CONFIDENTIAL

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POLICY COSTING - REQUIRING UNEMPLOYED JOB SEEKERS TO BE EMPLOYED IN COMMUNITY WORK AND/OR TRAINING

Introduction

1. On 30 October 1996, you requested a costing on requiring unemployed job seekers to be employed in community work and/or training. On 31 October 1996 we requested further information on the assumptions to be used in the costing. As a result, it was agreed that officials would also provide comment on the practical implications of these policy options.

Costing Request

"What is the cost and practical implications of requiring the following unemployed job seekers to be employed in community work and/or training for the number of hours per week equivalent to their unemployment benefit calculated at market wage rates?: (a) those job seekers registered for 26 weeks or longer? (b) all registered job seekers?"

Summary

2. Costing assumptions have been developed in the absence of clearly stated programme objectives. As a result the model used has been based on experience with current programmes of a considerably smaller scale.

3. The models that have been costed assume that participation in the Community Work/Training Programme will be compulsory for all work tested job seekers and work test sanctions will apply to anyone who fails to meet programme requirements (ie reductions in benefit will apply). Those who are covered by the programme will be required to be in work or training for two days per week.

4. The main costs associated with the programme are the administration of the work placement process, and the subsidisation of sponsor overheads, both of which are directly related to the number of participants on the programme.

5. There are two key drivers which impact on the numbers of programme participants, and therefore programme costs. These are the success of the programme in terms register reduction, and the impact on the labour market (displacement). Given the difficulty in estimating these impacts, we have prepared costings on the basis of a range for both options. The total fiscal impact of the programme(s), depending on the scenarios used, are as follows:

Figure 1: Initial Fiscal Impact Excluding Finance Costs and Tax Implications

Deleted under section 9(2)(g)(i) of the Official Information Act 1982 to maintain the effective conduct of public affairs through the free and frank expression of opinion by employees of departments in the course of their duty.

6. The net fiscal impacts in the table above assume savings in the order of $30 million per annum from the abolition of Taskforce Green and Community Taskforce, and the inclusion of current participants in those schemes in the proposed programmes.

7. Deleted under section 9(2)(g)(i) of the Official Information Act 1982 to maintain the effective conduct of public affairs through the free and frank expression of opinion by employees of departments in the course of their duty.

8. In order to cost the model provided, it has been assumed that the programme could be phased in from 1 July 1997 and be fully operational by 1 July 1998. It has also been assumed that 100% take-up would be achieved. These are extremely optimistic assumptions. The scale of the programme envisaged would make the achievement of the participation targets extremely difficult, and in the case of option (b) virtually impossible.

9. The assumptions underpinning the costings have been based upon experience with similar, although smaller, schemes. The larger the proposed scheme is, the more likely that additional costs will be incurred (for example in the sponsorship of places) and the less relevant assumptions which relate to past experience become. Thus there is a risk that the costings contained in this paper are conservative in nature.

10. The parameters of the request did not specify the objectives that were being pursued. There are a range of possible objectives (for example, register management, enhancing employment outcomes through work experience, skill maintenance and improvement and maintaining contact with the labour market particularly during periods of low aggregate demand). The design of interventions will be guided by the objective(s) that are set. Experience to date has been that targeted interventions are more likely to be successful at lower cost than more broadly focused approaches.

Assumptions

Standard assumptions

- intangible costs are not included;

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[1] Half year impact.

- costings are given on a nominal basis;
- the costing is for the *initial* fiscal impact of the policy change. We have included first round displacement effects which are a direct result of these policy options;
- GST costs are excluded. Further, the travel allowance paid will be a tax free allowance. This assumption is maintained in the costings;
- depreciation and other additional operating expenses (arising from capital expenditure) are included;
- finance costs are included as both proposals have been costed at over $50 million.

The following additional assumptions have been made:

Nature of the programme

11. Participation in the new programme is compulsory and those job seekers who fail to satisfactorily participate in community work or training will be deemed to have failed the work test and will face the standard work test sanctions to be introduced from 1 April 1997 (ie graduated reductions in benefit). Individual participation in the new programme is limited only by duration of benefit receipt (that is, as long as job seekers continue to receive work-tested benefits, they are required to participate).

Numbers involved in the programme

12. The target group is taken to mean those registered job seekers who are subject to a work test from 1 April 1997[2]. The programme will commence on 1 July 1997, with full implementation by 1 July 1998.

13. It has been assumed that registered unemployment remains constant at the levels as at 30 October 1996, except for changes resulting from this programme (Appendix A refers). As a consequence, by July 1997, the potential stock of programme participants is assumed to be 68,108 for those registered for 26 weeks or longer and 142,472 for all registered job seekers. By July 1997, the potential annual flow of programme participants is assumed to be 86,983 for those registered for 26 weeks or longer and 221,922 for all those registered.

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[2] This will include unemployment beneficiaries and their spouses, with no dependent children or a youngest child aged 14 years or over (both subject to a full-time work test) and widows beneficiaries and the recipients of Domestic Purposes Benefit (DPB) (both subject to a part-time work test if they have no dependants or when their youngest child is 14). These groups together constitute about 81% of the register. Note: this therefore excludes individuals who have voluntarily registered with NZES and do not receive a work-tested benefit, such as recipients of Sickness and Invalids' Benefits, some DPB beneficiaries, most 55+ beneficiaries, young people not receiving a benefit, and people looking to change jobs. Students enrolled with Student Job Search during the summer vacation (who may be in receipt of a benefit) are also excluded.

14. There are two key drivers which impact on the numbers of programme participants, and therefore programme costs.

I) register reduction rates

15. We have assumed that the introduction of the programme will have three effects which will impact on the numbers of registered job seekers.

- it will reduce to some degree the numbers of work tested people enrolling on the job seeker register

- it will provide an ongoing incentive to those already on the register to leave the register (either for full-time employment, transfers to non-work tested benefits, or exit from the labour force); and

- it may provide some participants with work experience and basic work skills which will assist entry into paid employment.

ii) displacement effects

16. The placement of a subsidised worker has the potential to encourage employers to replace existing workers with subsidised job seekers or to recruit directly from the subsidised pool instead of the open labour market. This effect is referred to as 'displacement'. A displacement rate of 100% would mean that for every programme participant placed, one unsubsidised worker loses or misses out on a job. To the extent that a job placement is not full time (as is the case with the proposed programme), the displacement effect is pro-rated down.

