue to apply with respect to the part of the period that exceeds 90 days; and
- the parties are also free to agree to terms and conditions of probationary employment that are more ‘generous’ to the employee than those specified by law.

2.2 According to the Bill's Explanatory Note, the purpose of a probationary period for new employees is to enable employers to take a chance with new employees, without facing the risk of expensive and protracted personal grievance procedures. It will enable people who have not had previous work experience to find their first job and make it easier for people re-entering the workforce, thus contributing to increased growth and productivity in the New Zealand economy.

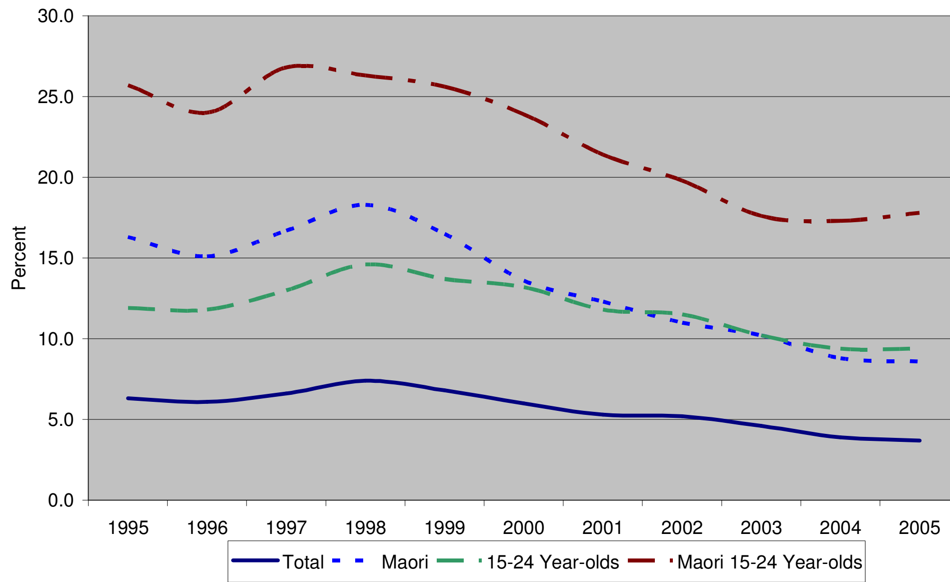
3. Assessment of the Bill

3.1 Our principal reason for supporting the Bill is that the introduction of a 90-day probationary period for workers at the start of a new job would encourage employers to offer a job to vulnerable workers who might otherwise be overlooked because they pose a 'risk' and a potential personal grievance if the job does not work out.

3.2 Such a 'grievance-free' trial period is likely to have a positive impact on the employment opportunities available to workers who are on the margins of the workforce, including some young workers, re-entrants to the labour force, the long-term unemployed, older workers, individuals with criminal records, immigrants and disadvantaged groups such as Maori and Pacific People.

3.3 Despite years of strong growth and considerable improvement in their labour market outcomes since the mid-1990s, the unemployment rates for youth and Maori are considerably higher than for the general population, as outlined in Figure 1. The unemployment rate for Maori remained above 8 percent in 2005, while that of youth remained above 9 percent. The situation is worse among Maori youth – those who could potentially benefit most from the 90-day probationary period – whose unemployment rate stood at nearly 18 percent in 2005. There has been little improvement in the rate of unemployment for Maori youth since 2003.

Figure 1: Unemployment Rates for Various Groups, 1995-2005



Source: Data supplied by Statistics New Zealand.

3.4 The extent of the disparity between Maori and youth unemployment and the overall unemployment rate can be seen from Table 1. The

Table 1: Difference Between Overall Unemployment Rate and Rate for Various Sub-groups 1995-2005

Year	Maori (Percentage Points)	Youth (Percentage Points)	Maori Youth (Percentage Points)
1995	+10.0	+5.6	+19.4
1996	+9.0	+5.7	+17.9
1997	+10.1	+6.4	+20.2
1998	+10.9	+7.2	+18.9
1999	+9.7	+6.9	+18.8
2000	+7.6	+7.2	+17.9
2001	+7.0	+6.5	+16.1
2002	+5.8	+6.3	+14.6
2003	+5.6	+5.6	+13.0
2004	+4.9	+5.5	+13.4
2005	+4.9	+5.7	+14.1

Source: Data supplied by Statistics New Zealand.

unemployment rate for Maori exceeded the overall unemployment rate by nearly 5 percentage points in 2005, while the youth unemployment rate was 6 percentage points higher than the overall unemployment rate. The unemployment rate for Maori youth was 14 percentage points above the overall unemployment rate in 2005.

