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Liberating labour: The New Zealand employment contracts act

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Inhalt

Dieser Beitrag von Prof. Dr. Wolfgang Kasper, Department of Economics and Management, University College (ADFA campus), University of New South Wales, Cambell, Australia, entstand im Rahmen der Schwerpunktbereiche "Ethik und Markt" und "Führung und Motivation" des Forschungsprogramms "Weiterentwicklung und Perspektiven der Sozialen Marktwirtschaft", das von der Bertelsmann Stiftung, der Heinz Nixdorf Stiftung und der Ludwig-Erhard-Stiftung gefördert wird.

Main Points

- Between 1984 and 1991, New Zealand converted its economic system from the most heavily regulated to the least regulated in OECD. The public sector was restructured to separate core administrative functions from government-owned production activities. The latter were corporatised, and many privatised. Product markets were deregulated and opened to international competition. Virtually all producer subsidies were abolished. Foreign trade was liberalised. Financial and capital markets were liberalised and foreign investment and immigration were made welcome. Labour markets were freed up, and workers were given the right to associate freely. In the process, a formerly inward-looking, slow-moving economy with rising unemployment was turned into a flexible, globally competitive, high-growth economy with price stability, above-average job creation and small, effective government.

- New Zealand had long been known internationally for its system of centralised wage fixing and arbitration. Since 1991, however, it has become equally known for the new *Employment Contracts Act* (*ECA*), which was the capstone of the comprehensive economic and social reform programme. The *ECA* converted a centralist, corporatist industrial relations system into a decentralised market order. Freely negotiated labour contracts are now the basis for responsive, diverse labour markets. The effects of the Act can only be understood as an integral part of all-round liberalisation and New Zealand's "reinvention of government".

- Previously antagonistic industrial relations have given way to cooperation between employers and workers, flexible adjustment to competitive conditions and an enhanced competitiveness of New Zealand workplaces and firms in a rapidly changing, internationally open economy. The new workplace relationship has led to profound attitude changes which have been inspired by the discipline of open, competitive product markets and the withdrawal of several labour-supply disincentives in the form of public-welfare supports. The main effect of the labour reforms has been to assist in making the supply-side of the New Zealand economy fairly price elastic. This has been underpinned by a price-level target for independent monetary policy and by fiscal downsizing, privatisation and public debt reduction.

- Employers and most employees have welcomed the freedoms under the new contracts system. In many sectors, productivity has risen steeply, reflecting more rational work practices. Managers are now able to effectively manage the human resources that firms hire. Real wages have risen, but slowly, reflecting productivity gains. Union membership and the number of union officials have fallen, as many workers now use bargaining agents to negotiate employment contracts. The frequency of strikes and lockouts has fallen considerably.

- The ECA and the other reforms have created a "Kiwi job-creation machine", which has increased aggregate employment by over 10 percent during the long upswing of 1991-95. It has nearly halved the overall unemployment rate within less than two years — in contrast to earlier upturns in the New Zealand cycle and the pattern in Australia. As labour shortages are emerging in the present cyclical upswing, many long-term unemployed, the young and Maori are being drawn back into gainful employment. Labour market deregulation has also increased the market premia for skills and reduced transaction costs in operating about markets.

- Most observers predict a period of sustained, inflation-free growth and further drops in unemployment (March 1995: 6.6%) as New Zealand – despite a strengthening currency – is now seen as an internationally highly competitive exporter and an attractive location to internationally mobile capital and enterprise.

Foreword

This report deals with the dramatic reforms of labour market institutions in New Zealand. It has been written at the invitation of Professor Horst Siebert, the President of the Institute of World Economics at Kiel, Germany. It is to be part of a major project undertaken by the Kiel Institute on behalf of three foundations, the Bertelsmann Stiftung, the Heinz Nixdorf Stiftung, and the Ludwig-Erhard-Stiftung. This project deals with the rejuvenation of the "social market economy", amongst other things, by reevaluating the role of government in labour markets and social welfare. It is motivated by concerns that the institutional order that underpins the market economy and the rule of law have gradually been eroded in Western democracies and that this has contributed to a spreading disillusionment with elected government, apart from a loss of economic dynamism and high unemployment.

In preparing this study, I greatly appreciated the practical and friendly help I was given when I visited in New Zealand. I had to draw heavily on the published and the unpublished work of others, who gave generously of their time and knowledge. Since this paper deals with structural reforms that have, as yet, not had the time to work themselves out fully, I have greatly benefited from the professional judgements and forecasts of experts in the field. In particular, I acknowledge the help of:

Her Excellency Ms Rosemary BANKS, Deputy High Commissioner, New Zealand High Commission, Canberra, Australia

Ms. Julie FRY, The Treasury (NZ), Wellington, New Zealand

Dr. Jim HAGAN, Manager, The Treasury (NZ), Wellington, New Zealand

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Mr. Alan JONES, Fletcher Challenge Ltd., Auckland, New Zealand

Dr. Peter KENYON, Institute of Applied Economic and Social Research, Melbourne University, Melbourne, Australia

Mr. Roger KERR, New Zealand Business Roundtable, Wellington, New Zealand

Dr. Tim MALONEY, Economics Department, Auckland University, Auckland, New Zealand

Mr. Steve MARSHALL, Chief Executive, NZ Employers' Federation Inc., Wellington, New Zealand

Mr. John PASK, Business Analyst, NZ Employers' Federation Inc., Wellington, New Zealand

Mr. Greg WILLIAMSON, Saunders Unsworth and NZ Centre for Independent Studies, Wellington, New Zealand

Some were good enough to read through an earlier draft of this report and point out oversights, inaccuracies and errors of interpretation by this outsider. Whilst not all — in particular trade unionists and academics in the industrial-relations speciality —will agree

with my reading of the inspiring New Zealand evidence, I feel confident that the majority of New Zealanders would. Possible errors and misreadings of the evidence remain, of course, exclusively my responsibility.

WK

Canberra, Australia, June 1995

Contents

Graphs and Tables

"We passed through this difficult economic period ...... when there was a tremendous period of adjustment. When things are tough, people do new things and pull themselves up by their shoestrings to become successful again.

Not only did we remove all our subsidies but there were major changes to union power. In order to survive in the world we had to diversify, and this is finally bearing fruit."

Sir Edmund Hillary, New Zealand, first man to climb Mt. Everest
(in *The Australian*, 10-11 June 1995, p. 4.

New Zealand — Basic Background Data

Land surface	268 676 km^2
	[north-south extension over both islands: ca. 1500 km]
Population (mid-1995)	3.5 million
	[growth rate, last 30 years: 0.93% p.a.]
Labour force (mid-1995)	1.7 million
GDP per-capita (1995)	US-$ 14 550
	[growth rate of per-capita GDP 1970-1995: 2.1% p.a.]
	62% of USA's per-capita GDP, if purchase-power parities are applied
Exports (1994)	31% of GDP
Public consumption (1995)	15% of GDP
Foreign debt (1995)	75% of GDP
Public debt (1995)	38% GDP
Inflation (CPI, 1991-95):	1.8% *p.a.*

Liberating Labour
– The New Zealand *Employment Contracts Act* –

On 15 May 1991, the *Employment Contracts Act* (ECA) became law in New Zealand. It capped a seven-year programme of comprehensive microeconomic liberalisation. It laid the foundation for a dramatic change away from the traditional system of collective bargaining, centralised wage fixing and the control of working life by bureaucracies and pressure groups. Labour is now treated as a marketable service and the wage as a market price, agreed freely between employers and individuals or groups in decentralised contract negotiations. The ECA greatly reduced the role of government and unions in wage setting and the workplace.

This paper will investigate the background, context and consequences of labour-market reforms and will try to evaluate the lessons from the — at the date of writing incomplete — response of New Zealand labour markets to the complete reshaping of its underlying institutional order. The main questions that this paper will address are:

- What did the New Zealand labour market reforms attempt to do and what immediate impacts did they have? *(Section 2)*
- What possible generalisable lessons can be drawn for economies with rigidified labour markets, where high and durable unemployment apparently coexists with obvious labour shortages?*(Section 3)*

The *Employment Contracts Act* of 1991 and related labour-market reforms cannot be properly understood without the wider political and economic context. We therefore begin with a summary sketch of New Zealand's economic development over recent decades and an outline of the general budget, microeconomic and welfare-policy reforms implemented since 1984. These were initiated by a Labour administration and were later broadened and completed by the conservative government of the early 1990s *(Section 1)*.

1. Background: Economic Failures Drive Comprehensive Reform

"God's Own Country"

New Zealand shares with other "societies of the Antarctic Rim" (Australia, South Africa, Argentina, Chile) a pattern of (a) relatively late and thin white settlement, (b) a history of almost instantaneous wealth thanks to easy land or resource exploitation, (c) a historic aspiration to protect the newly rich "antarctic Rim societies" from undue competitive pressures, and (d) heavy reliance on government protection and redistribution. In addition, strong, almost utopian aspiration to create a "better Britain Downunder" pervades New Zealand's short history from the start of white settlement in the 19th century (Hawke, 1985, p. 4), coupled with a late-19th century belief in the perfectibility of man, a trust in government "can-doism" and a reformist zeal to create a materially safe, egalitarian society.

Late last century, New Zealand placed strong central controls on the labour market and industrial relations and, as early as the 1920s, foreign trade and domestic product markets were tightly controlled.

After the second world war, New Zealand was one of the most prosperous countries on earth, with living standards not far behind those of Switzerland at the time. Prosperity was based on pastoral farming and natural resource exploitation and benefited from high world market demand for natural resources and foodstuffs. New Zealand's prosperity also owed much to the innovative use of technologies, in particular innovations to overcome perpetual labour shortages[1].

In response to the shock of the 1930s depression, policy was committed (in 1938) to full employment and the establishment of a welfare state. Post-war prosperity made it possible to promise more comprehensive social security, providing universal family benefits, state assistance for young children, education, health and a comprehensive government pension scheme. The government directly produced and distributed these services. As well, many utilities, transport, energy and financial services were socialised. These arrangements responded to strong, popularly held preferences for predictability and security. They also relied on the self-motivation and self-discipline of a fairly homogenous population which was predominantly of lower-middle-class British stock[2]. The demand for security was also met by political and military alliances and close cultural ties with distant Britain. In the 1950s, New Zealand society was rather self-contented and inward-looking, considering theirs as "God's Own Country".

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1 This section has benefited in particular from an unpublished survey paper by Kieran Murray (1994) and the piece by Alan Bollard (1991), both cited in the References.

2 In 1951, 92% of New Zealanders had claimed British descent, 7% Maori.

The role of collective action and government intervention in the post-war economy was pervasive. Imports were licensed; foreign exchange was rationed. Many types of investment required prior government approval. Government directly intervened in many markets to guarantee prices, subsidised interest rates for many types of borrowers and gave farmers tax incentives. The workplace was heavily regulated and collectively organised; the five-day week was mandated, and most workers were required by law to belong to a state-registered union covering particular occupations (closed shop). Wages were fixed centrally in tax-financed conciliation meetings between unions and employer representatives and were subject to the quasi-legal rulings of government's Arbitration Court. In a pattern of "egalitarian creep", award wages tended to move up without much change in wage relativities. Rewards for skills were small, if they existed at all. The political culture stressed equality and "social justice" (Hawke, 1985). Only 10% of the workforce had formal qualifications. Where occupational bottlenecks arose, government-assisted immigration, mainly from England, was an easy 'quick-fix' to fill the gap (Kasper, 1990). Economic growth was taken for granted. Businesses operated on a cost-plus basis in protected markets. And living standards were perceived as internationally underwritten by the country's rich endowments of natural resources and its special market access to Britain.

The Fall from Grace

In the 1960s and 1970s, New Zealanders gradually and often reluctantly discovered that they were not really living in a paradise on earth any more, indeed that their relative productivity and living standards were slipping (Table 1). The power of Britain — still called "home" by New Zealanders — and of Europe was waning, and East Asia was increasingly in the ascendancy. In 1973, when Britain joined the EEC, New Zealand began to lose its preferential access to traditional markets, especially for agricultural produce. New Zealand's primary exporters increasingly suffered from the European Community's dumping of subsidised surpluses in third markets, as well as the politicisation of access to American markets.

Attempts to find new markets were normally left to government-run marketing boards — compulsory monopsonies for New Zealand primary producers. The attempts were not very successful. The oil shocks of 1973-74 and 1979-81 created further problems and uncertainties.

Table 1

Trend in Productivity Growth

— GDP per person employed, % *per annum* —

	1961-73	1974-79	1980-86	1987-92	1993-95 (e)
New Zealand	1.2	0.2	1.1	1.1	1.9
OECD average*	4.0	1.9	1.6	1.6	1.4

* aggregated with 1990 GDP weights
(e) own estimate

Sources: OECD, *Economic Survey; Australia* (Paris: OECD, 1994); OECD, *World Economic Outlook* (Dec.) 1994.