17. The displacement impact of a programme will be affected by the extent to which placements are absorbed by the currently voluntary sector, and to which placements are work which would otherwise not be undertaken (and is presumably therefore of low value). The larger the scale of the programme, the less likely it is that the voluntary sector will be able to absorb placements, and the higher the likely level of displacement.

18. In light of the lack of empirical evidence on which to base the cost of the proposals, a range has been used for key drivers (register reduction and displacement). The 'low scenario' essentially assumes a best case outcome from the programme(s) - relatively high register reduction and low displacement. The 'high scenario' represents a estimated upper bound on the fiscal cost of the programme(s) and assumes relatively poor register reduction and high displacement rates.

Figure 2: Key Driver Assumptions

	Option (a) >26 weeks		Option (b) all registered	
	Low	High	Low	High
Register Reduction Rate	10%	5%	10%	5%
Displacement	22%	66%	33%	66%
Displacement - Pro Rated	9%	26%	13%	26%

19. The register reduction rate estimates for the low scenario have been based on experience with the existing Work Focus Interview and other programmes which job seekers become eligible for at 26 weeks duration. The high scenario has a lower register reduction rate due to an assumption that the programme will have a lesser effect in assisting job seekers into work than existing programmes.

20. The displacement rate has been based upon evidence from a 1994 study of a Swedish public relief work programme which showed a 69% displacement rate in the construction sector[3]. The displacement rate for the high scenario is directly related to the Swedish experience, whilst the rate for the low scenario has been adjusted downwards to allow for the potential for the voluntary sector to absorb some of the job placements. The scale of the option chosen will impact on the capacity of the voluntary sector to absorb job placements (and this is reflected in the 'low' assumptions for options). The displacement effect in the model is based on two days community work (the pro-rated figure reflects this).

Type of community work and training

21. It has been assumed that any community work undertaken will be required to be of benefit to the community (this has implications for the cost of administering the programme). Community work placements are most likely to be in the education sector, with local authorities and the voluntary sector in areas such as childcare, conservation projects, personal care and community welfare.

22. There will need to be a larger supply of community work than training as training programmes cannot (by definition) continue indefinitely. Approximately 85% of placements are assumed to be in community work, with the remaining 15% in training (this reflects current patterns).

23. For the purposes of costing these policy options, it has been assumed that an appropriate quantity and quality of community sponsors will be found. However, achieving this assumption will require subsidisation of some administrative costs which are not currently subsidised, such as supervision and equipment.

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[3] Fay, R.G., Enhancing the Effectiveness of Active Labour Market Programmes: Evidence from Programme Evaluations in OECD Countries, OECD 1996

Market Wage

24. Average benefit and market wage rates should be used as a basis for calculating the number of hours each job seeker will be required to be in community work or training each week. These have been derived as follows:

- the average market wage will be considered to be $9.39 per hour before tax ($7.42 after tax). This is an average based on industry-wide average minimum adult rates in collective contracts lodged with the Department of Labour; $9.39 therefore represents a crude average for a low skill, adult starting rate;

- an average benefit level will be considered to be $118.74 per week (after tax). Note: firstly, this is the UB rate for single people aged 18-24 years and half the married rate of UB; secondly, the majority of work-tested job seekers are in receipt of UB; and thirdly, 80% of unemployment beneficiaries are single.

- full time work tested job seekers will therefore be required to participate in community work or training for 16 hours per week; and

- part time work tested job seekers will be required to participate in community work or training for half the time required of full-time job seekers.

Administration

25. One agency will administer this programme (costings have been based on existing NZES experience). The larger programmes become, and the more placements are required, the more difficult it will become to find appropriate placements. This is reflected in increasing administrative costs per placement as the scheme grows.

26. The on-going administration costs of the new programme would include: finding community work opportunities (including screening sponsor quality to, among other things, minimise displacement); purchasing training; matching and referring unemployed job seekers to work or training opportunities; monitoring compliance; processing claims; auditing; and evaluating the effectiveness of the programme;

27. The costs of administering work test sanctions and an appeals process for a programme of this type cannot be quantified at this stage, and have not been included.

Programme costs

28. It has been assumed that 25% of participants will be on individual projects (many of whom will self-refer to placements) and the remainder will work in supervised groups of eight people[4]. Supervisors will be drawn from the job seeker pool and receive an additional allowance of $40 per day (based on $80 per week allowable earnings for beneficiaries).

29. As the programme increases in scale and placements become more difficult to find, it is assumed that some additional expenditure will be required to cover a proportion of sponsors' overhead costs as an incentive to take on job placements (and that the subsidy will increase as the programme grows).

30. Participants will be paid a travel allowance of $6.65 per day to attend community work or training, which is comparable to the current CTF travel allowance.

31. The cost of purchasing training will be $44 per day, which is comparable to the current Training Opportunities Programme (TOP) price per day.

Income Support Impacts

32. The programme(s) will impact on income support costs in two ways:

- income support costs will be reduced as people move from the register to work; and

- income support costs will increase as the displacement effects of the policy result in some people moving from paid work to work tested benefits.

33. The magnitude of these effects depend on assumptions made regarding register reduction and displacement rates.

Sponsor Costs

34. The programmes involve, to a greater or lesser degree, a significant expansion in the current supply of job placement opportunities. Whilst it is likely to be relatively easy to find placement opportunities for smaller numbers of job seekers, as numbers increase additional placements are likely to become increasingly difficult to find.

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[4] This supervisor:participant ratio of 1:8 is higher than that used by the Taskforce Green programme (1:4) and lower than that used by Community Corrections for Periodic Detention work groups (1:10)

35. It has been assumed that given the size of the programmes, it will be necessary to subsidise sponsor overheads in order to encourage the creation of additional placement opportunities. For the purposes of costing, it has been assumed that this cost will be equal to $15 per week per placement under option (a), rising to $30 per week per placement under option (b). These costs have been derived from those experienced with PEP. The models costed however, involve considerably larger numbers of placements than PEP, and thus it is highly likely that the sponsorship costs will be higher than those previously experienced and that the $15 and $30 figures are in fact conservative. We have not quantified the fiscal impact arising from the risk of higher sponsor subsidies.

