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WELLINGTON ROTARY CLUB

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JOB PROBATION: WHAT IS ALL THE FUSS ABOUT?

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WELLINGTON  
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## **JOB PROBATION: WHAT IS ALL THE FUSS ABOUT?**

As you will all know, National MP Wayne Mapp has a member's bill in front of a select committee proposing a 90-day probationary period for new employees. Essentially it provides that either party to an employment contract can terminate it at any time within 90 days without having to run the gauntlet of the 'unjustifiable dismissal' rules of the Employment Relations Act.

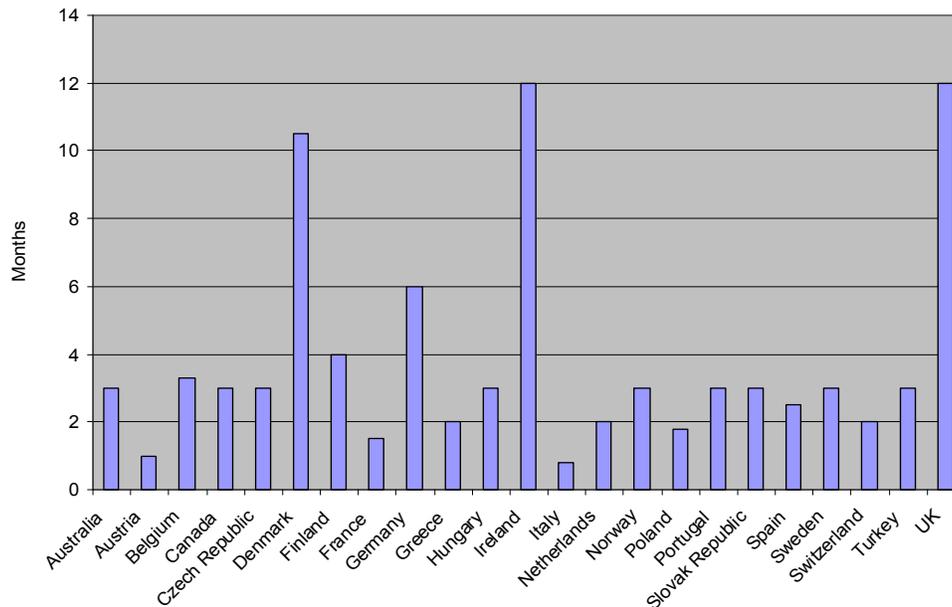
If the number of MPs who voted for the bill to go to the select committee maintain their support, it seems likely to go through by the end of the year.

The union movement is up in arms about the bill. I am reminded of the sound and fury that surrounded the Employment Contracts Act (ECA) in the early 1990s. It turned out to signify nothing.

Instead of mass exploitation and the end of civilisation as we knew it, firms and workers started going about their business in much more productive ways, contracts better reflected the diverse needs of all parties, employment growth accelerated and the unemployment rate fell like a stone.

When will the New Zealand union movement recognise that its basic understanding of how the labour market works is wrong? I suspect the answer is 'never', which is why it is likely to continue to decline, and to keep running to the state for help in getting members.

The idea that Wayne Mapp's bill is some kind of unconscionable assault on workers' rights doesn't pass the laugh test. A large majority of OECD countries – including social democratic icons like Sweden – have similar provisions in their employment laws. And in some cases these 'grievance-free' periods are much longer than the one proposed in the Mapp bill as Figure 1 shows – a year in Ireland and the United Kingdom and more than ten months in Denmark. Can anyone seriously believe that most of the advanced world is barbaric in its treatment of workers?

**Figure 1: Probationary periods, OECD countries**

Source: OECD

Indeed, New Zealand itself had no unjustifiable dismissal rules for non-union workers – who were already in the majority – prior to the ECA. There was no evidence of widespread abuse of this freedom to contract at will.

It is pleasing to see the National Party recognising its mistake of expanding the personal grievance regime in the ECA. The Business Roundtable argued strongly against that move at the time. As we said in a submission:

Proposals for statutory personal grievance provisions are often motivated by well-intentioned concerns for fundamental fairness or enlightened employment relations. However, they should be evaluated in terms of the generally harsh results that they actually produce. They introduce an enormous amount of undesirable complexity into the law of employment relations; they increase the frequency of civil litigation; and over the broad run of cases they work to the disadvantage of both employers and employees.

We pointed out that National was being inconsistent in allowing free bargaining over wages and other employment conditions but not over any provisions in contracts governing dismissals. We said this was not a peripheral matter: it was the most serious weakness in the legislation. We argued that compulsory grievance provisions aimed at strengthening job security raised the costs and risks of employment to employers. These were inevitably offset by lower wages and/or other employment conditions,

and the overall result was to disadvantage many employers and employees and to make it more difficult for less able workers to find jobs.