Another challenge to New Zealand's secure, established order came from the rapid growth of the Maori population and high immigration from the Pacific islands. The non-white element in the population increased (1981: 14%). Many Maoris became more assertive in challenging the concept of outright integration into the predominant, British-derived culture. Female participation rates in the workforce rose, reflecting another major social change.

Import protection was no longer capable of safeguarding New Zealand's high-cost domestic industries. Protected managers and a protected workforce had cared little about productivity and world-optimum work practices. Industries had ossified. International competitiveness declined steeply while the prices of New Zealand's traditional raw material exports fell. Between the mid-1960s and mid-1970s, New Zealand's terms of trade deteriorated by 30%. International competitiveness was further damaged by rapid wage increases mandated under the quasi-judicial, union-dominated, centralised award system. In 1971, the General Wage Order system broke down, with the result of a 25% wage hike. All through the 1970s, nominal wage rises exceeded both productivity improvement and the inflation rate. Nevertheless, investments remained fairly high, but the system of pervasive industry regulation mitigated against the attainment of good capital efficiency because they made for low utilisation rates and rigid work practices. One prominent economic historian concluded that "New Zealand has something of a genius for wasting capital" (Gould, 1985, p. 65).

The current account of the balance of payments began to register big deficits in the 1970s, a move accelerated by the oil shocks. Initially, it was easy to borrow overseas, but — as foreign debts piled up — interest payments rose and New Zealand's international credit ratings slipped. Total public debt went from NZ$4 billion in 1975 to NZ$28 billion ten years later, despite increases in income tax rates.

The existing social arrangements and economic institutions conspired to produce a poor and deteriorating record of economic growth (Table 1). Between 1975 to 1982, the annual growth rate averaged a mere 0.4%.

In the early 1980s, average New Zealanders began to realise what well-informed insiders had concluded for well over a decade, namely that their productivity performance was the poorest among OECD countries. Increasing numbers of observers began to conclude that this had much to do with New Zealand's regulatory order, it being the most heavily regulated economy in OECD (James, 1992). Many critical observers began to accept that in particular the increasingly comprehensive and generous provision of public cradle-to-grave welfare and highly politicised labour-market arrangements were undermining economic growth. These institutions had shifted the emphasis of policy more and more from efficiency to security. But these institutions had broad electoral support. Poor economic prospects and the sterility of pervasively regulated economic and social life at home combined with better information about the outside world to induce many young New Zealanders to migrate elsewhere, in particular to Australia[3] (Kasper, 1990). This brought the message directly home to many families that not all was well in "God's Own Country".

New Zealanders had enjoyed full employment from the 1950s to the 1970s. But that pillar of private welfare and material security began to crumble from the mid-1970s when unemployment went up rapidly, in part reflecting low incentives to search for work. Underlying conditions for social stability and cohesion began to deteriorate. The incidence of serious crime tripled between the 1950s and early 1980s; ex-nuptial births rose from 4% in the 1940s to 38% in the early 1980s; divorce rates increased enormously. Whilst these developments have their parallels in other Western societies, they came as a serious disillusionment to New Zealanders who had prided themselves of being able to create a more perfect, more secure life for the average citizen.

Macroeconomic conditions deteriorated from the mid-1970s to the early 1980s. As mentioned, the current account went into unsustainable deficit from 1974. Welfare costs climbed to over 25% of GDP, helping to push the government deficit to 7% of GDP by 1984. Inflation and legislative changes pushed up income taxes, so that the average wage earner paid 24% of gross income in tax and social security contributions in the early 1980s (up from 14% in 1950-51). Inflation was fuelled by quasi-automatic wage indexation. Direct interventions in financial markets had no lasting effect.

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3 Australia and New Zealand have always had an integrated labour market with unrestricted mobility across the Tasman Sea (no restrictions on settlement or work for citizens of either country in the other), but product markets that were separated by tariffs and quotas since New Zealand refused to join the Australasian Federation in 1901. Only with the implementation of the CER free-trade arrangement in the late 1980s have product markets become as integrated as labour markets.

The conservative (National Party) government under Prime Minister Robert Muldoon saw the way out of the growing social and economic crisis frequently in more centralised intervention, culminating in a wage and price freeze in 1983-84. Its "Think Big" strategy aimed to develop a number of new, capital-intensive industries either by direct public investment or by government assuming the risk for private investments. This expansion policy raised national income temporarily, especially in the election year, 1984, but it drove up the budget deficit (9.5% of GDP in 1985-86), the current account deficit and international debt (1985: 70% of GDP by the mid-1980s). New Zealand's credit rating dropped further. OECD diagnosed at that time that New Zealand "risked entering a vicious circle of uncontrollable deficits and debt" (OECD, 1989, p. 11).

It is true that the conservative government took some half-hearted steps towards some deregulation, including of transport, import quotas, interest rates and international payments, but it did so in a stop-start manner, timidly and late, caving in to pressure groups. As these changes were tried out piecemeal and without a clear strategy, they met with political resistance and were perceived as too marginal to affect general economic behaviour.

Two Waves of Economic Reform

In 1984, a national election took place against the perception of a widening economic crisis. This feeling was accentuated by a 20% devaluation of the New Zealand dollar immediately after the election of a Labour Party government (Table 2). The incoming government used the foreign exchange crisis to give a sense of urgency to its programme of pervasive and fundamental economic reform.

The reforms were based on a strategy to implement new conceptual thinking that emanated from a critical analysis in New Zealand Treasury. This reinforced the adoption of a new economic paradigm (see below) and a reform programme adopted by the energetic incoming Labour Finance Minister, Roger Douglas (Douglas, 1982). The package of energetic, rapid reforms deregulated many aspects of private business, opened the economy to freer trade and investment, abolished producer subsidies, and reshaped or privatised parts of the public sector, while putting a tight monetary policy into place (Douglas, 1990; Walker, 1989; James, 1992). The reforms were based on a critical new look at what collective action can achieve and relied heavily on trust in market forces and the resolute action by a few economic ministers and their advisers.

The reforms were supported by substantial sections of the business community, most notably after the formation of the *New Zealand Business Roundtable*. The reforms were tolerated by the Labour government team, many of whom embraced basic philosophies opposed to what became known as "Rogernomics". At least many Labour politicians were slightly perplexed, but the new administration was not beholden to entrenched lobbies and tolerated the reformist zeal of Roger Douglas and his associates.

The support of the Labour Party was won by quarantining much of the public welfare system from reform, by exempting the labour market from comprehensive exposure to competitive forces, and by being cautious on cutting public spending. The economic reformers in the Labour government also buttressed their radical programme by supporting the Prime Minister, David Lange, who lacked interest in economic affairs, in his foreign policy ambitions. However, that alliance crumbled when the costs of reform became felt. Lange and his allies withdrew support from Roger Douglas in 1988. He resigned as Finance Minister, finding his position untenable. By that time, however, many of the essential reforms were already in place (see Table 2) and key supporters of "Rogernomics" held many of the commanding heights in policy making gremia. His successor, David Caygill, supported public sector reform and implemented the *Reserve Bank Act* that made the central bank independent and committed it to the task of providing stable money.

Under the influence of electoral defeats in 1984 and 1987, the National Party opposition underwent a thorough conversion from collectivist statism to free-market ideas. The intellectual and generation change was even more dramatic than in the governing Labour Party. In the following national election of 1990, they campaigned confidently on a platform of more complete deregulation. They made it clear from the outset that they would extend reform to welfare benefits and liberate the labour market. The National Party's manifesto was explicit about taking government out of the labour market and withdrawing all privileges under the law from the trade unions. This played a major role in the 1990 election campaign.

The election was won by the conservative side. They faced a dire fiscal outlook, after Labour had spent big and the economy weakened. The new National government implemented a second round of quick economic reforms, many of which were pushed through by the energetic new Finance Minister, Ruth Richardson (Table 2). As a result of implementing sweeping public-sector reforms, budget accounting was now done on virtually the same standards as business accounting, including not only accounts of annual flows of revenues and outlays, but also balance sheets on assets and liabilities. These accrual accounts revealed that the New Zealand government had considerable unfunded net liabilities (in plain English: it was broke). Welfare payments were targeted to enhance personal self-reliance, especially of single unemployed people. Welfare service provision was handed to competing private producers, where possible. The combination of welfare targeting and the flatter income-tax regime did not overcome, and in some instances exacerbated, high marginal taxes at transition to work (St. John, 1993; see also Boston, 1992).

Table 2

MAJOR REFORMS 1980-1995

1982-84	Corporatisation of the publicly owned transport industry
1983	Start of Closer Economic Relationship (CER) with Australia, to open both economies to free trade in goods and services
1983-89	Phasing out of all import licensing requirements
1984, July	Reformist, economically rationalist Labour government elected
1984	Devaluation of the NZ $ by 20% and freeing-up of the foreign exchange market and international capital flows.
1984	Controls on domestic credit abolished. Removal of interest rate controls.
1984	End to general price and wage freeze
1984	Re-introduction of compulsory unionism (closed shops)
1984	Termination of government guarantees of minimum prices for agricultural products.
1984-88	Abolition of major wage and price controls. Abolition of several compulsory domestic agricultural marketing boards but retention of boards with monopolies to export.
1984	Government withdraws from direct involvement in wage negotiations
1984ff	Corporatisation of government departments. Shift to public service provision on a commercial basis [full-cost recovery]. Output measurement in public sector. Government procurement opened to private competitors. Local autonomy in hospitals and education. Core of government moves to 'accrual accounting' to show net asset effects of policies.
1984-89	All government-regulated monopolies are exposed to outside competition (contestability).
1985	Deregulation of banking (end of quantity restrictions), removal of entry barriers into banking.
1985	Freely floating exchange-rate.
1985	Simplification of corporate tax regime.
1985ff	All subsidies to agriculture and industry are to be phased out.
1985-88	House rents and energy prices are deregulated.
1986	Foundation of the *New Zealand Business Roundtable*, which is to become a key forum for ideas on economic and social reforms.
1986	Tax reforms begin with introduction of comprehensive uniform, one-stage General Goods and Services Tax (GST, now at 12.5%). Most other indirect taxes abolished.
1986	*Commerce Act* liberalises merger and take-over provisions, stressing dynamic efficiency and relying on international competition to control business behaviour. It also puts trade practices on liberal basis.
1986-91	Corporatisation/restructuring of government-owned electricity industry.
1986-92	Pre-announced, gradual, across-the-board reduction of import tariffs (exemptions for motor vehicles and textiles/garments/footwear).
1987	Labour Party is re-elected. Tensions between economic reformers and the political Left in the Party.
1987	Income tax scale is lowered and made flatter. Targeting of 'poverty traps' in the tax-welfare system.
1987	Deregulation of domestic airlines.
1987-89	Telecommunications deregulated. Privatisation of the telecom sector foreshadowed.
1987	*Labour Relations Act* encourages decentralised bargaining and union amalgamation. Compulsory unionism is reaffirmed.
1988	Roger Douglas dismissed as Finance Minister.
1988-92	Privatisation of gas, other energy holdings and NZ Telecom foreshadowed and initiated.

1988-90	All import quotas and import licensing (protection) phased out for most industries. Residual tariff protection for motor cars, clothing and footwear remains in the 25-35% range.
1988	*State Sector Act* places public sector employment on a footing comparable to private sector employment. Redesign of public accounts to accrual accounting.
1988-89	Decentralisation of compulsory education system, based on elected boards of trustees.
1989	*Public Finance Act* changes management of government departments. Output-based monitoring of performance.
1989	*Reserve Bank Act* makes Reserve Bank of NZ independent of government and stipulates a price-level target of 0-2%.
1989	Corporatisation of all ports.
1989	Removal of all restrictions on shop trading hours.
1989	David Lange quits as Prime Minister.
1989-91	Peak of privatisation wave (Post Office Savings Bank, Rural Bank, Bank of New Zealand, Air NZ, Telecom, insurance).
1989-93	Gradual liberalisation of immigration. Attraction of business migrants.
1990	Deregulation of the taxi industry.
1990	All bilateral tariffs with Australia are rapidly eliminated under the Common Economic Relations (CER) agreement. Unilateral, phased tariff reductions vis-a-vis other countries are re-affirmed (effective rate of protection 1989/90: 19%, as against 37% in 1985/86). Tariffs announced to be 10% on most goods by 1996.
1990	The establishment of a contestable pool of public funds for R&D replaces direct funding of research institutes
1990, Oct.	Election of the conservative-reformist National Party government initiates stringent fiscal policies and labour-market reforms. Substantial expenditure cuts.
1991	Comprehensive overhaul of the social welfare system with the objective of replacing reliance on the state by self-reliance and market provision.
1991, May	*Employment Contracts Act* adopted. It completely liberalises labour markets (voluntary unionism; contestable unions of any size, freedom of arrangements for employer/employee bargaining at joint or individual level).
1991	Removal of cabotage in coastal shipping.
1992	Corporatisation of government research organisations.
1993	National Party government re-elected; referendum on voting system seen a voter protest against the reforms imposed on the public by political and business elites.
1993	Sale of New Zealand Rail (which will lead to a further productivity increase over 2 years, of 35%).
1994	Reformist Finance Minister Ruth Richardson leaves Parliament.
1994	*Fiscal Responsibility Act* obliges government to transparency in its accounts and to adhering to the same accounting standards used in private companies. The operating surplus has to take account of the debt-servicing costs.
1994	Government posts the first budget surplus in 17 years.
1994	Government sets in train moves to abolish all remaining tariffs, with the highest tariffs to be no more than 15% by 2000.
1994	Roger Douglas, with the support of businessmen, launches a radically reformist political party (ACT) with a platform to complete the reforms of taxation and economic institutions and the aim of adopting a zero income tax.
1995	Government spending reduced to 35% of GDP (down from 41% in 1990/91). Budget surplus (of nearly 4% of GDP and projected to rise to 7.3% by 1997/98) achieves a positive net asset position for the government and triggers talk of income tax cuts (from current rate of 33% for top income earners).