Policy costing

Policy options (a) and (b) will have the following fiscal impacts on the Crown's financial statements:

Table 2: Cost of requiring all job seekers registered for 26 weeks or more to participate in community work or training (option (a))

Fiscal Impact[5]	**1997/98 $m**	**1998/99 $m**	**1999/2000 $m**
Operating balance[6]	Figures Deleted under section 9(2)(g)(i) of the Official Information Act 1982 to maintain the effective conduct of public affairs through the free and frank expression of opinion by employees of departments in the course of their duty.		
Net worth (cumulative)[7]			
Cash flows			
Net public debt (cumulative)			
Finance costs			

[5] Figures are rounded to the nearest $5 million.

[6] A positive number indicates an improvement in the fiscal position.

[7] These figures include finance cost where the policy's fiscal impact is $50 million or more per year

Table 3: Cost of requiring all job seekers to participate in community work or training (option (b))

Fiscal Impact	1997/98 $m	1998/99 $m	1999/2000 $m
Operating balance			
Net worth (cumulative)	Figures Deleted under section 9(2)(g)(i) of the Official Information Act 1982 to maintain the effective conduc of public affairs through the free and frank expression of opinion by employees of departments in the course of their duty.		
Cash flows			
Net public debt (cumulative)			
Finance costs			

Practical Implications

36. The model costed goes beyond any current (or past) schemes which involve placement of job seekers into subsidised community work or training. Current schemes of this type (e.g. Community Taskforce which involves 7,000 job seekers) are targeted at a smaller group of disadvantaged job seekers. Schemes which have had wider coverage involved moving clients off the unemployment register and paying them a wage for full-time, approved, work (e.g., Project Employment Programme [PEP], and other fully subsidised schemes, which in 1985 involved 21,000 job-seekers at a cost of $268 million[6]).

37. The lack of past experience with direct job creation schemes of this scale and scope makes arriving at a robust cost estimate problematic. The costings contained in this report represent a best estimate of the possible fiscal impacts. In the absence of specified objectives for the programme(s), no changes to existing patterns of work placement versus training have been made.

38. The design of labour market interventions will depend upon the policy objective(s) which are set. It is recognised that there are a range of possible objectives (for example, register management, enhancing employment outcomes through work experience, skill maintenance and improvement, maintaining contact with the labour market particularly during periods of low aggregate demand). However, no assumptions regarding policy objectives have been made in preparing this paper.

[6] Including wage costs.

39. Experience to date has been that targeted interventions are more likely to be successful at lower cost than more broadly focused approaches. Targeting might be on the basis of job seeker characteristics (e.g., low qualification levels), or on the basis of the type of assistance given (e.g. a focus on training, or job environment skills), or a combination of both.

40. There are a number of implications arising from the proposals which flow from:the extremely large scale of the model (especially where all registered job seekers are required to participate);

- the fact that it is compulsory in nature;
- the fact that participants are required to remain on the register until such time as they move off a work-tested benefit;
- the relatively modest impact of the model on flows off the unemployment register;
- increased unemployment resulting from the displacement by programme participants of potential or existing unsubsidised employees; and
- deadweight effects (where resources are used to achieve employment outcomes which would have occurred without any intervention).

41. Under the best case scenario, (where displacement is assumed to be low), the overall impact of the programme is that the stock of registered unemployed job seekers reduces slightly. The cost associated with achieving this effect is significantly greater when the programme is extended to all registered job seekers (option [b]).

42. Under the "high" scenario (where displacement is assumed to be 66%) the overall impact of the programme under both options (a) and (b) is to increase the size of the unemployment register. The main reason for this is that under the model, job seekers remain on the unemployment register while they are participating in the new programme. As existing unsubsidised employees are displaced they also join the unemployment register. Thus the size of the register increases. The effect is exacerbated under option (b) both because of the scale of the programme, and also because displaced workers are required to take part in the programme as soon as they join the unemployment register. Under option (a) at least some of the displaced workers will have left the register during the 26 week period before participation in the programme becomes compulsory thus reducing the impact on the register numbers.

43. In reality, the impact of the model is likely to fall somewhere between these two scenarios. While it is highly likely that some displacement will occur (particularly under option (b)) it is not possible to predict the level. This will be influenced by a number of unknown factors, including the proportion of community work placements which may absorbed by the voluntary sector.

44. In order to try and counter these displacement effects, most direct job creation schemes have an "additionality" requirement associated with them. That is, that the employer or "sponsor" is required to demonstrate that the job is additional to those which would ordinarily offer. Additionality requirements have the potential to increase the administration costs associated with direct job creation programmes in two ways - through increasing the time required to locate an appropriate placement and through additional monitoring requirements. Costings have been based on the same level of per project monitoring as existing schemes. Programmes of the scale which being considered are likely to require higher levels of monitoring and resultant increased costs. In general, while additionality requirements may lead to jobs which would not otherwise have existed, the jobs tend to be of low value.

45. A number of other factors have not been able to be taken account in the costings provided. These include:

- the cost of foregone tax income resulting from the displacement of existing or potential unsubsidised employees;

- the additional cost associated with transfers between work tested and non-work tested benefits (which tend to be more generous). Current information suggests that around 25% of new Sickness and Invalid Benefit recipients have transferred from the Unemployment Benefit.