3.5 The labour market performance of vulnerable groups such as Maori and youth is likely to worsen in the event of an economic downturn. Less-skilled workers – a group which includes a disproportionate number of Maori and youth – are often the first to be laid off when the economy is weak. The recent increase in the overall unemployment rate – from 3.6 to 3.9 percent – is of concern in this regard. The impact of a slowing economy on youth unemployment would exacerbate the negative effects of the abolition of the youth minimum wage (if it goes ahead) and the government's commitment to a $12 per hour minimum wage by 2008, if economic conditions permit. Enduring unemployment imposes high economic and social costs and leads to a loss of skills. Much more needs to be done to address the labour market problems facing these groups.

3.6 Unfortunately, recent government labour market policy has been moving in the opposite direction and has introduced further rigidities in the labour market – for example, the introduction and subsequent tightening of the Employment Relations Act (ERA), the renationalisation of ACC, paid parental leave, holidays legislation and successive increases in the minimum wage. These have raised the costs of employment in New Zealand. The increases in non-wage benefits have limited the scope for real wage increases.

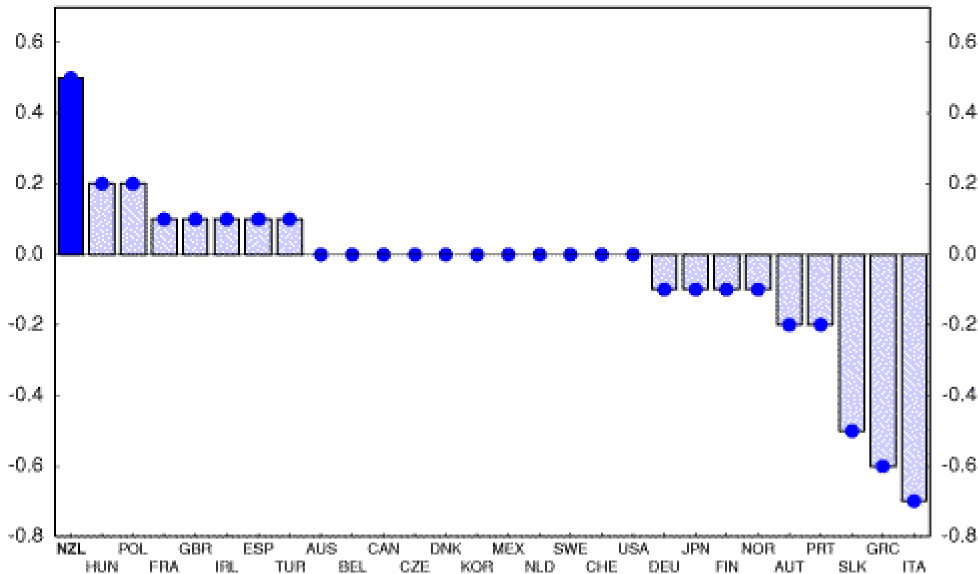
3.7 In 2005, the OECD voiced concerns about the recent direction of the New Zealand labour market policies, noting that:

> New Zealand has one of the most flexible labour markets in the OECD and is one of the countries where performance has improved the most over the last few years ... [H]owever, legislative changes since the beginning of the decade have been in the direction of increasing rigidities in the market …[1]

1 OECD (2005) *OECD Economic Surveys – New Zealand 2005*, Paris, July, pp 89-90.

This is confirmed by Figure 2, which shows that employment protection increased more in New Zealand than in any other OECD country between 1999 and 2003 – although it remains low by international standards.

Figure 2: Change in Employment Protection, OECD Countries, 1999-2003



Source: OECD (2005) OECD Economic Surveys – New Zealand 2005, Paris, July, p 91.