Bill Birch and Max Bradford would not listen, however. It was largely this move by National, aided and abetted by Chief Judge Tom Goddard in the Employment Court, which National unwisely retained, that led to the explosion of personal grievance cases that continues to this day. National, not subsequent Labour-led governments, set the gravy train rolling.

The case for scrapping mandatory dismissal rules, or at the very least establishing a grievance-free period, does not need to be made at length. The key arguments are:

- There is nothing special in an economic sense about labour markets and employment contracts that calls for extensive state intervention. Normal freedom to contract should apply.
- Firms competing in today's competitive markets may need to be able to lay off staff quickly and easily to maintain their viability and protect other jobs.
- Making dismissal hard or costly makes it difficult for employers to obtain acceptable levels of performance from some employees.
- Mandatory unjustifiable restrictions are a tax on employment, resulting in some combination of fewer jobs and lower wages, with negative impacts on income inequality. One study found that the provisions in the ECA might have reduced employment in New Zealand by somewhere between 1.5 and 3 percent (equal to between 19,000 and 47,000 jobs in the mid-1990s) relative to what it might otherwise have been.<sup>1</sup>
- Such restrictions hit marginal workers, such as some youth and Maori, particularly hard. If it is hard to fire, it is more risky to hire in the first place. Employment law should make it easy for employers to

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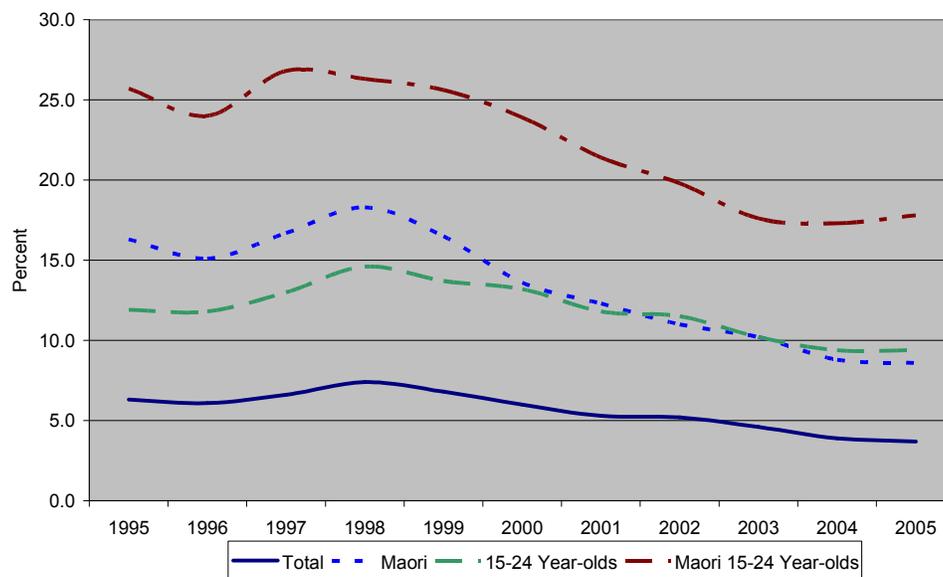
<sup>1</sup> Baird, Charles W (1996) *The Employment Contracts Act and Unjustifiable Dismissal: The economics of an unjust employment law*, New Zealand Business Roundtable and New Zealand Employers Federation, Wellington.

'take a chance' on marginal workers in particular, so that they can get a foot on the bottom rung of the employment ladder.

Unions, of course, do not see things this way. They represent the interests of labour market insiders – those who are already in the labour market. They have an incentive to lobby for job protection laws for union members and little incentive to consider their effects on labour market outsiders – those with casual and temporary jobs or no jobs.

Thus Ross Wilson of the Council of Trade Unions recently argued that the proposed reform is unnecessary because “unemployment has gone down substantially in the past 10 years” (due largely, incidentally, to reforms that the CTU opposed). However, there are still almost 40,000 people on the unemployment benefit – about a quarter of the population of Wellington City – tens of thousands on other benefits, many part-time workers who would like full-time jobs, and older workers who find it hard to get new employment. Why make it unnecessarily difficult for these people to find meaningful work?

**Figure 2: Total unemployment rates and unemployment rate for 15-24 year olds, by ethnicity, 1995-2006**



Source: Statistics New Zealand

What's more, Ross Wilson conveniently overlooked the fact that the unemployment rate for Maori is still around 8 percent, that for youth 9 percent, and that for Maori youth a tragic 18 percent, as Figure 2 shows. Little improvement has occurred in Maori youth unemployment in recent years.