- the potential costs associated with the crowding out of other government programmes which use community work as a vehicle for achieving their objectives (such as those operated by Community Corrections);

- the administrative costs associated with processing the increased number of appeals against failing the work test (for not participating satisfactorily in the programme) which are likely to arise; and

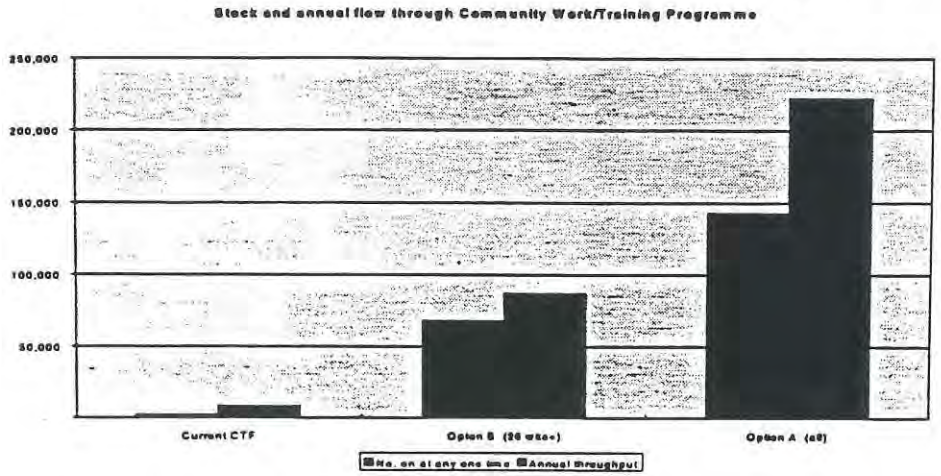
- any savings associated with reductions in benefits paid due to work test failure.

46. It has also not been possible to factor in deadweight effects and the possible impact of the model on the numbers of long-term unemployed. "Deadweight" in this case refers to the use of resources to assist someone into employment who would have achieved this outcome without assistance. As at August 1996, 34% of all job seekers enrolling with NZES left the register within 26 weeks. Most of the assistance provided to job seekers in the first 26 weeks of registering is relatively inexpensive. Option (b) is likely to result in the provision of costly assistance to many job seekers who would have left the register anyway. Indeed, by restricting the time available for active job search, option (b) may reduce the numbers of job seekers leaving the register over the first 26 weeks resulting in an increase in the numbers of long-term unemployed.

Achievability of participation targets

47. In order to cost the model provided, it has been assumed that the programme could be phased in from 1 July 1997 and be fully operational by 1 July 1998. It has also been assumed that 100% take-up would be achieved. These are extremely optimistic assumptions. The scale of the programme envisaged would make the achievement of the participation targets extremely difficult, and in the case of option (b) virtually impossible. Figure 1 illustrates the difference in scale and throughput between options (a) and (b) and the most comparable existing NZES programme, Community Task Force.

Figure 1: Estimated Stock and Annual Flows for Options (a) and (b) compared to the Community Task Force Programme



48. The problems associated with the finding the requisite number of opportunities in which to place job seekers would be further exacerbated by:

- the extent to which emphasis is placed on quality rather than just the quantity of placements;
- the level of screening required of job seekers placed in "caring roles"; and
- the time required to find jobs suitable for part-time work tested job seekers.

49. There may also be some job seekers (such as people with disabilities or those living in isolated rural communities) where participation in the programme is not possible. Consideration would need to be given to possibility of exemptions from participation for these groups.

Interfaces with existing programmes and initiatives

50. Detailed consideration will need to be given to the extent to which a Community Work/Training Programme of the kind envisaged interfaces with the current range of employment and training assistance available. For example, if an individual is engaged in another employment-related activity which is deemed to be appropriate (such as a job search seminar or a week-long Job Action seminar for example), would they be exempted from taking part in the Community Work/Training Programme. Consideration would also need to be given to the relationship between this programme and concept of Individualised Employment Assistance (IEA). Under IEA, individuals are "staircased" through a range of assistance measures based on an assessment of their particular needs. Currently community work placement would form part of a person's 'back to work plan' only if this is assessed an appropriate intervention for that particular individual. Compulsory participation in community work / training as envisaged under options (a) or (b) could work against the client focused nature of the IEA approach.

Training

51. In costing the models, consideration has been given primarily to community placement as this under current settings, this is the major focus of activities (85% of placements are into work, with 15% in training). To the extent that it was desired to shift the focus of the programmes towards training, further consideration will need to be given to:

- what types of training would be included within the scope of the programme? This could have implications for the interface between this programme and the remainder of the education and training system;

- issues related to trainee motivation if participation on training courses is compulsory;

- duration of training - will courses be of two days duration or will the first two days of a training course per week be assessed as "counting towards" the mandatory requirements under this programme;

- how will the community work and training portions of this programme interface with each other?;

- will the training provided be required to be linked to the New Zealand Qualifications Framework? This would have flow-on implications in terms of course cost and provider supply; and

- trainee outcomes. If one of the major outcomes of training becomes participation in subsidised community work, leverage over training providers to obtain unsubsidised employment outcomes will diminish.

Legislative Implications.

52. Implementation of the model is likely to require amendments to the Social Security Act. Consequential amendments may also be required to other pieces of legislation in order to clarify the relationships between the job seeker, the sponsor organisation and the Crown in terms of the Health and Safety in Employment Act and ACC. An assessment of the policy would also need to be made in terms of its consistency with the Human Rights Act and New Zealand's obligations under International Conventions, particularly those which are aimed at ensuring that work is as productive as possible. Consideration would also need to be given to where the burden of care rests where the action of a job seeker causes injury to individuals or the wider community.

Appendix A

Stock of registered job seekers receiving a work-tested benefit, July 1997

This appendix details the assumptions underlying projected register stock in July 1997.

Projected number of registered job seekers receiving a work-tested benefit July 1997

Jobseeker group	26 weeks and more9	Total register
Work-tested registered job seekers receiving benefit October 1996	59,650	122,301
Full-time work-tested beneficiaries added to the register April 199710	2,981	7,097
Part-time work-tested beneficiaries added to the register April 199711	5,513	13,000
Total work-tested registered job seekers on 1 July 1997	**68,144**	**142,398**

These numbers were calculated using the following assumptions:

(i) no change in registered unemployment due to other factors.

Note: most forecasters are expecting either no change in the HLFS unemployment rate, or a very slight rise to March 1997 followed by a slight fall by March 1998:

	March 1996 (actual)	March 1997 (forecast)	March 1998 (forecast)
Tsy (PREFU) (seas adj)	6.2	6.3	6.1
NZIER (seas adj)	6.2	6.2	6.1
Consensus (ave) (unadjusted).	6.5	6.6	6.4
NZIER (unadjusted)	6.5	6.6	6.4
NZIER (number)	116,000	120,000	118,000

Registered unemployment numbers, although consistently higher than the HLFS measure, have generally followed a similar trend to the HLFS.