3.8 There has been considerable empirical work carried out to assess the effects of employment protection legislation (EPL) – the term used internationally to describe labour market policies such as unfair dismissal rules, restrictions on temporary work and requirements for notice periods in the event of redundancies. While the theory and evidence on the labour market effects of EPL is ambiguous in some respects, several studies show that it has clear negative effects on the employment of certain groups – in particular youth and women.[2] As noted by the OECD:

> … there are reasons to think that youth, as new entrants into the labour market, and women with intermittent participation spells, will primarily be affected by any reduced hiring caused by EPL … [A]s a consequence, employment protection would damage their employment opportunities.[3]

[2] OECD (2004) *OECD Employment Outlook 2004*, OECD, Paris, pp 81-84. See also Young, David (2003) *Employment protection legislation: its economic impact and the case for reform*, Economic Paper No 186, European Commission, Brussels.

[3] OECD (2004) *OECD Employment Outlook 2004*, OECD, Paris, p 85.

3.9 In such studies, the impact of EPL may be hard to identify because employers may respond in a variety of ways to strict labour market policies. For example, restrictions on dismissals may not affect overall employment levels but may simply lead employers to hire more temporary staff – which may result in workers having less job security than if dismissal policies were less strict. This is certainly the case in Europe, where countries with strict EPL (eg Germany, France, Sweden and Spain) have a much greater proportion of employees on temporary contracts than in countries with more flexible policies (eg the United Kingdom and Ireland).[4] Alternatively, employers may offset the risk of an unjustified dismissal claim by, for example, offering a lower salary than otherwise. Strict EPL laws may also lead to an increase in self-employment or a rise in the use of temporary workers through employment agencies.[5]

3.10 A 1996 study by US academic Charles Baird published by the Business Roundtable explained that mandatory unjustifiable dismissal laws are a tax on employment, resulting in some combination of fewer jobs and lower wages, with negative impacts on income inequality and the low-skilled. One of his findings was that the unjustified dismissal provisions in the Employment Contracts Act (ECA) could have reduced employment by somewhere between 1.5 and 3 percent (equal to between 19,000 and 47,000 jobs in the mid-1990s).[6]

3.11 The introduction of a probationary period for new workers would also help New Zealand businesses. According to the Ministry of Economic Development's *Business Compliance Costs Perceptions Survey 2003*, 46 percent of managers surveyed reported that regulations applying to releasing a person who no longer suits the business ('firing') were likely to 'divert or distract' them from improving productivity and concentrating on growth. This percentage was

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4 Young, David (2003) *Employment protection legislation: its economic impact and the case for reform*, Economic Paper No 186, European Commission, Brussels, p 23.

5 Benoit, Bertrand (2006) 'A German job that is not for life is often barely a living', *Financial Times*, 11 April, p 11.

6 Baird, Charles W (1996) *The Employment Contracts Act and Unjustifiable Dismissal*, New Zealand Business Roundtable, Wellington, www.nzbr.org.nz/documents/publications/new-publications/ecaf-cont.doc.htm.

higher than for any other compliance requirement identified in the survey.[7]

3.12 In 2002/03, almost 50 percent of applications that were 'settled' by the mediation services or the Employment Relations Authority were for unjustified dismissal.[8] Successful claims for unjustifiable dismissal cost employers an average of $8,790 in awards and more in terms of legal fees and 'lost' time defending the claim.[9]

3.13 The adoption of a 90-day probationary period would be consistent with the proposal by the Small Business Advisory Group (SBAG) to introduce a 12 month performance-based personal grievance-free probationary period for new employees. As the most recent SBAG report noted:

> SMEs throughout New Zealand continue to describe to us their fear of taking on new employees, and particularly those who are, initially, only marginally qualified for their new role. Therefore we re-submit our recommendation for a 12-month personal grievance-free probationary periods for new employees. The exemption would apply only where the grounds for ceasing the employment relationship were non-performance by the employee.[10]

3.14 In the view of SBAG, the introduction of a probationary period would be the single most important change needed in employment law, would not be against the intent of the ERA, would not remove health and safety or other statutory workplace protections from employees, and would bring New Zealand closer to the situation prevailing in countries such as the United Kingdom, France, the United States and Australia. While the Bill does not go as far as recommended by the SBAG, it would be a significant improvement over current policy.