Although not always uncontroversial, the policy was guided by a comprehensive, consistent, coherent and transparent strategy. The government's trading enterprises shed 30,000 employees since 1987, the (non-trading) core administration a further 4,000. From 1990/91 to 1994/95, real government consumption spending has been shrunk every year by an average 0.5 per cent annually. The share of government spending in gross national expenditure has been reduced, and public debts are being repaid, which has led to the upgrading of credit ratings. By 1993/94, the operating balance of the government showed a surplus (which has since grown in size). The net liability position (the 'Crown Balance') has been steadily cut back, partly by privatisation. As of the 1995 budget, the New Zealand government would no longer be considered insolvent by accountants who apply general business principles[4].

In an uncanny repetition of history, Ruth Richardson lost the Finance portfolio after the 1993 election in which the electorate again returned the National Party, though with a marked reduction of its majority. It appears that the key movers of reform in New Zealand pay a political price and that Prime Ministers and cabinet majorities tend to lose the taste for reform after a first, concentrated effort.

In the 1993 election, the New Zealand electorate also voted on a referendum about the electoral system. It threw out the British "first-past-the post" system that tends to make for decisive majorities, in favour of a mixed system of direct representation and party lists (similar to the German electoral system). This vote was widely interpreted as a protest against the imposition of dramatic reforms by both major political parties and against the short-term burdens that the reforms had imposed on the population. Nonetheless, even the outspoken enemies of reform (amongst them the intellectual left, the old trade union establishment, and churchmen) did not propose to resurrect the previous socio-economic order. Their criticism is confined to specific elements and second-order aspects of the new institutional rules.

First Fruit of Reform

Thanks to the two waves of deregulation in the decade 1984 to 1994, New Zealand has moved from being the most heavily to the least regulated economy in OECD, and the public sector has been dramatically reshaped and scaled back. Government now concentrates on the rule of law and limits its "social justice mission" to providing a minimum safety net. Subsidies for exporters and farmers have been discontinued. Interest rates and the exchange rate were quickly decontrolled (Graph 1). Tariff protection has been scaled back and is virtually set to disappear. Manufacturing underwent dramatic structural adjustments and became world-market oriented and competitive (Savage-Bollard, 1990). The tax system was

4 In many respects, the "reinvention of government" in New Zealand is the most interesting and innovative element of the reforms. To the best of my knowledge, it is also the most understudied and underreported component.

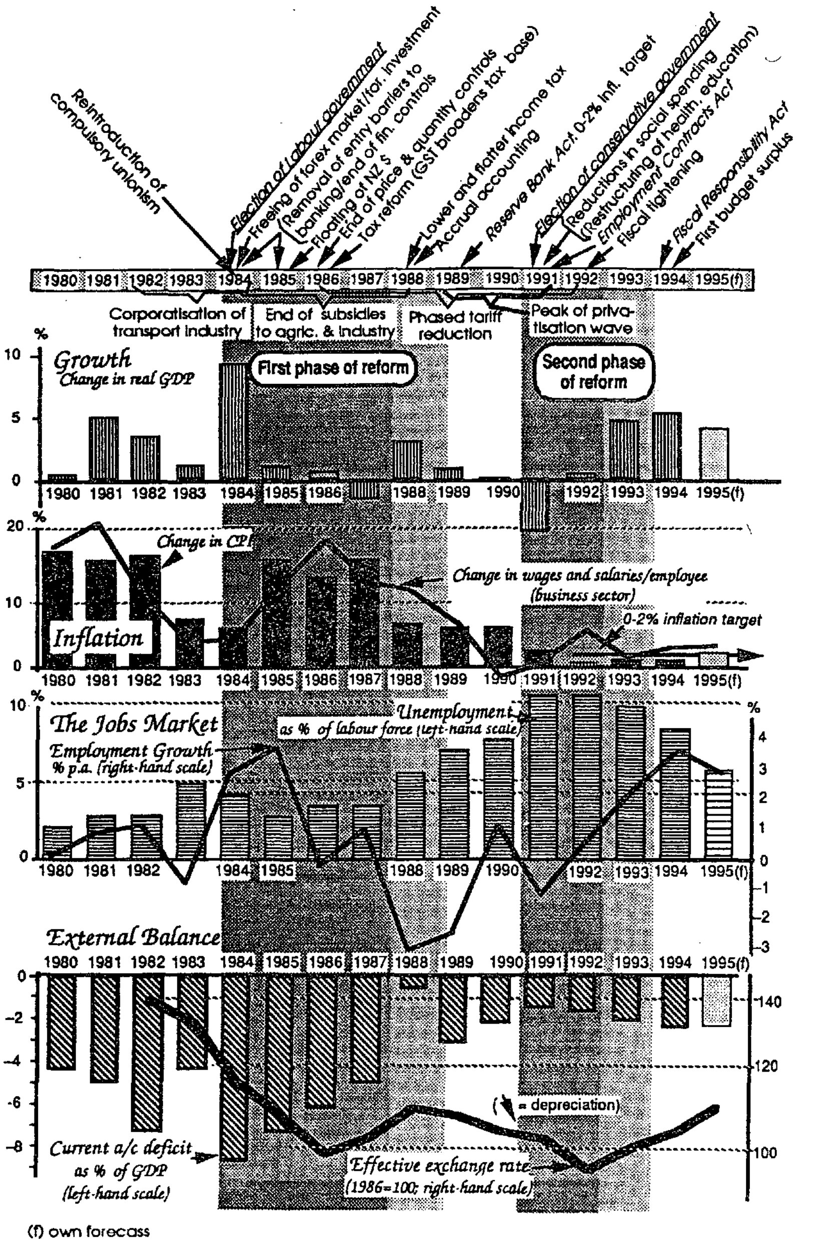
reformed, shifting from progressive income taxes to flatter and lower direct taxes combined with a comprehensive Goods and Services Tax (GST). Many state enterprises have been sold off. Most others underwent dramatic performance-oriented management reforms, as did government departments that are now corporatised and managed to achieve clearly specified performance criteria. Public-sector finances have been made transparent.

The reforms of 1984-94 did not all proceed on a pre-determined schedule of sequencing. Consequently, many relative prices — including the real wage, interest and exchange rates — were distorted during the transition. In particular, the quarantining of labour markets and welfare provision in the first round of reform ensured that labour costs rose relative to goods prices and that labour productivity was hampered, leading to a profit squeeze. The incentive for many workers to search for a new job was reduced. The removal of protection and tax concessions hit previously protected industries harder than others. On the other hand, the level of producer costs was reduced by infrastructure reforms — rail, ports, communications — and import liberalisation, as well as a credible commitment to price stability during the second half of the reform sequence. For example, the cost of rail freight dropped by 48% in real terms (made possible by a reduction in NZ Rail staff from 21 000 to about 5 000 by 1995), and productivity was raised by no less than 35 per cent since NZ Rail's privatisation in 1993. State enterprises frequently doubled their productivity and reduced their charges.

In the first wave of deregulation, the aggregate economic growth rate dropped, reflecting much 'creative destruction' of previously privileged industry and jobs (Graph 1). Industrial employment fell from 328 000 in 1986 to 243 000 in 1991, and the construction industry lost 40 per cent of its workforce (Bollard, 1992, pp. 36-7). Because the Labour government had inserted a contradictory element into the reform strategy when re-introducing compulsory unionism and because labour markets were perceived to be exempted from reform pressures, wage and salary payments rose by 18% in 1984 alone (Graph 1), quickly eroding the competitive advantage from devaluation and driving up inflation. With a lag, employment growth plummeted, and unemployment rose during the second half of the 1980s. The asset market crash of 1987 complicated matters.

Graph 1

New Zealand: Reforms and Economic Performance, 1980-1995



(f) own forecass

In the wake of the first wave of reform and the shrinkage of industry jobs, labour productivity rose significantly faster than before. From 1984-85 to 1990-91, it grew by about 3 per cent annually. Industry was forced to specialise under the onslaught of cheaper imports and to seek scale economies by conquering export markets, most notably in Australia thanks to the new Closer Economic Relationship (Table 2).

The second wave of reform (1991/92) was initiated against a background of negative growth, high unemployment, but low inflation and a weak exchange rate (Graph 1). By mid-1991, the New Zealand economy began to pull out of the various adjustment shocks, and a sense of optimism began to spread. By September 1993, real GDP had risen 10 percentage points (seasonally adjusted) above the cyclical trough of June 1991. From 1991, New Zealand outperformed OECD in job creation, productivity, growth and aggregate production (see Table 1).

As of mid-1995, the economy is in a respectable, low-inflation recovery, with real growth in 1994 having come in at 6.2% and 1995 growth being widely forecast at 3 to 4 per cent[5]. The projection is for the economy to keep growing for the remainder of the decade at a trend rate of 4-to-5 per cent. Confidence is running high, as reflected in buoyant business investment. Unemployment has dropped and the white, male unemployment rate stands at about 5 per cent (see Section 3 below). Interest rates are the same as in the United States (for 10-year bonds at about 7%).

New Zealand's international competitiveness has improved dramatically (Enderwick, 1992). If, for example, one takes the data published annually by the World Economic Forum and Lausanne business school IMD, one can see the beneficial effects of the virtual completion of the reform agenda in the early 1990s:

(a) In 1989, New Zealand's international competitiveness index ranked a poor 18th amongst OECD countries (IMEDE/WEF, 1989, p. 1), and 22nd amongst the 33 countries covered (Kasper, 1991, p. 39).

(b) By 1994, New Zealand had moved to 9th place out of 41 ranked countries (IMD-WEF, 1994, p. 17), and the "Quality of Government" received the top ranking amongst all OECD countries.

Such dramatic changes in international competitiveness ranking are rare.

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5 The 1995/96 budget is built on a forecast of 3% growth in 1995, but this is widely regarded as overly cautious.

Tentative Lessons

With hindsight, the reforms may look like a pre-designed, cohesive programme. It was not. Nonetheless, the central elements of the New Zealand reforms now fit together in a logical mosaic:

— a commitment to monetary and fiscal rectitude and stability, underpinned by legislation in the form of the *Reserve Bank Act* of 1989 and the *Fiscal Responsibility Act* of 1994;

— a near-total withdrawal of direct state interventions in individual product and service markets, reinforced by the opening of the economy to international competition;

— a liberalisation of factor markets, first for capital, and after 1991 for labour (underpinned by the *Employment Contracts Act* of 1991) and a pruning-back of distortive welfare payments.

The reforms depended on a small number of politicians, civil servants and business leaders who understood the overall picture of where New Zealand should head, as well as a few politicians who pragmatically and resolutely implemented what was possible (Douglas, 1990). In the first phase of reform, the Labour Party endorsed, or tolerated, a considerable number of changes to the underlying socio-economic order, but believed that their constituency — (organised) labour and welfare recipients — should and could be exempted from the change.

The Douglas reforms were a quick, major attack on New Zealand's traditional economic order. Given the political constraints, they consciously changed the institutions in those product and factor markets, and in governing those parts of public administration, where change was feasible. "Hard" centres of resistance were bypassed (Douglas, 1990). This pragmatic reform strategy introduced inconsistencies, unsettling changes in relative prices and leads and lags in the reform process and — as Eucken, the advocate of consistent sub-orders, would have appreciated — led to losses in efficiency and a disemployment of resources, including labour. As the artificial defences against international competitors were dismantled and a competitive order spread in complementary areas of the economy, the residual collectivist regulations were, naturally, felt with particular acuity. However, over the long run, the inconsistencies between sub-orders were again remedied, because of the visible costs they created. After a change in government, labour markets, welfare provision and budget policy were placed in a more competition-oriented, institutional framework as well. With the completion of the New Zealand reform agenda, spontaneous forces of economic growth emerged in a surge reminiscent of the West German response to market forces after the Erhard reforms in the 1950s and early 1960s.