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[9] On 1 April 1997, several new groups of beneficianes will be work-tested, resulting in an increase to the register. While the number of those on the register who have been there 26 weeks or longer will occur later in the year as their duration increases, we included them now to indicate a standard number for the year.

[10] Unemployment Benefit (UB) spouses with no dependent children or with a youngest child over 14 years will be subject to a full time work test from 1 April 1997.

[11] DPBs or widows beneficiaries with no dependent children or with a youngest child over 14 years will be subject to a part time work test.

(ii) that the increase in the register from 1 April 1997 due to the extension of work testing to additional groups will have the following impact on stock:

Estimated Stock of Newly Work Tested Beneficiaries12

Category	Estimated Stock
Full-time work test (UB spouses with no dependent children or youngest over 14 yrs):	**7,097**
Part-time work test:	
DPBs with no dependent children or youngest over 14 yrs	10,094
Widows beneficiaries with no dependent children or youngest over 14 yrs	3,032
Total:	**13,126**

(iii) that the number of long-term job seekers (26 weeks plus) as a percentage of the total remains constant at 42 percent.

[12] Estimates of the stock (as at July 1996) of newly work tested beneficianes were made previously as part of the ETF response work. In the time available, it has not been possible to update this data.

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'ONE STOP SHOP' - NEW ZEALAND EMPLOYMENT SERVICE, INCOME SUPPORT SERVICE, COMMUNITY EMPLOYMENT GROUP, EDUCATION TRAINING SUPPORT AGENCY INTO A "ONE STOP SHOP" FOR UNEMPLOYED JOB SEEKERS UNDER ONE ADMINISTRATIVE REGIME

Costing Request

1. On 30 October 1996 you requested the approximate cost and practical implications of integrating the New Zealand Employment Service, Income Support Service, Community Employment Group, and Education and Training Support Agency into a "one stop shop" for unemployed job seekers under one administrative regime.

Summary

2. The option specified draws together the income support services for work tested beneficiaries with the employment services of NZES and the Community Employment Group, and the training purchase of ETSA, into a one-stop shop. Duplication of the existing Income Support shop-fronts under this arrangement leads to a significant increase in transitional and ongoing costs and operational risks. Alternative options could be explored which are likely to be more effective and cheaper.

Costing Assumptions

3. Several standard assumptions have been used:

- intangible costs are not included;
- costings are given on a nominal basis;
- the full year costing of the policy is given, starting in 1997/98;
- the costing is for the *initial* impact of the policy change. Any second-round effects with fiscal implications (for example behavioural changes macroeconomic effects, interaction with other policy changes etc.) have been excluded;
- GST costs are excluded

- a savings ratio of 5% is applied to any transfer payment or tax changes;
- depreciation and other additional operating expenses (arising from capital expenditure proposal) are included;
- finance costs are included where the initial operating balance impact of the policy is $50 million or more per year.

4. The following additional assumptions have been made:

General

The Organisational Model

For the purposes of this exercise it is assumed that the "one-stop shop" is a new delivery service within an existing Departmental structure. This new service shall hence forth be referred to as " the new entity". The new entity would combine the functions of the:

- New Zealand Employment Service;
- the Community Employment Group;
- that aspect of Income Support which deals with the total income support needs of work-tested beneficiaries[1] (core benefit entitlement and supplementary assistance); and
- that aspect of the Education and Training Support Agency which deals with the Training Opportunities Programme.

5. Work-tested beneficiaries would access both the core benefit and any supplementary assistance through this entity. Non work-tested beneficiaries for example, Sickness Beneficiaries, Invalid beneficiaries, superannuitants, non work tested DPBs would continue to access income support services through the current means.

[1] Unemployment beneficiaries, unemployment beneficiaries spouses, DPB and widows beneficiaries with youngest child aged 14 years and over, training benefit, independent youth benefit, 55+ benefit, and emergency unemployment benefits (e.g., students, etc).

6. The new entity would have a local "shop-front" presence. As the diagram below indicates, it is assumed that upon arriving at the service delivery site, the client would have their needs clarified at a general level. The client would then be introduced to the relevant specialist needs assessor (employment or income support). Access to employment or income support assistance would be based on these assessment processes. There would however be one enrolment process with all client information collected once only. The model presented provides an initial structure and it is likely that over time there will be further integration of the services provided by staff in the One Stop Shop.

7. The new entity would also purchase training and employment assistance. This function would not be located in the "shop front" or visible to the client. Information would be available to front-line staff to facilitate the referral of job seekers to appropriate training. Due to the nature of its operation, CEG currently does not have, or require, a shop front operation as its field workers transact their business out in the community. In some cases its field workers would use the "shop front" as a base.

8. It is assumed that as with the current system, non-work tested beneficiaries and others seeking to enter the labour market would be able to register with the new entity in order to gain access to pre-employment and employment related assistance.

9. The new entity would be responsible for assessing and approving income support entitlement, for instigating fraud investigations and establishing debt in relation to its clients. It would not be responsible for :

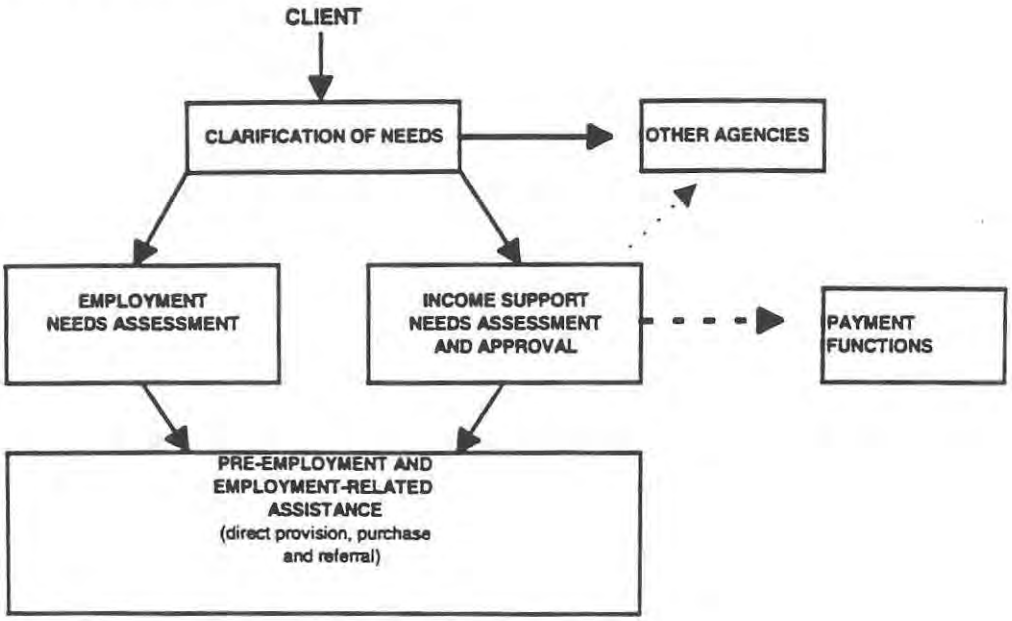
- benefit payment - currently Income Support uses TRITEC for the payment function; and