3.15 Providing a better environment for business through more flexible labour market policies would have a positive impact on the economy's ability to innovate. As noted in a recent OECD report:

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7 http://www.med.govt.nz/templates/MultipageDocumentPage____9538.aspx

8 Department of Labour (2003) Annual *Report 2002/03*, Government of New Zealand, Wellington, pp 189-190. The actual number of unjustified dismissal claims would obviously be much higher given that, in many cases, the employee and employer will have 'settled' the claim prior to reaching the more formal stage involving outside parties.

9 Lowe, David (2006) 'Committed employees have nothing to fear', *New Zealand Herald*, 3 May, p A15.

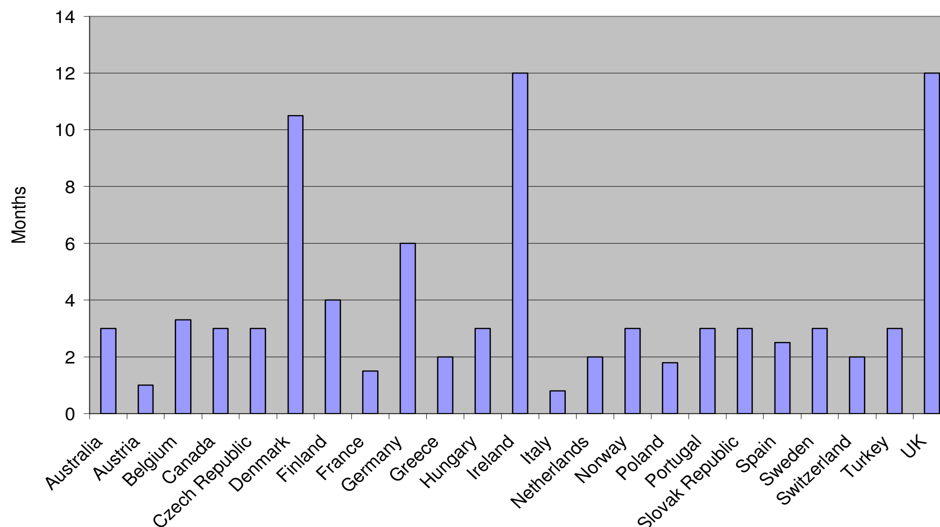
10 Small Business Advisory Group (2006) *Small Business Advisory Group Report 2006*, Government of New Zealand, Wellington, p 10.

> … policies that make hiring and firing difficult can increase the cost of implementing innovations, when these require labour downsizing or reorganisation; and policies that favour the bargaining power of insiders can reduce the ability of firms to appropriate innovation rents, especially when post-innovation wage re-negotiation is possible.[11]

The OECD notes that the effect of entry regulations is particularly important for productivity performance in industries in which technology is evolving rapidly, such as information and communication technology industries. Furthermore, the OECD notes that product and labour market policies can also affect the propensity of a country to concentrate production in innovative industries, by, for instance, affecting the pace of resource re allocation in the economy.[12]

3.16 The introduction of a 90-day probationary period for new workers would also bring New Zealand more closely into line with other OECD countries, most of which already have probationary periods. These range from a few months in Austria, Italy and France to six months in Germany and a full year in the United Kingdom and Ireland (Figure 3).

Figure 3: Probationary Periods in OECD Countries, 2003



Source: OECD Employment Outlook, p 110.

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11 OECD (2002) 'Productivity and Innovation: The Impact of Product and Labour Market Policies', in *OECD Economic Outlook*, Volume 2002/1, No 71, June, p 178

12 *Ibid*, pp 178 and 181.

3.17 Other countries further restrict the application of unjustified dismissal legislation by exempting some employers from such regulations. For example, the Australian government exempted all businesses with under 101 employees from unfair dismissal laws as part of its 2005 industrial relations reforms and established a probationary period of six months for larger firms. Australia now has one of the least restrictive regimes among OECD countries. Asian countries are also generally characterised by unrestrictive regimes.

4. Evaluation of arguments against the proposed changes

4.1 Opponents of the proposed 90-day probationary period for new employees argue that the reform is unnecessary. In particular, they argue that employers already have three avenues available to them that provide, in effect, a probationary period for new employees:

- employers can hire workers on a casual basis;
- employers can hire workers on a fixed-term agreement; and
- section 67 of the ERA 2000 already allows workers and employers to agree to a probationary period.