It is easy with the benefit of hindsight, to be critical of the costs of such an uneven reform process (unemployment rising from 3-4% to 11%, high interest rates and a squeeze of profits and business investment). But alternative reform sequences were hardly available within New Zealand's political framework.

It took a sequence of two governments and a virtual generation change to complete the reform agenda and enshrine a set of underlying institutions that made the market economy efficient and desirable in the eyes of the majority of New Zealanders. The labour market reform of the *Employment Contracts Act* has to be seen in this context.

Like any massive programme to reform a society's institutional setting, the New Zealand experiment depended on a new set of ideas. The reforms were built on a new socio-economic paradigm which was embraced by a (small) group of leaders. The economic paradigm long prevalent in New Zealand had comprised Keynesian notions of aggregate demand stabilisation, the view that only collective action could correct widespread market failure — inspiring a mechanistic, collectivist "can do" attack on problems — and that collective goods should be produced with socialised means of production. Stimulated by growing economic failure at home and a change in the global intellectual climate (Reagan era, Thatcherism, Australian reform proposals), a group of economists centred on Treasury embraced a new paradigm based on doubts about "can-doism" and on evolutionary supply-side economics, as well as the insights of principal-agent theory and government failure, transaction-costs economics, and an understanding of innovation and efficiency in contestable markets (Bollard, 1992, pp. 7-11). Central to the reforms was a rethinking of the role of government, turning it from a pervasive solver of all problems into a rule setter and supporter of private, spontaneous initiative. In the intellectual footwork that underlies the reforms, the *New Zealand Business Roundtable*, a self-selected group of around 60 business leaders with a small secretariat, played a major role. Since its formal foundation in 1986, the *New Zealand Business Roundtable* has argued a logically coherent position without respect for privilege, including big business interests. It has patiently explained the case for markets and private property through publications and speeches of business leaders, research staff and invited academics (New Zealand Business Roundtable, 1986, 1987, 1988, 1990, 1991, 1992, 1993, 1994). Both the "Douglas wave" and the "Richardson wave of reforms" were inspired by a medium-term, market-oriented politico-economic paradigm and helped along by a growing number of "intellectual footsoldiers" supporting the reform push.

The New Zealand reforms came closer to the "big bang approach" than to gradualist reform. Because politics prevented any adherence to an ideal model of sequencing, the costs were high. One may speculate with the benefit of hindsight that a reversal of the sequence of liberalisation (with price stabilisation, public expenditure cuts and labour-market deregulation first-up), would have imposed fewer sacrifices. But that option did not exist in 1984. With reference to Eucken's theory of complementary orders, one might say that the reformers chose to alter those sub-orders that they were able to and to wait till the other, complementary sub-orders were exposed and would fall into place. The result was a "two bang approach", before a path of sustained growth was opened up.

The task of reform was never going to be easy. This was summed up by the influential Executive Director of the *New Zealand Business Council*, Roger Kerr, as follows: "The task of transforming an inflation-prone, debt-ridden, hyper-regulated and inward-looking economy was always going to be formidable. It was compounded by policy errors, particularly the failure to free up the labour market and clamp down sufficiently on government spending, by the share market crash and the international recession that followed, and by the Labour government's disintegration after 1988" (Kerr, 1994, p. 4).

On balance, the reforms imposed considerable adjustment burdens on New Zealanders in the late 1980s. Employment in government enterprises was cut and employment in manufacturing dropped, as real wages were driven up and tight monetary policy hit home, at a time when world market forces (in particular the competition of low-skilled workers in Asia) had an acute impact on this long-sheltered economy. Much physical and human capital specific to formerly protected industries had to be written off. Several major companies collapsed, others faced shrinking balance sheets and had to cope with shrinking asset values. The effect on total employment was, however, attenuated because the newly deregulated tourism, finance and retail industries expanded quickly.

One basic reason why most New Zealanders accepted the dramatic changes and voted for reform governments was that New Zealand society is fairly coherent by international comparisons and shares a basic social consensus of the sort that Hayek identified as crucial for a functioning, free society (Hayek, 1960). Another was bold political leadership that formed public opinion and shunned populism. Leaders in both major parties considered the economic slide as a trauma and a danger which had to be addressed by principled action and break with the past. Other, more superficial reasons were that many consumer goods could now be imported cheaply, the deregulation allowed improvements in variety and quality of goods and services far in excess of what aggregate statistics could capture, and that the price level was stabilised by the newly independent *Reserve Bank of New Zealand* (see Table 2). From 1992, when the 0-2% inflation target became legally binding, the rate of inflation remained below 2%, most of the time markedly so, as mandated under the *Reserve Bank Act* (as compared to 12.3 % p.a. 1975-1990, see Graph 1)[6]. In the boom of 1995, there is some pressure on staying within the inflation target, but a strengthening currency, effective

6 To be precise, the consensus in New Zealand is that the price-level target is expressed in terms of "underlying inflation", i.e. CPI movements adjusted for interest rate variations (mortgage interest is in the CPI basket), some administered prices and a few other factors.

monetary controls and fiscal discipline are in place to effectively defend the purchase power of the "Kiwi dollar".

From the viewpoint of mid-1995, the major macroeconomic effects of the entire integrated reform package have been:

— The economy has overcome the shock of the first phase of reforms (1984-88) and grows with low inflation, indicating a greatly enhanced elasticity of supply. This is expected to continue in the medium term.

— In the upturn of demand, the economy responded with unprecedented productivity increases. Wages and salaries have risen moderately and without driving up labour-unit costs.

— Business investment runs high in response to greater institutional stability and higher profits.

— National savings, which ran at a low rate during the first phase of reforms (1984-88), picked up, but not sufficiently to finance all of the dramatic growth in business investment. The current-account deficit is running at about 2% of GDP. That this is no concern is indicated by the considerable appreciation of the New Zealand dollar.

— Public spending has been pruned back and the budget is in surplus. This has not only allowed a repayment of public debts and increases in health and education spending, but - as of 1995 - also foreshadows tax cuts, possibly to the tune of about 2% of the national product over the remainder of the decade (*Australian Financial Review*, 2 June 1995, p. 8).

One of the most remarkable aspects of this dramatic recovery was that it began at a time of poor world demand during which New Zealanders captured growing world market shares. And whilst some of the performance can be attributed to the long cyclical upturn 1991 to 1995, it would not have been imaginable without the pervasive and energetic reforms. No one predicts a return to the slow-growth, high-inflation economy of the preceding two decades.

2. Reforms of the Labour Market

History, 1890 - 1991

The prevailing traditional philosophy of governance in virtually all Western "mixed economies" has long asserted that labour markets are special and different from markets for other production factors and products in that the price (the wage) has great social impact[7]. It was concluded that the labour market could not be "left to the vagaries of the market process" and that labour should not be treated as a commodity. In many Western countries, governments, as well as organised labour and employer federations, consequently gained a strong, direct influence on all aspects of work, often to the detriment of individual communication between employer and employee.

New Zealand not only shared this philosophical tradition. It often took a lead and subordinated efficiency considerations to demands for security and equality of outcomes. In 1894, after the new technology of ship-borne refrigeration had opened profitable new markets overseas for New Zealand meat and dairy producers and after bitter strikes had erupted in the maritime industries over a share of the windfalls from the new trade, New Zealand's first Liberal government undertook to rule out strikes. The key influence was William Pember Reeves, a Fabian, who designed the *Industrial Conciliation and Arbitration Act* of 1894. It gave unions special legal rights and protections in exchange for their promise to give up the right to strike. The Act set up a conciliation and arbitration mechanism, administered by a specialist labour court (Hawke, 1985). This had the effect of taking industrial relations and the workplace out of the common law.

From the outset, the trade-off between the right to strike on the one hand and official arbitration on the other was controversial amongst organised labour. The stronger unions — especially where high capital intensity gave them "hold-up leverage" (Williamson, 1985) and where tariffs protected them from international competition — ignored the proscription of strikes. The judicial system did not challenge them (Jones, 1993, p. 2). The labour movement created its own political party (the New Zealand Labour Party which was founded in 1916). When it won government in 1935, in the wake of the Great Depression, the Labour Party made unionism compulsory, ensuring the labour movement a secure membership income.

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7 In this respect, the old industrial countries of the West differ fundamentally from the new industrial economies of East Asia where governments have by and large abstained from "social justice interventions" considerations in labour-market, taxation and social arrangements. It is probably no coincidence that New Zealand, a frontline state in the competition with Asia, has become one of the first mature Western societies to re-examine the fundamental belief that governments should intervene on equity grounds to correct market outcomes, underpinning the concept of the Western "mixed economy" or "social market economy".

In the post-war period and up to the 1980s, the unions enjoyed four legally sanctioned and government-enforced privileges (which were in excess of the legislated privileges given to unions anywhere in Europe):

(a) Union membership was compulsory for all those working in a defined craft area. If no other unions were laying claim to a type of work or occupation, a few people could form a union, register with the government's Registrar of Unions and be given monopoly rights to cover henceforth all workers in the registered occupation or craft. Workers had no choice of union unless they changed their occupation.

(b) Unions, once registered, had the monopoly to cover all work in "their" occupation or craft with all employers.

(c) Union could notify a "representative sample" of employers of new claims and negotiate with those in the sample. Under the law, all employers of that specific type of occupation and craft were then covered by the agreed award. This was called "blanket coverage". In practice it often meant that employers who had not bargained for wage or other conditions, indeed who were not even aware of the fact that negotiations were going on, had to pay and comply after the conclusion of negotiations (Jones, 1993; Brook, 1990). "Blanket coverage" was supported by those businesses that wanted the comfort of every competitor having the same wage cost and that preferred the "cost-plus" framework of cosy closed markets.

(d) When disputes arose, employers and workers were subjected to compulsory arbitration in the government's Arbitration Court (later known as Labour Court, now as Employment Court). Compulsory arbitration had the effect of replacing direct conflict resolution by legalistic-politicised confrontation, freezing historic wage relativities (wage rigidity) and removing specific technical, regional or business circumstances almost completely from wage negotiations, because wages were fixed at the aggregate industry level. Complex circumstances specific to place and time relating to work practices, productivity and special circumstances in individual workplaces were pushed aside for the convenience of centralised national wage awards.

The economic, often personal, employment relationship was transformed into legalist antagonistism and bluffing and conducted —like a broken-down marriage — through spokesmen before a court. The system frequently gave priority to industrial-relations peace to the detriment of economic necessities, cooperation in the workplace, innovation and flexible adjustment. Specific labour and skill shortages coexisted with labour surpluses, either in the form of underutilised staff or — especially after 1985 — in the form of rising unemployment.

Pay had little relationship to performance. The widespread perception amongst workers was that they were paid for their mere presence in the workplace.

The system could survive for a long time because it was under-pinned by official protection from competition in many products, services and occupations and by the nation's great resource wealth, shared by relatively few people. As we saw, the entire economic system came under growing strain in the 1970s and 1980s (see Section 1).

In 1983, the National Party government — under the leadership of the then Minister of Labour, now Prime Minister, Jim Bolger — legislated to abolish compulsory union membership. After the election of the Labour government in 1984, compulsory union membership was reintroduced to quarantine labour markets — on perceived "social justice" grounds — from the dramatic reforms of capital and product markets and of the government.

As the Douglas reforms took hold, the inconsistency between the new set of rules and the surviving sub-order on industrial relations became evident (see Section 1). The Labour government adopted a new *Labour Relations Act* in 1987 which perpetuated many features of the corporatist old order, but abolished the government's role as the enforcer of industrial awards. That was henceforth to be the task of employer or labour organisations. When industrial conflicts erupted, the government now remained on the sidelines. This created a new industrial-relations climate which forced employers and unions to act more responsibly. The Minister for Labour also began action to amalgamate the many, often small, crafts unions into unions of at least 1000 members. In 1989 the Labour government, as part of its effort to reform the notoriously troubled and inefficient waterfront, cancelled officially endorsed wage and employment arrangements in the ports, leaving the waterfront to its own devices. In one port, employers and employees negotiated a reasonably workable agreement to improve work practices and productivity, which allowed that port to compete better with other ports. The habit of a free, untutored industrial negotiation spread to other ports and proved to work. Workplace relations improved in one of New Zealand's previously most cantankerous sectors. This was to become the model for the labour-market reforms of the early 1990s.

In the campaign for the 1990 election, the newly free-market-oriented National Party made the reform of the corporatist, regulated labour market its key point of distinction from the Labour platform. This happened against growing awareness in newly deregulated industries that labour rigidities were the Achilles heel of the New Zealand economy. In the situation, the *Employers' Federation* — an integral part of the industrial relations establishment — spoke up for gradualist reform. But the entire economic order surrounding work had changed. The *New Zealand Business Roundtable*, a then newly formed network of selected business leaders, argued consistently from 1986 onwards for quick, radical change: labour should, like any other good or service, be subject to freely negotiated contracts subject to the common law (New Zealand Business Roundtable, 1986; Brook, 1990). They advocated steadfastly a clear first-best position, based on simple legislation, a few pages long, that should be permissive of spontaneous variety in workplace arrangements and that should contrast with the prevailing, prescriptive tradition.