- the investigation of benefit fraud or debt collection - these functions are carried out by specialised units within Income Support.

10. These activities would be contracted out to another part of the parent Department or to an external agency. No costs have been included in the costings provided to cover this activity.

11. New review and appeal structures will need to be developed within the new entity. . No costs have been included in the costings provided to cover this activity.

INITIAL STRUCTURE OF NEW ENTITY



New Entity

- In the order of 130 shop front sites will be established. This number is based on the existing Income Support outlets. The number of 130, while slightly larger than the current NZES network, was used to ensure that there would be no decrease in the availability of service to clients. These will be supported by some form of area or regional structure which would include the purchase of training and employment assistance functions. There will also be a national office in Wellington.

- Will include all staff (2187) currently employed in the separate agencies working in the areas specified in the description of the organisational model above. There will be staff savings over time but at this stage it is not possible to identify where these will be achieved or their quantum.

- Assumes establishment of the new entity during 1997/98 with implementation costs incurred during the 1997/98 financial year. The new entity would be fully operational from 1 July 1998.

- There will be additional costs to cover fraud investigation and debt management. No provision has been made in the costings to cover these activities, although it may be possible to provide these services from the existing Income Support units.

- There will be additional costs to cover the establishment of new review and appeal processes. No provision has been made in the costings to cover these activities

- There are likely to be some reductions in the Department of Social Welfare or Department of Labour corporate and support costs arising from the reduction in the scope of Income Support operations and size. There may also be some increase in costs at the corporate level for the new entity. These savings and costs are non-quantifiable at this stage.

Buildings and fitout

- The lease for the new premises (based on Income Support recent experience) will be $300per m^2 (average of $250 and $350 currently experienced). The space allocation per person (based on Income Support recent experience) is 23 m^2

- Fitout, associated building costs and PC leasing have been estimated on the basis of recent Income Support costs.

Operating

- Marketing for the new entity will be $7.5 million per year. This is an existing cost. It does not represent an additional cost.

- There will no be additional costs for consumables, travel or communications above that currently budgeted within the existing organisations.

IT assumptions

- The IT assumptions and consequent costings require significant technical review.

- It is assumed in the short term that the current databases within Income Support and NZES will be utilised within the new entity. The costs only reflect the additional costs to be incurred by the new entity. The new systems infrastructure of NZES can be used in the new entity without any redundancy.

- The model is built upon the assumption that there will continue to be separate databases with income related and employment related information. There will be enhanced connectivity between these databases and staff of the new entity will have immediate access to complete client information. (The possible privacy implications of this are referred to in the section on practical implications.)

- A second option for IT provision has been identified but not fully costed. This would involve the replication of part of the Income Support system within the new entity. This would entail an additional annual lease cost in the order of $4million. The appropriate system would need to be confirmed in the technical review referred to. In the longer term when the new entity develops their own system, there may be additional cost.

- CEG is about to rebuild its IT system and the cost of integrating with the new entity would be marginal.

- The costs of integrating the ETSA information system have not been identified or included in these costings. It has been assumed that, at least in the initial stages, the current ETSA information system would continue to be used. There is no direct interface between ETSA and individual work-tested clients.

Income support related assumptions

- The new entity will require the equivalent of 910 front-line staff currently employed by Income Support (this is the number of staff currently employed to provide customised service to work-tested beneficiaries)

- The creation of the new entity will require an additional 220 people at an estimated cost of $8.69 million (these people are in addition to the current 910 Income Support staff who will transfer to the new entity at no direct additional salary cost).

  (a) 50 of the additional people are related to increased transactions due to registration and assessment in two agencies when transferring between benefits and will be split between the new entity and Income Support.

  (b) 170 relate in the loss of efficiency in the new entity (relative to Income Support), as the new entity will not have access to Income Supports telephone call centre (which has reduced Income Support's front-line staffing requirements).

- The inability to exit current Income Support sites means the Income Support property costs will remain at the current level. This will result in an increase in the per unit output price for Income Support (but no additional total cost).

Employment related assumptions

- The total staff (1020) and resources of NZES will be moved to the new entity and the current NZES national office structure will be absorbed into the new entity .

- The total staff (87) and resources of CEG will be moved to the new entity with its existing structure, functions and focus.

Property

- NZES will retain 35 of its 104 existing offices. The balance of the existing leases will be bought out as the existing office accommodation will be too small to house the number of staff in the new One Stop Shop. This assumption has been based on an average office size of 15 staff. The cost of the lease buy out has been costed at $5.833 million

- The cost of buying out CEG leases is $500,000, based on current commitments.

Redundancies and Associated Costs

- It has been assumed that between 10% and 20% of staff required to transfer from Income Support and NZES to the new entity will not take up the opportunity. There will be additional costs arising from redundancy payments for these staff, recruitment of replacements, and training of replacements.

  Costs associated with these activities have derived from recent experience with redundancies, recruitment and training in Income Support and NZES. The total additional cost is between $8.4 million (assuming 10% do not transfer) and $16.8 million (assuming 20% do not transfer).

Education and training assumptions

- The current personnel budget for staff (170) delivering TOP in ETSA is $8.3 million.