None of these arguments is valid. Underlying them, however, is acceptance of the concept of a probationary period.

4.2 The first two arguments are invalid because businesses cannot use either casual or fixed-term employment for the purposes of a trial period. In the former case, such employment arrangements must be linked to genuine casual work flows. In the latter case, employers and employees can agree to fixed-term employment where:

- there is a genuine reason for doing so (such as seasonal work, project work, temping work, or where the fixed-term employee is filling in for a permanent employee on leave); and

- the employer advises the employee of those reasons and how or when the employment will end, and does so prior to employing the employee.[13]

4.3 The Department of Labour employment relations website states explicitly that an employer may not employ someone on a fixed-term agreement where the job is really a permanent one and the employer wants to avoid having to go through a fair disciplinary or dismissal procedure if there are problems.[14] Indeed, the 2004 amendments to the ERA were specifically designed to override a Court of Appeal decision by limiting the applicability of fixed term agreements.

4.4 The third argument – that the proposed 90-day probationary period is redundant because section 67 of the ERA 2000 already contains a provision allowing for probationary arrangements – is also invalid. Section 67(1)(a) of the ERA 2000 states that:

> Where the parties to an employment agreement agree as part of the agreement that an employee will serve a period of probation or trial after the commencement of the employment … *neither the fact that the probation or trial period is specified, nor what is specified in respect of it, affects the application of the law relating to unjustifiable dismissal to a situation where the employee is dismissed in reliance on that agreement during or at the end of the probation or trial period* [emphasis added][15]

It is clear that this section affords employers little protection against personal grievances and is not a substitute for the proposed 90-day probationary period. This is because the ERA's unjustifiable dismissal provisions continue to apply even in cases where such employees and employers have included probationary requirements. This view is supported by information on the Department of Labour employment relations website, which states that:

> Employers and employees may agree to an initial probationary or trial period ... This must be recorded in writing in the employment agreement. Failure to record the probationary arrangement in writing means that the probationary period will be unenforceable if the employee chooses to contest it. If the employer thinks there are problems, the employer still needs to follow a fair disciplinary or dismissal procedure. The employer cannot merely tell the employee to go at the end of the trial period.[16]

13 http://www.ers.govt.nz/relationships/fixed.html
14 *Ibid.*
15 Employment Relations Act 2000, s 67(1)(a).
16 http://www.ers.govt.nz/relationships/fixed.html

4.5 On a practical level, probationary arrangements will only have their intended positive effects if they fundamentally address the issue of personal grievances. Arrangements such as the current ERA provisions have little effect on the day-to-day workings of business. They do little to help more vulnerable workers into jobs or improve the climate for New Zealand business. The view that the current section 67 of the ERA 2000 represents an effective probationary clause, although promoted by union leaders, is not even accepted by the government. This is evident from a recent speech by the Hon Lianne Dalziel, minister for small business, in which she argued that the significant number of unwritten agreements means the current probationary provisions are unlikely to be effective:

> There are probationary provisions in the legislation now, but they require the parties to negotiate with each other and include them in the written agreement and to commit to take steps to ensure that expectations are met on both sides of the agreement. It's hard to imagine that working when most of these employers probably don't have written agreements to start with …[17]

According to a survey cited in the *New Zealand Herald* in 2004, nearly 30 percent of businesses do not have written agreements for staff. Fully two-thirds of small firms operated without written agreements.[18]

4.6 Although supporters of employment protection legislation often assert that it is necessary to offset the unequal bargaining power that is said to be inherent in the labour market, this is a fallacy. Wages and other terms of employment are determined largely by supply and demand, as in any other market. Real wages have risen steadily in market economies. In a recent report, Hogbin (2006) notes that there is no evidence that employees in more heavily regulated labour markets receive 'fairer' shares of national income than those in less regulated labour markets. He presents data showing that labour's share of income in lightly regulated economies such as the United States has been consistently higher than in most of the more heavily regulated

[17] Dalziel, Hon Lianne (2006) *Speech to Canterbury District Law Society*, 27 March.