The Employment Contracts Act

In the years 1988 to 1990 this latter approach gained the political endorsement of the National Party under the then opposition leader, Jim Bolger (now Prime Minister) and labour spokesman Bill Birch. OECD and other international observers signalled that the reform programme was being sabotaged by the refusal to free up industrial relations (OECD, 1989). The National Party won office in October 1990; it was well prepared on labour market reform. Its *Employment Contracts Bill* was before Parliament by Christmas and became law the following May; the process moved with a speed and energy reminiscent of the reform thrust of Roger Douglas in the mid-1980s.

The main aim of the proposed legislation was to enhance the adaptability of private enterprises so that they could compete more effectively in the global market place. Its key features were

— the reintroduction of voluntary union membership, turning unions into strictly private associations without special legislated privileges (the Bill did not even mention the word "union"), and

— a dramatic reform of the rules governing bargaining processes and structures.

As is common in New Zealand with major legislation, the *Employment Contracts Bill* was made the subject of Select Committee hearings to collect and assess public reactions and to review the legislation. The Select Committee received hundreds of submissions, many from unions. At the same time, the government cut social-welfare payments, a circumstance that led to public agitation and street rallies in which welfare recipients joined unions against the reforms introduced by the new conservative government. The press, and academics with a stake in the specialised field of industrial relations studies, added to the protests. Many employers were nervous and unsure.

In this atmosphere, parliament edited the Bill with a strong input of civil servants wedded to the old system (Jones, 1992, p. 8). Yet, despite some watering down, the legislation emerged from the onslaught of pressure groups intact and was adopted into law on 15 May 1991.

The key provisions of the Act (of 91 pages) were straightforward ([NZ] Parliament, 1991):

- Part I of the Act establishes the freedom of association in plain language worth quoting: "Employees have the freedom to choose whether or not to associate with other employees for advancing the employees' collective employment interests ..... nothing ..... shall confer on any person, by reason of that person's membership or non-membership of an employees' organisation any preference ..... no person shall exert undue influence .....".

- In Part II, people are given freedom to bargain, with or without the assistance of freely chosen agents, to obtain judicially enforceable employment contracts of a stated duration.

- In Part III, allowance was made for "personal grievances" concerning contested dismissals and discrimination, harassment and duress. In this respect, the Act retained some features of special labour law, and not the common law, that the draft legislation had proposed to throw out: procedural defects in dismissal procedures retained some recognition in law, making firing for substantive causes more difficult, but recognising that procedural defects can be set aside when substantive cause is proven. This was a major change against the past when it was very difficult to dismiss staff.

- Part IV of the Act states that "employment contracts create enforceable rights and obligations". It retains Tribunals[8] and the Employment Court to settle disputes, subject to review on points of law in the ordinary courts of the land.

- Part V recognises the rights to strike and lock out, but only after the expiry of the employment contract and after decisions at the enterprise level (not industry level). The residual of the Act deals with the setting up of Tribunals and the Employment Court and transitional and miscellaneous provisions. Previously made awards were allowed to be carried on until they were replaced by negotiated contracts.

The most important innovative features of the ECA were:

- Employment was in principle the concern of freely contracting individuals, not — as previously — collective entities, such as entire industries or enterprises. Where people agreed to associate, deals could be struck to cover entire enterprises or multi-enterprise groups (freedom of association).

- The law was non-prescriptive as to the contents of employment contracts. Wage rates were, however, subject to minimum wage laws.

8 The Employment Tribunals continue the former Mediation and Conciliation Service. They are tax-financed and provide mediation assistance and adjudicate on differences how to interpret contract clauses. Tribunal decisions may be appealed in the Employment Court.

— The ECA abolished compulsion and union monopoly powers. No area of work could be claimed any more as "belonging" to a group or organisation.

— The ECA made it illegal for unions to strike against multi-employer (i.e. industry) collective arrangements. Strike action has to be decided at the enterprise level.

— Recourse to arbitration is voluntary. Collective action provides Employment Tribunals, the Employment Court and the civil judicial system to enforce, interpret and mediate employment contracts. In some respects, these organisations, which are staffed by the same people who ran the old system, have at times tried to deviate from the spirit of the new contracting philosophy. Civil courts and competitive pressures in product markets are some protection against a relapse into the self-centred, special industrial-relations rules of the past, but the Employment Court has repeatedly interpreted the ECA in ways that rely more on the collective memory of arbitration system and less on the common-law spirit of the ECA.

— "Blanket coverage" is gone. All affected are now involved in negotiating new wages and work practices.

— The New Zealand taxpayer, who previously used to fund the transaction costs of award negotiations, is no longer responsible for the expenses of contract negotiation. Contract negotiations are now fairly straightforward and simple. This has cut overall transaction costs in operating the labour market.

— Government does not register unions or collect detailed information on contracts[9], just as it does not collect much information on credit contracts or garage sales.

— Freedom, choice, responsibility and flexibility in give and take have changed the cultural attitudes of workers and managers.

Predictions and Outcomes

The *Employment Contracts Act* ushered in a genuine revolution. An old set of institutions that had evolved over about 100 years — reliance on organised interest groups, politicisation, collective bargaining, compulsory arbitration — was replaced by a completely new labour-market order, reliance on depersonalised, decentralised market processes based on the much older British traditions of freedom of contract and the rule of law. The Act completed the

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9 Effort to gain a collective statistical picture of the many diffuse labour markets are made by the Industrial Relations Centre at Victoria University, Wellington (for example: Harbridge, Honeybone, Kiely, 1994; Hince-Harbridge, 1994) and occasional surveys by the Department of Labour ([NZ] Department of Labour, 1994). For statistical purposes, the Secretary of Labour requires to be informed of collective contracts covering 20 or more employees, but – since there are no sanctions – several employers treat employment contracts as private and do not report.

change-over in the various, mutually supportive sub-orders to give New Zealanders a cohesive institutional framework of free markets that was conducive to individual initiative, self-reliance, flexible adjustment and competition. It was supplemented by a minimum safety net of public welfare provisions.

One can conclude that New Zealand workplaces are now operating under more of the flexible market and social- welfare conditions that the 1994 "OECD Jobs Study" advocated as a solution to the OECD-wide employment problem — though New Zealand has steered clear of OECD's idea of "active labour market policies" (OECD, 1994).

During the controversy over the *Employment Contracts Bill* in 1990 and early 1991 and following the legislation, many vocal opponents made predictions of the effects of the reforms to mobilise public resistance:

— Real wages would fall, creating "poor quality jobs" (NZ Council of Trade Unions, 1991).

— "Anarchy" and "uncivilised behaviour" would break out (Council of Trade Unions leader, Ken Douglas); strikes and confrontation would become prevalent.

— "Gangster unionism" would become widespread (Prof. R. Harbridge, *Dominion*, 4 April 1991).

— National awards would be impossible, and employers would not be able to calculate their costs and high unemployment would become entrenched (*Dominion Sunday Times*, 19 May 1991).

— Workplace democracy and participation would be suppressed (Prof. M. Wilson, *Radio New Zealand Sunday Supplement*, 24 February 1991).

Some businesses went on the public record to express fears of discontinuity (Jones, 1992), but the *New Zealand Business Roundtable* kept arguing the case for pervasive, principled reform. The primate of the Catholic Church in New Zealand called the legislation "sinful" (as quoted by D. Myers in *Business Review Weekly*, 8 May 1992). The Labour Party committed itself to abolish the ECA, if elected.

When the ECA became law, the *Council of Trade Unions* set up a telephone "Sweatline", so that predicted employer abuses could be reported. There were relatively few complaints, most of which the individual unions did not know how to address. By and large, the initiative soon lapsed (*The Dominion*, 2 May 1992).

With the benefit of hindsight, one can say that all the fears projected to mobilise the public in 1991 were groundless. The tactics of the government to sit back, trusting its overwhelming electoral mandate, and to stick to their strategy, cost them some support at the following election (in New Zealand's short electoral cycle) in 1993, when the economy suffered from the continuing, long recession and high unemployment. This led to a protest against further reforms in the form of a referendum to change the electoral system in ways that will make clear majorities less likely and multi-party coalitions as likely as they are in Germany (compare Section 1).

Given the 1991-92 recession and prevailing price stability, wages and salaries per employee in the business sector rose only slightly after the ECA (compare Graph 1). Where wages were increased, they were typically raised in exchange for cooperation in gaining productivity. The prediction of widespread strikes turned out to be wrong. Strike activity fell. In the first ten months after the passage of the ECA 90% fewer working days were lost than in the ten months from May 1990 to March 1991 (*New Zealand Herald*, 23 July 1992). Non-government work days lost, which had averaged several hundred thousand per year in the period 1987 to 1990, was

1991	99 032	
1992	113 742[10]	
1993	23 770	
1994	49 744	(Source: Statistics New Zealand)

The unions, who could previously feel sure of their privileged position, now had to prove their usefulness to their members and often began to provide useful information and a service. Some added value and gained membership, others lost members and had to reduce the number of officials. Overall, union members have fallen from 675 000 in 1990 to 345 000 in mid-1995 (*The Australian Financial Review*, 5 June 1995, p. 14).The (in the past often pace-making) Engineers Union saw a drop in membership from 60,000 members in 1980 to 36,000 in 1992 (*Australian Financial Review*, 3 July 1992). Since then, the union has converted itself into a service provider to its "employer clients", for example carrying out management training for members. The case of all 2,000 workers leaving their union in the Comalco aluminium smelter was rare (Jones, 1994).

On the whole — and in line with an OECD-wide trend — overall union membership dropped, to 30% of the workforce in 1994 according to Maloney (Maloney, 1994c, p. 340). Maloney found that "industry growth rates in both employment and aggregate hours of work ..... were higher in industries experiencing large reduction in unionisation". In the absence of reliable statistics, other labour-market observers estimate that union membership is markedly

[10] The 1992 figure is inflated by one long stoppage in one plant with a big workforce over a long-simmering issue that pre-dated the ECA.

lower, possibly approaching the 16-17% mark in the USA (private communication from Alan Jones; June 1995).

The number of unions dropped quickly from 80 before the ECA to 66 by the end of 1992. But many unions maintained an influential position, in particular in capital-intensive industries where they can exert influence by shutting down expensive capital stock and in the public sector (Hince-Harbridge, 1994, p. 4). Other unions reshaped themselves into innovative service providers. Many unions have restructured, and are now in a more competitive mode.

Different from what some predicted, the drop in union coverage (and strike activity) has not reduced real wages or led to gross inequities and injustices in the work sphere..

The Employers' Federation has also had to adjust. Whereas it used to negotiate numerous awards for the employers in an industry, which habitually all rose by the same rate in each wage round, the central employer body now has nothing to do with wage negotiations. Its regional organisations are offering to act as bargaining agents for employers, but many firms now act on their own behalf or employ independent bargaining agents. The national Employers' Federation provides labour-market information to paying members. Few other industry organisations found it necessary to act as collective coordinators of employer bargaining. As a result, wage negotiation has been "de-collectivised" on both the supply and the demand side.

Surveys and Case Studies

The immediate effects of the ECA on employees and businesses have been recorded in some opinion surveys, partly because existing statistics were not designed to record such fundamental systems change:

— A survey of 190 employment contracts by the Department of Labour in 1992 showed that most new contracts were enterprise-based (not industry-wide), that unions acted as bargaining agents in about 45% of cases, that 5% of wages decreased, 23% did not change and 65% increased, and work hours became more flexible[11].

— A detailed survey of employers in March 1993 (Table 3) showed that the impact of the ECA was to greatly improve the flexibility of operations and the productivity of labour, to raise staff training and to reduce the costs of hiring and firing (Table 3).

11 This evidence is not quite reconcilable with the results of surveys done by the *Industrial Relations Centre* of Victoria University on behalf of and financed by trade unions (Harbridge, 1993a; 1993b).

Table 3

Impact of ECA: Business Leader Survey
— Percentage of replies, March 1993 —

	Compared to what would have happened without the ECA				
	Lower	Same	Higher	n.a.	Net Balance*
Wage rates (ordinary time)	12	63	21	4	9
Employment level	11	69	16	4	5
Growth of labour productivity	1	47	45	6	47
Overtime work	20	55	14	11	–7
Part-time work	6	51	26	17	24
Cost of hiring additional labour	28	54	3	15	-29
Cost of shedding labour	19	55	4	22	-19
Level of staff training	1	59	30	10	32
Flexibility of operations	1	31	63	6	66
Quality of management	1	55	37	8	39

* Net balance = (percentage of "lower" answers – percentage of "higher" answers) as per cent of replies other than "not available" (n.a.)