- All 170 staff delivering TOP will transfer to the new entity

- The cost of buying out ETSA leases is $5 million based on current commitments and taking into account that these are "younger" leases

- The response to this question has been based on the information held by the Ministry of Education on the Education and Training Support Agency. No information has been sought directly from the Education and Training Support Agency

Policy Costing

The above policy will have the following fiscal impacts on the Crown's financial statements:

Fiscal Impact[2]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance[3]	(55) to (65)	(30) to (30)	(30) to (30)
Finance costs	(5) to (5)	(5) to (5)	(10) to (10)
Total impact on operating balance	(60) to (70)	(35) to (35)	(35) to (35)
Net worth (cumulative)[4]	(60) to (70)	(95) to (100)	(130) to (140)
Cash flows[2]	(80) to (90)	(30) to (30)	(30) to (30)
Net public debt (cumulative)[2]	(80) to (90)	(115) to (120)	(145) to (155)

Comment

- In calculating the financing costs on the capital expenditure the expenditure is assumed to be made on 1 July 1997. This is because the capital is required to be in place as at 1 July 1997.

- Costings are based on merging of current operations, and do not take account of potential longer term efficiencies.

- There is a risk that the restructuring costs associated with establishing the new entity may be larger than those included in these costings. This would occur if more than 20% of the affected staff refuse to move to the new entity.

- IT assumptions in particular are subject to technical review, and represent initial estimates only.

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[2] A positive number indicates an improvement in the fiscal position.
[3] Costs have been rounded to the nearest $5 million.
[4] These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

Practical Implications

12. Increasing the number of existing NZES sites to duplicate the current Income Support 'shop-front' network (so as to maintain existing levels of access to income related services for work tested beneficiaries) results in signficant additional transitional and ongoing costs. Other key cost drivers include redundancy costs and the loss of planned efficiencies in the delivery of Income Support services.

13. The approach that has been costed in response to the request (the integration of income and employment related services for unemployed job seekers) is one approach along a spectrum for closer co-ordination of employment and income related services to provide 'one-stop shops' for unemployed job seekers. The approach costed integrates services for work tested beneficiaries, but in doing so fractures the current integration of income services which applies for all beneficiaries (work tested or non-work tested).

14. At one end of the spectrum would be the acceleration of the existing co-location programme which Income Support and NZES are already pursuing. This approach provides a low cost means of providing all services in one locale (although separate systems are maintained). In the last eighteen months 30 NZES offices (out of a total of approximately 100) have co-located with Income Support Offices. In other cases cross-location (the placement of a NZES staff member in an Income Support office, or vice versa) has occurred to facilitate co-ordinated service delivery from one site. A core feature of the current redesign of Income Support and NZES computer systems has been to enable an effective interface between the two agencies.

15. At the other end of the spectrum is the full integration of income and employment services for all beneficiaries (not just work-tested beneficiaries). The full integration approach would provide a 'seamless' income/employment assistance system, with one institutional point of contact for all beneficiaries, although possibly to the detriment of the efficacy of the employment focus, and employment outcomes.

16. The model which has been used for the basis of the costing is essentially a 'startup' entity in the way that it operates, in that the current separation of income and employment specialists are retained within the new entity. Over time, and as the new entity matured, it would be expected that a more integrated approach would be taken to the provision of these services (although some specialist staff would be likely to be retained for more complex procedures). The ongoing refinement of procedures within the new entity is likely to generate savings over time (in much the way as has occurred with the current Income Support Service), although these are not able to be quantified at this stage.

17. Whilst integration of income and employment services for work tested beneficiaries is likely to have benefits, it also creates some new interface issues. Currently all income services are provided by Income Support. Under the model that has been costed, income services would be split between Income Support and the new entity (depending on the status of the beneficiary receiving them). There is currently a great deal of migration between work tested and non-work tested benefits (e.g, currently 25% of new sickness beneficiaries have moved from the Unemployment Benefit to Sickness Benefit). Inter-benefit migration is currently managed by the one entity (Income Support). The dual income services structure that has been costed creates a new interface which this migration must be managed across. This may give rise to increased potential for debt creation and benefit fraud.

18. In addition to the new entity / Income Support interface, the new entity will need to replicate a number of the existing interfaces between Income Support and other entities (e.g., ACC, health, CYPS, IRD). Duplication of interfaces may give rise to increased transaction costs.

19. The critical interface for assisting people from welfare to work, is with IRD. Ensuring effective and timely communication between agencies, particularly with respect to GMFI, Family Support, child support and independent family tax credit entitlements, is key to assisting people into work.

20. A further issue to consider is whether the focus of the new entity (across both income and employment matters, with a family focus for income and an individual focus for employment), may be so broad as to undermine the effectiveness in meeting either objective, or whether one or other objective will come to dominate the other (for example income support services may become the focus of the organisation to the detriment of employment assistance). Careful corporate structuring and management may minimise this risk.

21. Whilst individual clients directly access the services of Income Support and NZES, CEG focuses on facilitating employment initiatives with disadvantaged community groups, and ETSA purchases training from a range of providers. Inclusion of CEG and ETSA in the new entity may not, therefore, directly contribute to providing a one-stop shop for individual clients.

22. Implementation of the model costed may have legislative implications, particularly with respect to the Social Security Act and the delegation of the Director-General of Social Welfare's powers. There may also be Privacy Act implications relating to the holding and transfer of information by the new entity.

23. Maintaining consistency of operation policy relating to income support, and the application of operational policy at the front-line level, would require careful attention. Application of discretionary powers by front-line staff in Income Support offices is already variable. Variability is likely to be exacerbated under a dual income services model.

CONFIDENTIAL

GF No: 504/3
Copy No:

5 November, 1996

WHAT IS THE COST AND PRACTICAL IMPLICATIONS OF CREATING REGIONAL EMPLOYMENT COMMISSIONERS TO OVERSEE A CO-ORDINATED APPROACH TO REGIONAL EMPLOYMENT?

Introduction

1. On 30 October 1996, you requested a costing and the practical implications of creating Regional Employment Commissioners to oversee a co-ordinated approach to regional employment. The original request is attached.