[18] 'Get it in writing', *New Zealand Herald*, 1 September 2004.

labour markets of continental Europe.[19] The imbalance of power hypothesis is even less credible in a New Zealand context, where the labour market is characterised by low unemployment, significant labour shortages and a large number of small employers. The best 'protection' for workers is a labour market with high levels of employment where alternative jobs are readily available. Unrestrictive employment legislation facilitates such outcomes.

5. Conclusion

5.1 Employment protection laws – whether minimum wages, minimum notice periods or personal grievance protections – are often said to be in the interests of the poor or those who are 'powerless' in the labour market. The government has passed a raft of legislation in recent years that is predicated on this mistaken belief, including the ERA. The reality is that such regulation often works against the interests of the poor and the so-called 'powerless'. While pressure for such regulation is often well-intentioned, it is sometimes promoted by unions whose interests are those of their employed members and union officials, not labour market 'outsiders' who have difficulty finding work. Unfair dismissal laws may have a positive impact on job security for those in employment, but they come at the expense of reduced opportunities for vulnerable or marginal workers. The interests of young people with few skills, including disproportionate numbers of Maori and Pacific Peoples, are more likely to be promoted through the introduction of policies that open up opportunities and enhance the prospects for economic growth.

5.2 It is not credible to argue that the Bill would 'strip away workers' rights' when most OECD countries have similar provisions in their employment laws. Employment is a contractual matter, and the inclusion of a mandatory dismissal provision in a contract inevitably means a reduction in some other contractual benefit (eg wages). In other words, it is employees themselves who largely pay for such a

[19] Hogbin, Geoff (2006) *Power in Employment Relationships: Is There an Imbalance?*, New Zealand Business Roundtable, Wellington, p 5.

provision, either through lower wages or fewer jobs, not firms (which have to make competitive returns or go out of business).

5.3 For workers, the best protection against unfair dismissal is competition among employers for their services since 'bad' employers will suffer a loss of reputation and competitive disadvantage relative to good ones. The introduction of a 90-day probationary period for employment would provide employers with the 'insurance' they need to take a chance on 'riskier' employees, including those who have been out of the labour force for some time, who have a criminal record or who have a poor work history. It would allow them to establish themselves in the workforce, prove that they are 'good risks' and gain valuable work experience and on-the-job training. For these reasons, the OECD has recently supported the introduction of a probationary employment period along the lines proposed in the Bill, arguing:

> But although some protection is certainly needed to avoid unfair dismissals, it creates a disincentive to hire, especially for workers 'at-risk' such as older workers, young people or immigrants, where the employer may find it particularly difficult to assess how suitable these job-seekers would be for the job. Introducing a minimum probation period for new employees during which the law relating to unjustified dismissal does not apply would be a way to encourage hiring of these marginal groups. Indeed, this would give employers the opportunity to confirm the suitability of employees and would be particularly useful, as fixed-term contracts cannot be used as a form of trial period under the ERA.[20]

5.4 The introduction of a 90-day probationary period for new workers would only go part way towards reversing the significant expansion of personal grievance provisions that was included in the ECA. Prior to 1991, individual non-union workers were not covered by personal grievance provisions and could be employed on an at-will basis. The expansion of personal grievance coverage in the ECA was not justified by any evidence of widespread abuse and was a major mistake.

5.5 Ideally, the best course of action would be to remove the mandatory personal grievance provisions governing dismissals from the ERA. There is no sound public policy rationale for their existence in a

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[20] OECD (2005) *OECD Economic Surveys – New Zealand 2005*, Paris, July, p 90.

modern labour market. This is recognised in the recent Australian reforms, which have removed such provisions for smaller employers and limited them to six months for larger employers. There is no sound logic for this distinction, and Australian Treasurer Peter Costello has spoken in favour of their complete removal.

5.6 However, the 90-day probationary period proposed in the Bill represents a useful and important step in limiting the adverse effects of personal grievance provisions, and we commend its adoption as it stands. Failing that, we suggest that second-best alternatives be considered, including:

- a 90-day probationary employment period for 'small' employers – along the lines of the new regime in Australia;
- a loosening of the rules around fixed-term agreements to allow employers to use fixed-term agreements as *de facto* trial periods; and
- a salary limit on access to personal grievance provisions governing dismissals.