Source: New Zealand Institute of Economic Research (cited in Marshall, 1994), p.3

— A subsequent survey, conducted in September 1993, 15 months after the legislation, of 1000 employees and 500 company directors for the Department of Labour, revealed that employees with new contracts were more likely to approve of the new system than workers still on awards. 42% reported take-home wage or salary increases, and 39% no change to incomes ([NZ] Department of Labour, 1994). Ordinary work times now varied much more than under the old system. 50% of enterprises attributed productivity increases to the ECA, and about half of the senior managers agreed with the statement that the old award system had blocked productivity improvements. Employers felt much more favourably about the ECA than employees. 73% of employees perceived a drop in job security. There was an interesting contrast between (a) a general question asking about employees' overall opinion of the ECA, to which 36% responded with approval, but 43% with disapproval, and (b) a specific question whether people were satisfied with the terms and conditions of their employment: 73% approved and only 15 were dissatisfied. Personal satisfaction had obviously not influenced general political opinion.

— A related Heylen opinion poll (September 1993) found that 46% of private enterprises attributed productivity improvements to the ECA, with 1/5 saying it was an important source of productivity growth. 40% of public-sector enterprises also indicated that productivity enhancements in the preceding year were in some way caused by the ECA (Marshall, 1994, p. 3).

The general impression from opinion surveys is supported and supplemented by a careful case study of a plasterboard firm with two plants that were subject to two different paths to contract negotiation, but arrived at similar positive results (see Box "A Tale of Two Cities: A Case Study"). Positive outcomes have been reported by many other companies, too. Thus, the aluminium company Comalco reported a drop of 17% in crude labour costs and a speed-up in production time by 31% in its aluminium smelter (after they implemented their first employment contract), and the chemical industry offered increases in wage rates between 2.5 and 8% in its first contract negotiations in exchange for new work practices (Jones, 1993, p. 12).

In practice, both employers and employees adopted the contract system fairly smoothly. By February 1993, few jobs were left under the old awards system. However, 23.7 per cent of the private-sector workforce replicated their award conditions in their contracts. One third of all contracts had been negotiated individually by employees, 43.2% were on collective enterprise contracts, and 9% had signed new multi-enterprise contracts (information from "Household Labour Survey" of Statistics New Zealand). Most strikes were ended by direct negotiation and without recourse to outside intermediaries.

Attitudinal Consequences and Rule Changes

Opinion surveys, case studies, newspaper reports and episodic evidence have given substance to support conclusions that one would predict on the basis of simple economic theory about how the ECA works:

— Managers gained a new capacity to manage the human resources in their companies. They could offer wage incentives for more productive work practices and innovations. Communication between workers and managers is now direct and more intensive. And workers have gained much more say about how they want the

A Tale of Two Cities
— A Micro View of the Workplace Revolution —

Statistic and other summary evidence is frequently less well able to explain the genuine economic and social causation of productivity growth than case studies. We therefore draw on a carefully documented case study to shed light on the effects of the ECA in two plants (McMorland-Hunter-Woodcock, 1993). The case study of workplace changes in the early 1990s was conducted in two plants — one at Christchurch and one in Auckland — belonging to the Fletcher Challenge group. Both produce plasterboards and related building materials. It illustrates the profound change in the rules and institutional settings, as well as the process, responsibilities and outcomes of industrial work.

The company — Winstone Wallboards Ltd (WWL) — was long-established and, like all of New Zealand manufacturing — heavily union-dominated, subject to strict union demarcation of different jobs. It also enjoyed a monopoly in the domestic market. In the manufacturing shake-out of the 1980s, WWL closed one plant (in Wellington). What had long been a family company was taken over by Fletcher Challenge, a major conglomerate.

The workers were loyal to WWL, but that did not extend to a commitment to good work practices and high productivity. Workers and foremen refused to take over responsibility (*op. cit.*, p. 9) and little attention was paid to training, quality control and safety, the pressure of market competition being absent. Workers operated long shifts to claim over-time pay and had no incentive to increase output.

Around the time the ECA became law (May 1991), both plants were due for a new wage agreement. In Christchurch, an energetic former production manager took over and established authority by dismissing a non-cooperative foreman and communicating with the workers. The workers understood that their plant might be closed and that cheap plasterboard would be coming in from Thailand. When the law changed, it was agreed to extend the old award for a year to gain breathing space. There was much nervousness on both sides about the new challenge, but management saw this as a chance to lift productivity and do away with deeply entrenched, counter-productive work practices. It was also decided at an early stage to opt for a plant-wide contract, not individual contracts.

The workers soon decided that they would not entrust the contract negotiation to their old union, the Carpenters' Union. Nor did they take up a competitive bid for the negotiating task by the Engineers Union (*idem*, p. 16), partly because they had resented compulsory union membership, partly because they resented the demarcation of work imposed by the unions. A Consultative Committee was set up by the workers with the mission to negotiate a new wage contract, but subject to a final vote of all workers. The production workers cleverly kept their options open and might have returned to a union as a bargaining agent. In the end, the negotiation established a basis wage, laid down premia for skills and a "Gainsharing Plan" under which productivity improvements would be shared within teams of workers. This contract was accepted. Workers immediately showed a direct interest in productivity. They were no longer paid for being present in the workplace (and hence no longer maximised hours of labour input), but were paid for output, so they switched to a performance orientation. Everyone soon had the feeling that they were involved in a win-win process (p. 18).

The quantity of output went up, the speed of the production line was increased (41 metres of output per minute in 1991, 43 metres in 1992, 49 metres, a 15% increase, in 1993, a further increase by 6% in 1994 (p. 34). The quality of output improved, so that the firm switched to selling only "Grade A" plasterboard. Workers were being rotated and multi-skilling became the norm, adding interest to work. The need for supervision went down and people acquired new skills and knowhow. A new contract in July 1993 was settled within one day.

In the Auckland plant, the process of change differed. The workers opted for union negotiators, but a representative consultative committee was also set up. There was considerable confusion and conflict between two unions in the negotiation, which workers resented. Managers did not do much to communicate; indeed management switched to a three-shift operation, depriving many workers of overtime income. Negotiations were at an impasse. However, the example of the Christchurch success informed the negotiations and the basic format of the Christchurch enterprise contract was eventually replicated. Only after the event did workers realise that they would make income gains. Staff morale and productivity rose. Once a virtuous circle of productivity gain and higher wages was in place, the Auckland plant overtook Christchurch in productivity and product quality.

workplace to be organised. Both workers and managers made active use of these new freedoms from collective regulation of the workplace and varied work practices to suit the specific circumstances of time and place.

— It has become easier to dismiss staff who are inefficient or act against the employer's interests. Before the ECA, New Zealand workers who were dismissed, say for absenteeism or drunkenness, could go before the Mediation Service or the Labour Court to claim that proper procedures had not been followed in the lead-up of their dismissal.

Since most managers were not trained in legal procedures and since the Mediation Service and Labour Court tended to search for lapses in documentation and procedure, it was *de facto* very difficult to fire staff. Consequently, it was less attractive to create new positions, and many managers had often given up on effectively managing the labour force. Under the draft legislation, procedural shortcomings would not have constituted grounds for overturning dismissal; but the ECA retained procedural grounds and laid the foundation for the Employment Court to creating rules that make dismissals costly and complicated.

— Unions have no automatic rights as negotiators. They have to be authorised by each member to act, separately for each contract. Therefore, they have to compete with other "bargaining agents", some of whom are former union officials set up in private bargaining businesses, and with individual workers who negotiate their own deals. After three years under the new regime, a sample of contracts showed that union representation is still the most common form of bargaining, some 85% of employees used union representatives to negotiate on their behalf (Harbridge-Honeybone, in Harbridge, Honeybone, Kiely, 1994, p. 25). Other evidence indicates that this estimate may be on the high side. Whatever the share, workers have gained control over union officials when they chose to act on their behalf. They are able to instruct them how to act. In one case soon after the passage of the ECA, a building materials firm proposed separate contracts covering geographically dispersed quarries. The union, used to nation-wide coverage, demanded one uniform industry contract. Yet, the workers instructed the union to accept the several contracts that their company wanted and that contained regional variations (Jones, 1991, p. 17). There are numerous similar instances which show that employees willingly took control of their own job conditions and destinies.

— In many firms, negotiated changes in work practices have allowed a much better utilisation of the capital stock. As already mentioned, New Zealand had become adept in wasting capital, not least because of the rigidities of the old labour system. Employment contracts, and the across-the-board liberalisation of economic life, now allowed firms to work multiple shifts and to ensure that work schedules did not interrupt the steady use of the capital stock. The predictable response of business to the higher capital productivity allowed by the ECA has been a steep rise in investments.

— Under the old system, the wage was often paid for presence in the workplace, not performance or quality. New Zealand workers used to maximise their incomes by working much overtime. In many industries, hours on the job were long. Under the new system, performance counts for the size of pay packets, and multiple shifts work has often reduced effective work-hours. Performance measurement under new employment contracts has often posed challenges to management and affected the work attitudes of all involved.

— Wage rates became more differentiated, with many movements in relative pay rates and regional diversity in pay scales, a circumstance that attracts investments to backward rural areas and the poorer South Island. The biggest changes in relative wages occurred in the first two years under the new system. Since then relativities have been fairly stable (*idem*).

— Wage calculation was often simplified; a plethora of specific "penalty rates", for example for weekend work, noisy conditions or weather allowances, was integrated into uniform, more transparent pay scales. High "penalties" for overtime (double rate or more) were becoming less frequent. The simplification of wage calculation saved firms and workers considerable transaction costs. But productivity clauses have become quite frequent, by 1994 15% of all contracts contained such clauses, and flexible work hours have increased to 38% of contracts (*idem*, p. 10).

— Initially, the aggregate real wage level moved little due to the recession and a high degree of price stability, but basic wage rates rose on average by about 1 percentage point in 1992/93 and 1993/94 (Harbridge-Honeybone-Kiely, 1994, p. 4).

— The contracts system has led to the emergence of differential pay for skills. The old centralised system had given fairly egalitarian rates of pay to all, so that highly skilled toolmakers often found it preferable to work as taxi drivers or waterfront workers. Under the contracts system, people with skills have an incentive to market scarce skills, and there is evidence that needed skills are now indeed deployed where they have the highest productivity. Conversely, low-skilled people are increasingly facing low wage increases. This is not surprising because the New Zealand labour market is being internationalised and low-skilled New Zealanders are competing more directly with bountiful Asian labour supplies.

— In the first three years under the ECA, the traded-goods industries tended to record higher wage increases than community and public services (Harbridge-Honeybone, *op. cit.*, p. 6).

— A possibly unexpected result has been the disappearance, in many workplaces, of the historic distinction between blue-collar and white-collar workers. Team spirit has taken over from class distinction. The legacy of long-passed industrial conflicts in a far-away island — Britain — has been shed and a sense of cooperation and partnership is evolving in the better-run firms.

— The traditional, politicised "national labour-market circus" with conspicuous annual "wage rounds" has given way to contracts in numerous labour markets that do not merit much public attention. Often personalised interest-group conflicts about some perceived fundamentals have been diffused in numerous decentralised contract negotiations that resolve possible conflicts according to the specific circumstances of place and time. Industrial relations problems and strikes, a frequent item in New Zealand media coverage before, have virtually disappeared from the headlines.

As a result of the ECA, workplace arrangements are more performance-oriented and respond flexibly to changed circumstances, but overall patterns of work, pay and other contract conditions have not changed dramatically. Few workers or firms were disoriented by the changeover and information about market rates of pay was obviously readily available.

The ILO Case

As public opinion began to turn more in favour of the new employment law, the New Zealand Council of Trade Unions mounted an attack in February 1993 on certain aspects of the ECA before the International Labour Organisation, ILO. It tried to overturn by international covenant what New Zealand's elected parliament had put in place. The Council complained of violations of the freedom of association against the New Zealand government, claiming that the ECA's removal of recognition of unions violated the *Freedom of Association Convention*, 1948, and the *Right to Organise and Collective Bargaining Convention*, 1949. The government rejected the ILO's interim conclusions pointing out that the "*Employment Contracts Act* is an important element of the government's strategy for economic growth, increased employment and building strong communities and a cohesive society" (NZ Government, 1994, p. 29).

After an elaborate inquiry, the ILO did not uphold most of its preliminary findings in its final report. The New Zealand government, which had anyway not ratified these conventions (International Labour Organisation, 1994, p. 40), affirmed from the outset that it would not amend the Act. This ensured public confidence in the stability of the new institutions.