To illustrate what is at stake, I made the following point in a paper for last year's Hui Taumata:

[T]he most disadvantaged Maori (or non-Maori) should be able to say to an employer: "Give me a chance. I realise I have a bad employment record, I've been on drugs and in prison, but I'm now determined to get my life back together. I know I can do the job you're offering and I'll work hard at it. I don't even care if you won't pay me much for a while as my family will support me, and if things don't work out you're free to dismiss me, no questions asked. But I'm confident I'll make the grade and that you'll be happy to give me a permanent job and good wages down the track." Sadly, that employment contract is unlawful in New Zealand today, or at least unenforceable.

There was no negative reaction to that argument at the Hui: I think many there got the point. Some in the Maori Party seem to have got it too. Regrettably, co-leader Pita Sharples hasn't; he is reported to have changed his position on the bill. Yet Dr Sharples has been prominent in the public debate about the Kahui family tragedy. He of all people ought to see the connection between the problems of such dysfunctional families and the case for facilitating work opportunities.

There was, however, a furious reaction to my argument by Chris Trotter in *The Independent*. Essentially, he saw the labour market in traditional Marxist terms of exploitation of workers by bosses, and thought my hypothetical Maori job applicant demonstrated "to perfection" the imbalance in bargaining power.

It is extraordinary that the bargaining inequality myth has survived the demise of Marxism. A simple thought experiment exposes the fallacy.

If employers had unlimited bargaining power, a worker's wages could be driven down from, say, \$20 an hour to \$15 and then \$10, and so on down to subsistence levels. The fact that over time, always and everywhere, wages have risen in step with economic growth shows that bargaining power cannot be imbalanced in favour of employers.

Similarly, if unequal bargaining power existed, employers might choose to bind workers to stay in their employment while retaining the power to fire them at will. Yet, significantly, it is employees who have the uncontested ability to quit a job if they wish to do so.

A recent study comprehensively debunks the bargaining inequality myth and explains that labour markets respond to supply and demand like other markets.<sup>2</sup> At times there may be a sellers' or buyers' market for labour, but there is no systematic imbalance. Bargaining power for any firm or worker is a matter of alternative opportunities. The starting point for the disadvantaged Maori is few alternatives, other than welfare. The worst thing we can do is deny such people the chance to get a start in the job market and the possibility of moving on to other opportunities in the future. As Joan Robinson, the Cambridge economist, once said, the only thing worse than being exploited is not being exploited at all.

This illustrates what is wrong with the union refrain that the Mapp bill 'strips away workers' rights'. It does nothing of the sort. The basic right of workers should be the freedom to offer their labour services on terms that *they* – not a union or a government – see fit. One day I hope some government will pass a Workers' Rights Restoration Act which restores freedom of contract to employees. Nothing would do more to improve the position of workers as a whole and drive down the unacceptably high rates of unemployment of people who are on the margins of the labour force.

Far from being stripped of a right, the irony is that workers themselves are paying for a condition of employment that many of them, particularly low-skilled workers, would rather not have. Investors in firms are not ultimately bearing the cost, as many seem to think.

This isn't hard to see. Picture a world in which unjustifiable dismissal restrictions are introduced for a category of workers (such as non-union workers prior to the ECA) to which they didn't previously apply. This raises the costs to firms of employing them (because they must factor into their employment cost calculations some risk of a costly dismissal). They can't

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<sup>2</sup> Hogbin, Geoff (2006) *Power in Employment Relationships: Is There an Imbalance?*, New Zealand Business Roundtable, Wellington.

absorb this cost by reducing their profits (because investors won't keep putting money into firms that don't make competitive returns). So they have to offset the expected cost of likely dismissals by reductions in wages or other benefits, or by employing fewer staff, as I noted earlier.

This is not a deal that most workers – those not intent on shirking – would want if they were free to choose their conditions of employment. We know this from empirical evidence. As Judge Richard Posner has noted in respect of the United States:

One piece of evidence that job security is not really efficient is that outside of the unionized sector (which now employs less than 20 percent of the nation's labour force)... employment at will is the usual form of labour contract. The worker can quit when he wants; the employer can fire the employee when the employer wants.<sup>3</sup>

The situation was similar in the non-unionised sector of the New Zealand labour market prior to the ECA. The state does not know better than the parties themselves what is in their best interests.

Of course nothing in all this denies that there are bad employers just as there are bad employees. But we allow workers to escape from a bad employment situation by not restricting their right to quit. Similarly, employers should have the same freedom to dismiss, unless contracts include by voluntary agreement procedural or substantive provisions governing termination. The ordinary law of contract contains many remedies for things like fraud, misrepresentation and duress.