Then, in early 1994, after exhaustive investigations, the ILO Committee (Case No. 1698) found no major objections against the ECA but "affirmed established principles of collective bargaining" and hoped that there would be tripartite discussions. It also reiterated that "workers and their organisations should be able to call for industrial action in support of multi-employer collective employment contracts which is currently made expressly illegal under section 63(e) of the (Employment Contracts) Act". The ILO offered its advisory services (International Labour Organisation, 1994, pp. 85-86). The government of New Zealand and the ILO agreed to disagree on the basic philosophical issue of individual freedom versus corporatist collectivism. The government's rejection of collective social arrangements as preferred by the ILO is a logical extension of the individualist philosophies that have guided the labour-market reforms (Rasmussen *et al.*, 1995, pp. 25-28).

Residual Market Imperfections

Although it is widely recognised that the ECA placed the entire worksphere on a dramatically different institutional foundation, the reforms have been called "an incomplete revolution" (Brook, 1991). There has been some employer criticism against various remnants of the traditional system:

— The *New Zealand Business Roundtable* has been critical, on Stiglerian lines, of the continued existence of a legally mandated minimum wage (Stigler, 1946, see also Cumming, 1988; Gorman, 1993; Minford, 1993), not least on the grounds that this makes labour-market entry harder than necessary for less productive workers (ACIL Economics and Policy, 1994 and Sloan, 1994, both for Business Roundtable, see also Brosnan-Rea, 1991; Hartley, 1992). The best available evidence, differentiated for teenagers and adults, shows that the minimum wage has some effect on job creation: Careful econometric analysis suggests that a 10 per cent rise in the minimum wage would reduce employment of all young adults (20 - 24 years of age) by between 1.4 and 1.8 per cent and young adults without school or post-school qualifications by as much as 3.4 to 3.8 per cent. The young adult employment rate would be increased by a minimum wage reduction (Maloney, 1994b).

— Observers on the employers' side have been critical about the continued existence of the Employment Court and its practice of finding frequently in favour of employees. For example, the fact that employers failed to follow proper procedures leading to dismissals, even if there are substantive grounds for dismissal, often still leads to rulings that reinstate dismissed workers; in other words old conventions are perpetuated although they may be at loggerheads with the spirit of the ECA (NZ Business Roundtable/NZ Employers Federation, 1993; Sloan, 1994). There have been calls for the abolition of this specialist industrial-relations court, passing jurisdiction on employment contracts straight to civil courts who have wider experience in general commercial affairs (Alan Jones in *The Dominion*, 12 August 1993, p. 8). The ECA extended personal grievance coverage to non-unionists, including white-collar employees, and opened the door for more legalistic wrangles and a shift to procedural criteria. However, standard legal safeguards and common-law coverage appear to assert themselves gradually. The (general) Court of Appeal has upheld fewer than half of the Labour/Employment Court's decisions that were brought before it between 1987 and 1993 (23 out of a total of 48 cases). Nonetheless, the costs of running the country's employment system would probably be reduced if all employment contract matters were simply subjected to the common law and handed over to non-specialised, general courts.

— Social welfare provisions, although tightened and revised (St. John, 1993; Sloan, 1994) are still perceived by some observers as weakening the material incentive to search for work. As mentioned, the combination of a welfare safety net and a fairly flat income tax creates high marginal tax rates at the transition to work. Hence it can serve as a disincentive to seeking employment. It is a matter for concern that many people have transferred from receiving unemployment payments to sickness, accident or other social security payments.

— The most durable objections to the ECA come from the labour movement, both organised labour and the political wing, the Labour Party which is committed to do away with key provisions of the Act. The reasons for their objections are obvious: loss of fee-paying membership and loss of monopoly control. They rely on popular support from those segments of the electorate that are less interested in economic efficiency and more in equity and non-material objectives.

A government-appointed taskforce to look into measures to combat high unemployment, reported late in 1994 (Prime Ministerial Taskforce, 1994). Its report contained an elaborate collection of numerous detailed proposals, but it found little positive response, partly — one presumes — because New Zealand has moved from detailed administrative "can-doism" to reliance on a framework of fundamental rules within which spontaneous market forces are left to produce desirable results, and partly because that approach was already leading to substantial drops in unemployment by the time the report was published (see next Section 3).

3. General Lessons?

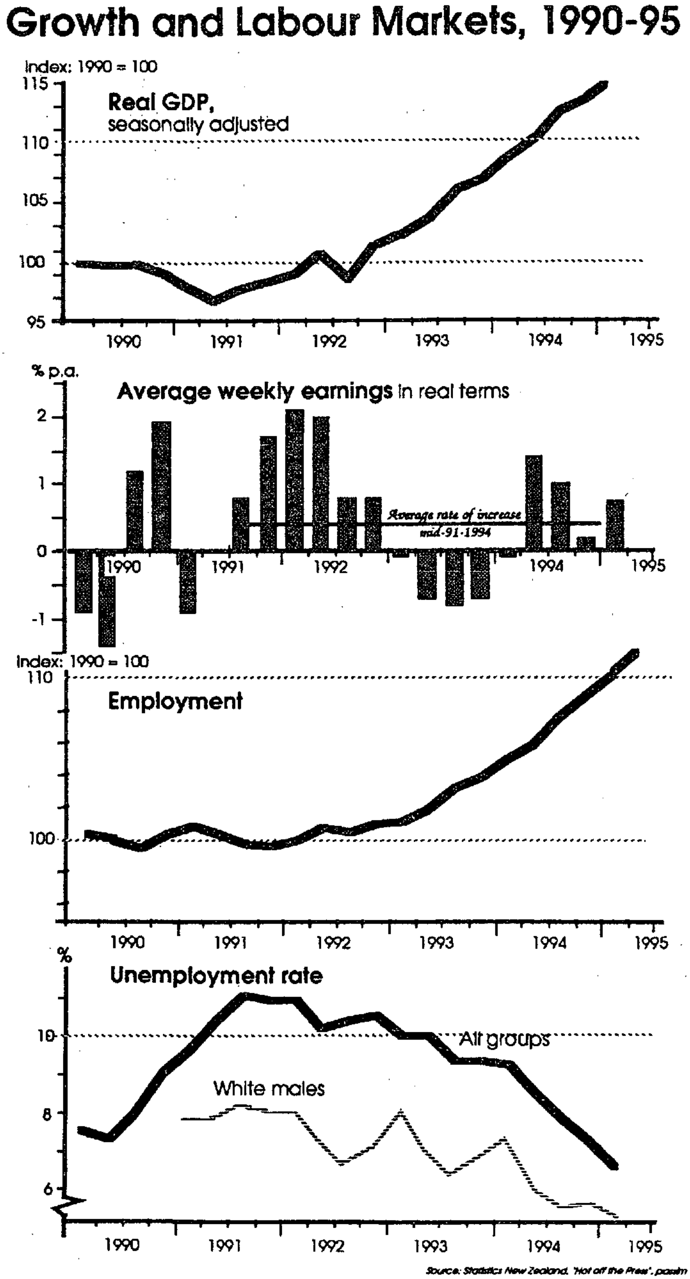
Economic Results to Date

In the first half of 1991, the recession which had begun in 1989, came to an end in New Zealand. Output grew by 15% in the three years to 1995, that is as much as it had during the entire decade 1974 to 1984, a period that New Zealanders used to regard as the "good old days". Since early 1991, the upturn in demand and output has been steady and has been accompanied by moderate rises in real earnings (average annual rate from the passage of the ECA to the end of 1994: 0.4%). This shape of the upturn contrasts with earlier cyclical turnarounds when improved demand promptly triggered across-the-board wage increases. Thus, the 1984-85 upswing, when the Labour government had begun the reform programme but re-regulated labour markets, had quickly led to a wages blow-out, followed by rising inflation and unemployment (compare Graph 1).

Now, the profile of the upswing was markedly different. Despite upward wage adjustments in the wake of the ECA (Graph 2), the upturn led to robust job creation and a spectacular drop in unemployment. The recovery — in particular in manufacturing and export activities — created numerous new employment opportunities. Between the passage of the ECA and the middle of 1995, over 150 000 new jobs were created, the equivalent of the entire workforce of Christchurch or Wellington (and 10.3% of the number of jobs at the bottom of the recession). In March 1995, there were 5% more jobs than a year earlier. The government now predicts a further 135 000 new jobs by 1998 (Myers, 1995, p. 2).

In the wake of the ECA, the workforce shows many indications of upskilling. The rise in the employment of people with tertiary qualifications has far exceeded total job growth, and the share of skill-intensive activities in total output is rising fast. This reflects the growing division of labour with the new industrial countries of East Asia where low-skilled labour is comparatively cheap. As a consequence of the internationalisation of the New Zealand labour market and the wage flexibility under the new regime, skill premia have been rising. The New Zealand workforce has reacted constructively to the market signals: people with skills, who used to work in jobs where these skills were not demanded, now move to where their skills earn extra income and many young workers now acquire and use post-school qualifications (1991: 43% of 20-24 year olds, up from only 12% in 1966). Among the young, there are now few without any qualifications, the exception being many Maoris and Pacific Islanders.

Graph 2


Growth and Labour Markets, 1990-95
Index: 1990 = 100
Real GDP,
seasonally adjusted
115
110
105
100
95
1990
1991
1992
1993
1994
1995
% p.a.
Average weekly earnings in real terms
2
1
0
-1
Average rate of increase
mid-91-1994
Index: 1990 = 100
110
Employment
100
%
Unemployment rate
10
8
6
All groups
White males
Source: Statistics New Zealand, 'Hot off the Press', passim

The outcomes of the labour-market reforms were greatly influenced by the growing openness of the economy and the competition on product markets, which amounts to competition for New Zealand labour. This was recently expressed clearly in an interview by Rex Jones, the leader of the Engineering Union, when he said: "New Zealand workers and employers together are taking on the export markets of the world" (*Australian Financial Review*, 5 June 1995, p. 14). The New Zealand workforce is becoming internationally more competitive. The "World Competitiveness Reports", which we already mentioned, show an improvement in the international competitiveness of the "People Factor": whereas New Zealand's "Human Resources" were rated 22nd out of 33 old and new industrial countries in 1989 (Kasper, 1991, p. 39), they attained 13th rank out of 41 countries in 1994 (IMD-WEF, 1994, p. 44). It would be hard not to attribute most of this enhancement to the improved institutional framework surrounding labour markets. By 1993, New Zealand had a 25 to 50 per cent wage-cost advantage over Australia (Jones, 1993, p. 12); and wharfage costs were 20-25% below those in Australian ports. Increasing numbers of plants relocate from high-cost Hong Kong and Australia to New Zealand. Apart from natural resource advantages, flexible work practices which allow multi-shift use of the capital stock, and low wage rates are cited as reasons for this locational innovation.

The enhanced responsiveness of liberalised labour markets has had a dramatic effect on unemployment:

— From a high of nearly 11% in September 1991, the aggregate rate of unemployment has fallen consistently (to 6.6% in March 1995, Graph 2). The unemployment rate of male Pakehas (whites) stood at 5.2 per cent in March 1995.

— Many long-term unemployed are being drawn back into employment. The reemployment of people with lesser job skills may have affected the rate of change in average weekly earnings during 1993 (Graph 2). But this ensured a welcome reduction in hard-core unemployment. In March 1995, the number of the long-term jobless was no less than 36.5% below that a year earlier.

— The upswing in the jobs market has also begun to affect the Maori and Pacific Islander segment, typically groups with high unemployment, high welfare dependency and serious social problems. In March 1995, the Maori unemployment rate was 19 per cent (down from 27.3 per cent four years earlier). In the year to September 1994, employment growth among the Maori was reported to be 16.4 per cent, twice the rate for Pakehas (*The Australian*, 18 November 1994, p. 5).

— Youth unemployment is higher than the aggregate, but is falling in line with overall unemployment. Many employment contracts with young people offer modest wages, but this wage flexibility allows young people to get "their feet on the lowest rung of the jobs ladder" and to gain on-the-job training.

— There are first reports of skill shortages. The number of unfilled vacancies has been on a (slight) upward trend.

Whilst some of the macroeconomic evidence is cyclically biased and is in part explained by the long period of poor performance before the upturn, it would, in our opinion, be impossible not to attribute the larger share of the current inflation-free expansion to the preceding institutional reforms.

Assessing the Record

It is clear that the completion of the reform agenda by the ECA has played a substantial role in attaining output and employment growth and achieving improvements in real earnings. It is also obvious that the sequencing of the New Zealand reforms — deregulation of capital and product markets before the freeing up of labour markets, macroeconomic stabilisation and public expenditure control (Section 1) — has imposed high burdens on the workforce whom an ill-advised Labour government had hoped to protect. Academics and observers in international organisations (OECD, 1991) would probably have engineered a different sequence of reforms. But political constraints made it inevitable to reform "back to front", as compared to the ideal designs of social engineers. Matters of labour and social welfare have probably the most widespread appeal in electoral democracies, so that it is well-nigh impossible to make these areas the front-runners of comprehensive institutional reform. Only when all the surrounding prop-ups for the old labour-market sub-order had been removed and the costs of the traditional sub-order had become evident, was labour reform politically feasible.