This will not prevent all bad employment relationships, just as we cannot prevent all bad marriages or other bad personal relationships. In framing legal rules we should recognise that there are some bad employers and some – probably many more – bad employees. We are, after all, talking about human beings with all their flaws, and it is sheer folly to try to legislate for utopia on earth. We have long since abandoned the idea of fault-based divorce and we allow people to make contracts governing relationship breakdown if they wish. When we consider the interests of workers as a whole rather than isolated hard cases, it is clear that the best

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<sup>3</sup> Posner, Richard A (1986), *Economic Analysis of Law*, Boston, Little, Brown and Company, p 306.

form of worker protection is not so-called job protection laws but ample alternative job opportunities, which a freer labour market delivers – a situation where if you lose your job or don't like your employer there are plenty of others available. A worker with alternatives in a fully employed economy is a very difficult worker to exploit.

There are other patently false arguments about the bill that I will deal with briefly.

One is that there is already provision in the law for probationary periods. This is an incredibly brazen and dishonest claim. If it were true, why all the fuss? – the bill would change nothing. But it is not true: Section 67(1)(a) of the Employment Relations Act reads:

*Where the parties to an employment agreement agree as part of the agreement that the 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].*

It may not be easy to interpret this regulatory gobbledygook but both the Department of Labour on its website and the minister for small business, Lianne Dalziel, have confirmed that the ERA does not provide for a grievance-free period as proposed in Wayne Mapp's bill.

Another union argument is that firms can get around the problem of risky hires by casual or fixed-term employment. It is, to say the least, unusual to hear unions promoting the virtues of casual employment. But the argument is wrong in both cases: the law requires that casual arrangements must be linked to casual work flows and that fixed-term contracts cannot be used when the job is intended to be a permanent one. Firms can, of course, employ temps or independent contractors but these arrangements are sometimes less satisfactory all round. Independent contracting grows when employment law is bad – and unions hate the fact that it provides an escape route and try to close it off by arguing for 'dependent contractor' rules – but why push people into arrangements they don't prefer?

Finally, we have unions saying that firms would use the proposed probation period to recycle workers within 90 days to avoid becoming subject to the

standard personal grievance rules. Do these people live in the real world? Imagine how a firm which got a reputation for doing that would get on in a tight labour market trying to attract staff. Not to mention the costs of hiring replacement workers, training them and losing productivity while they become familiar with their job.

Why do unions continue to make these utterly bogus arguments? Easy. As H L Mencken might have said, they have to keep workers alarmed by menacing them with an endless series of hobgoblins, all of them imaginary, in order to attract members. They also have little interest in the unemployed, who do not pay union dues. Yet we can be confident that change will occur in this area, if not as a result of the present bill, then at least with a change of government. Why can't unions see that sooner or later New Zealand will come into line with most other countries, and learn to survive without government-conferred privileges?

In truth, Wayne Mapp's bill is a timid but positive step in the right direction. Even the OECD, which still reflects a good deal of misguided European thinking about labour law, said in its last report on New Zealand that:

Introducing a minimum probation period for new employees during which the law related to unjustified dismissal does not apply would be a way to encourage hiring of ... marginal groups [such as 'at risk' older workers, young people or immigrants]. 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.<sup>4</sup>

Does anyone seriously believe that the OECD is an advocate of stripping away workers' rights?

Australia has recently moved to scrap unfair dismissal laws for all firms with up to 100 employees and established a probationary period of 6 months for larger firms. There is no logic for the distinction, as Treasurer Peter Costello has admitted; indeed folklore has it that 'bad' employers are usually to be found among smaller firms. Despite this inconsistency, Australia now has one of the least restrictive regimes in this area among OECD countries and has stolen a march on New Zealand. There is no point in National talking about matching Australian living standards if it is

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<sup>4</sup> OECD (2005) *OECD Economic Surveys – New Zealand 2005*, Paris, p 90.

not prepared to argue for policies that are as good as or better than Australia's. There is even talk that National is toying with the idea of watering down the current bill. With any further dilution it would barely be worth having.

To conclude: relaxing or, ideally, abolishing mandatory unjustifiable dismissal laws is sound public policy on grounds of individual freedom, economic efficiency and fairness towards the most disadvantaged in our society. The lodestar should be freedom of contract: people should be free to negotiate for any terms they like in their employment contracts, including terms governing termination, and courts should adjudicate disputes on the same basis as standard contract law. Only MPs who are in thrall to vested interests or mildewed Marxist mythology could vote against the basic idea of the Mapp bill when it reaches the floor of the House.