Much debate has taken place whether to attribute the improvement in labour markets and joblessness to the cyclical upswing or the reform of the institutional order through the ECA. The most careful econometric analysis has been conducted by Tim Maloney (1994a, c). Using industry-level quarterly data from 1986:2 to 1993:4, he found that "at least one percentage point of [the] employment growth [of 4.4 per cent growth since the ECA] can be attributed to his legislation" (Maloney, 1994a, p. 20). But he speculates that the ECA was partly responsible for the cyclical upturn, so that more of the employment growth could arguably be credited to the Act. Maloney's data base does not cover the continued upturn during 1994 and 1995 when internal labour and productivity reserves in plants would have been exhausted and the continued demand expansion led to more job creation. It is possible that an update would point to a more substantial impact of the institutional-legal change on job creation and unemployment. Maloney (1994a) also found that average real wages fell by

0.5 per cent from 1991:3 to 1993:4, which he entirely attributes to the Act. Yet, renewed wage income growth during 1994 (see Graph 2) might alter that conclusion[12].

Another econometric study of the recent behaviour of the New Zealand economy touched on labour-market reactions to the ECA (Hall, forthcoming, pp. 19-21). It cited sources in making the case that "the ECA has been a key factor in subsequently improved productivity and lessened pressure on existing labour costs and the costs of hiring. If so, then it could follow that the costs of New Zealand's disinflation process would have been somewhat lower if the ECA had been introduced at a significantly earlier date". To explore this point, Hall presented an illustrative macroeconometric simulation which brought forward the competitive impact of the ECA to early 1986. He assumed a 5 per cent improvement of labour productivity over 2 1/2 years and an initial wage drop (relative to the substantial baseline increases) of 2.5 per cent for two successive quarters, which remained in place for two years; thereafter he assumed a gradual return to baseline wage levels. The assumed combination of a permanent productivity gain and temporary wage reduction would have raised real output substantially over the following decade. Hall further found (p. 21): "As a result [of the simulation], employment gains were substantial and sustained..... Unemployment outcomes would also have been relatively better" (p. 21). Apart from giving substance to (politically blind) criticism of sequencing, the experiment again points to a substantial beneficial effect of the ECA on employment and growth.

Another, though less rigorous, way at arriving at a quantitative estimate of the effects of the ECA, four years after its introduction, is to compare New Zealand's recovery with that of Australia:

— Both countries embarked on comprehensive microeconomic reforms in the 1980s, but with one important difference: Whereas New Zealand completed its reform agenda in the early 1990s, Australia quarantined the labour market and, to a large extent, the government and welfare sector, from the reform[13]. With a grain of salt, differences in aggregate performance may therefore be attributed to the differential extent of the reform programme.

— Both countries have similar histories and economic structures, largely concurrent business cycles, and, as old industrial countries in the frontline of competition from East Asia, a similar competitive exposure.

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12 A volume on the New Zealand reform experience will be published in late 1995 or 1996 which will contain updates of the econometric estimates (Bollard, Lattimore, Silverstone, *forthcoming*).

13 The most obvious differences between the two countries are size (population: NZ: 3.5 million, Australia 17.7 million) and living standards (at purchase power parity, NZ had a per-capita income of US-$15 390 in 1993 and Australia of $18 490, i.e. about equal to Germany). Source: *World Bank World Tables 1995*).

— Economic growth bottomed out in both countries in the first half of 1991 and both have enjoyed a long steady recovery since. New Zealand's has, however, been significantly steeper (Graph 3). As of mid-1995, signs of an end to the Australian upswing are emerging, whereas there is no evidence of a "speed limit" to the New Zealand expansion.

— The centralised wage fixing system of Australia, subject to an "Accord" between the central union body and the Federal government to control wages (a soft kind of incomes policy), yielded higher average wage earnings, notably early in the upturn, than did the decentralised New Zealand contract system. The average real wage from 1990 to early 1995 rose by a 0.8% p.a. in Australia, but by only 0.4% p.a. in the freed-up New Zealand labour markets.

— This is connected with the dramatic differences in job creation and reduction of unemployment (Graph 3). The Australian system responded with a long employment lag: non-government employment began to pick up only 9 quarters after the turnaround in output. Since the bottom of the recession and the ECA, the New Zealand economy has generated 10% more jobs[14], the Australian economy none. Indeed, 15 quarters into the cyclical upswing, there were still 1.2% fewer civilian jobs in Australia than there had been in the recession year 1990. By contrast, the "Kiwi job creation machine" is now second to none (McKenzie, 1988).

— From the start of the recovery, New Zealand's unemployment rate dropped, as of March 1995 to 6.6%. In Australia, with a largely unreformed labour-market constitution similar to New Zealand's former system, unemployment rates fell later and by much less (2.4 percentage points against New Zealand's 4.4 percentage points).

This comparison offers fairly convincing evidence that decentralised labour markets yield more employment, growth and wage income than a regulated, centrally coordinated industrial order. It also puts the lie to the view that market competition produces inequitable outcomes and therefore has to be corrected somehow by collective interventions. On the contrary, free labour markets accepted an "unemployment discount" in the form of moderate wage rises and thereby spread jobs around to the less competitive workers. Compared to Australians, New Zealanders now have more equitable access to work opportunities (on the comparison, see also Kerr, 1995).

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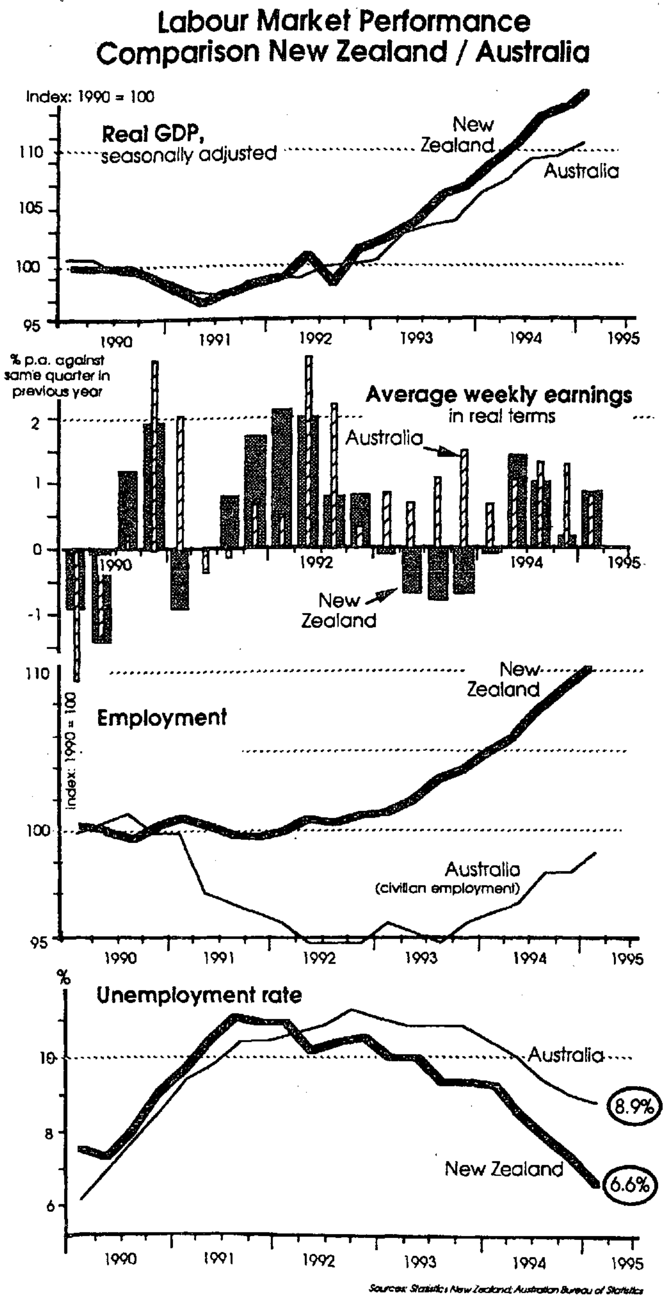
14 Some knowledgeable observers believe that employment statistics under-report employment growth since the ECA (Maloney, 1994c, p. 340)

Graph 3


Labour Market Performance
Comparison New Zealand / Australia
Index: 1990 = 100
Real GDP,
seasonally adjusted
New
Zealand
Australia
110
105
100
95
1990
1991
1992
1993
1994
1995
% p.a. against
same quarter in
previous year
Average weekly earnings
in real terms
Australia
New
Zealand
2
1
0
-1
Employment
Index: 1990 = 100
Australia
(civilian employment)
Unemployment rate
%
Australia
New Zealand
8.9%
6.6%
10
8
6
Sources: Statistics New Zealand; Australian Bureau of Statistics

Summary Evaluation

The evidence to date seems in line with *a priori* theory, namely that a freer play of market forces clears markets of unemployment imbalances and favours growth and job creation.

We can conclude that the *Employment Contracts Act* has

(a) substantively enhanced the productivity of labour and capital, output and employment growth because it has been an essential ingredient in the transformation of New Zealand's institutional order to greater flexibility and competitiveness, and

(b) greatly improved the atmosphere in the workplace, making work a more satisfying, more challenging experience, improving direct communication between those who are partners in productive effort, and giving more people an equitable opportunity to provide for themselves.

Arguments that predicted a drop in real wages have not come true despite high unemployment and poor demand, when the ECA came in force. Nor have widespread workplace conflicts erupted, as some predicted. The argument of entrenched critics of the Act now is that it is "a law which is only good for a recession", but the long 1991 to 1995-and-beyond recovery has shown that it is essential for inflation-free growth.

The *Employment Contracts Act* — a success from the viewpoint of efficiency growth, job creation, and equity of opportunity — fits in with New Zealand's overall economic order. It is therefore efficient.

The only drawback is that it has harmed previously deeply entrenched influential groups. The organised labour movement has not given up the fight for at least a partial return to the *status quo ante*, which it had enjoyed for nearly a century. According to first survey results of voter intentions, the Labour Party and the populist Alliance Party taken together are likely to gain a parliamentary plurality in the first election under the new multi-party-electoral system expected in 1996 (*The Dominion*, 18 May 1995). This would give New Zealand a left coalition government committed to undoing the present freedom of contract and to reintroducing collective, industry-wide wage negotiations.

Arnold Harberger recently remarked that "economic liberalization has triumphed in just about every corner of the world. But it has not, typically, been a joyous victory" (in his Introduction to Bollard, 1992, p. ix). This was for a long time also true of New Zealand. But, as of 1995, after the reforms had been completed to cover all relevant product and factor markets, as well as government, and after they have had time to work, one may conclude that the new socio-economic order has become an untypically joyous victory for the free-market approach.

Perspectives for the Future

Most observers predict fairly high growth rates for the remainder of this decade and anticipate low inflation and high employment. Few would undo the central features of the reforms that have led, during the long cyclical upturn 1991-95, to a rise in real national product by over 15 percent, the creation of some 150 000 new non-government jobs (10.3 % above the 1993 recession level) and an average rate of inflation of 1.6 percent per annum.

However, given entrenched political opposition to some features of the ECA and the possibility that the general political opinion about the ECA may not be influenced fully by the personal workplace experience of most workers, one has to contemplate at least two scenarios for the future:

(a) It is possible that the political system overturns the ECA and re-introduces contradictions into the current economic order. This would undermine the medium-term benefits of the "onerous decade of reform" that started in 1984, but would — over time and after frictions in the job and other markets — probably lead to labour behaviour compatible with the maxims of national and international product market competition. There is no doubt that no political group will ever re-erect the plethora of controls needed to prop up a centralist industrial-relations system, replicating the thoroughly "negotiated economy" that once existed. Consequently, the competitive maxims of the new order in product and capital markets can be expected to pull labour market institutions and attitudes eventually in line, but at a cost.

(b) The alternative is that, like in West Germany in the 1950s, the free market order is allowed to settle down and generate prosperity and freedom for all, so that widespread and durable electoral support for free markets all around grows sufficiently to make a re-regulation of labour markets impossible. Then, the political parties committed to labour market collectivity would be defeated repeatedly at the polls and would eventually abandon the political commitment to undoing individual contracts under the sheer weight of long-term success. Such an ideological conversion occurred for example when the West German Social Democrats recognised the durable success of the Erhard reforms in their "Godesberg Programme" of 1957, and recently the British Labour Party acknowledged the durable success of Thatcher's privatisation policy by jettisoning nationalisation from their party programme.

It is not clear which scenario will be played through in the remainder of the century — whether the political or the economic imperative will gain the upper hand. The battle for the compatibility of economic, political and social orders in New Zealand has not yet been completely won. It is the battle for the hearts and minds of the electorate that takes place in all electoral democracies between the obvious solutions of populist collectivism and the less obvious strategy of cultivating the spontaneous forces of genuine competition. The New Zealand story will therefore be of continuing interest.

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