Costing Request

"What is the cost and practical implications of creating Regional Employment Commissioners to oversee a co-ordinated approach to regional employment?"

Costing Assumptions

2. Several standard assumptions have been used:

- intangible costs are not included;
- costings are given on a nominal basis;
- the full year costing of the policy is given, starting in 1997/98;
- the costing is for the *initial* impact of the policy change. Any second-round effects with fiscal implications (for example behavioural changes macroeconomic effects, interaction with other policy changes etc.) have been excluded;
- GST costs are excluded;
- depreciation and other additional operating expenses (arising from capital expenditure proposal) are included.

3. The following additional assumptions have been made:

- Costings have been provided for 20 (based on the former Regional Employment and Access Councils [REACs]) and 40 Commissioners (roughly the number of Local Employment Co-ordination Groups);

- The existing Local Employment Co-ordination network will be discontinued. There are currently 37 local co-ordination groups established throughout New Zealand. Their membership comprises representatives of local offices of government departments and agencies, along with local organisations with an interest in employment and/or local development. Each group is co-ordinated by a member of the staff of either the New Zealand Employment Service or the Community Employment Group. It was envisaged that in the longer term co-ordinators would be drawn from a broader cross section of the community. Overseeing the network are two Managers, Local Employment Co-ordination supported by one executive assistant.

- One full time secretarial assistant for each commissioner has been costed at $34,000 (salary only). It is assumed that this resource will be sufficient to support both a Regional Commissioner and a Regional Employment Committee.

- It is assumed the Regional Commissioners will be in place on 1 July 1997.

- No public relations or marketing costs have been included.

Basis of costings

4. The costings have been made on the basis of figures supplied by the Department of Social Welfare and the Department of Labour.

5. The Commissioners' salaries have been based on an average of $50,000 with an expected range of between $45,000 - $70,000. The upper limit is based on the salary budgeted for Managers, Local Employment Co-ordination.

6. The fit-out for each office has been costed at $27,500.

Commissioner activities

7. No attempt has been made to cost initiatives Commissioners may undertake in the community.

Savings

8. The cost of winding up Local Employment Co-ordination (LEC), including the cost of any redundancies, will be met from the balance remaining from the $1.573 million appropriated for 1996/97. In subsequent

years the $1.573 million will be available to off-set the cost of the Regional Employment Commissioner network.

Policy Costing

9. The above policy will have the following impact on the Crown's financial statements:

Fiscal Impact[1]	1997/98 $m	1998/99 $m	1999/2000 $m
Operating Balance	(0.8) to (3.2)	(0.6) to (2.8)	(0.6) to (2.8)
Net Worth (Cumulative)	(0.8) to (3.2)	(1.4) to (6.0)	(2.0) to (8.8)
Cash flows	(1.3) to (4.3)	(0.6) to (2.8)	(0.6) to (2.8)
Net public debt (cumulative)	(1.3) to (4.3)	(1.9) to (7.1)	(2.5) to (9.9)

Practical Implications

10. Many of the practical implications relating to the Regional Employment Commissioners also relate to the establishment of the Regional Employment Committees.

11. The cost of establishing Regional Employment Commissioners is minor in comparison to the fiscal pressure that may arise from expectations created within their regions, and the extent of their role in overseeing a co-ordinated approach to regional employment (for example the degree to which this involves development of new or expanded initiatives).

12. The key to effective implementation of such a policy would be clarity regarding the accountabilities of the Commissioners (for what, and to whom), and their relationship with the Regional Employment Committees.

Local vs Regional Focus

13. A large number of commissioners will be better able to respond to the needs of individual communities and labour markets than a small number of commissioners operating on a regional basis.

14. The experience from the Regional Employment Access Councils suggests that the more commissioners established the greater will be the desire from them to establish some form of national co-ordinating mechanism to facilitate networking and sharing examples of good practice.

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[1] A positive number indicates an improvement in the fiscal position

15. This has not been allowed for in the costings.

CONFIDENTIAL

GF No: 504/4
Copy No:

5 November 1996

WHAT IS THE COST AND PRACTICAL IMPLICATIONS OF CREATING REGIONAL EMPLOYMENT COMMITTEES WITH RESPONSIBILITY FOR WORKING WITH THE REGIONAL EMPLOYMENT COMMISSIONERS TO ESTABLISH SHORT AND MEDIUM TERM EMPLOYMENT PLANS?

Introduction

1. On 30 October 1996, you requested a costing and discussion of the practical implications of creating Regional Employment Committees with responsibility for working with the Regional Employment Commissioners to establish short and medium term Employment Plans. The original request is attached.

Costing Request

What is the cost and practical implications of creating Regional Employment Committees with responsibility for working with the Regional Employment Commissioners to establish short and medium term Employment Plans?

Costing Assumptions

2. Several standard assumptions have been used:

- intangible costs are not included
- costings are given on a nominal basis
- the full year costing of the policy is given, starting in 1997/98
- the costing is for the *initial* impact of the policy change. Any second-round effects with fiscal implications (for example behavioural changes macroeconomic effects, interaction with other policy changes etc.) have been excluded
- GST costs are excluded
- depreciation and other additional operating expenses (arising from capital expenditure proposal) are included
- finance costs are included where the initial operating balance impact of the policy is $50 million or more per year

3. The following additional assumptions have been made:

- Costings have been provided for 20 (based on the former Regional Employment Access Councils [REACs]) and 40 (roughly the number of Local Employment Co-ordination Groups)

- Costings have been provided for committees meeting 1 and 2 days a month.

- Costings have been provided on the basis of each Regional Employment Committee having 10 members. Based on experience of the Regional Employment and Access Councils and other community committees at least this number is needed to ensure a wide community representation.

- That the current Local Employment Co-ordination network will be discontinued.

- That the role of the regional commissioners and committees will be to co-ordinate and not deliver or directly purchase services.

Costings

4. The costings have been based on the lower end of the SSC scales of daily fees for statutory boards and committees ($140 per day). Staff salary costs have been based on a mid-point of a range of salaries for executive assistant positions.

5. No attempt has been made to cost the implementation and monitoring of the employment plans or any other work that the committees may undertake.

Policy Costing

6. The above policy will have the following impact on the Crown's financial statements:

Fiscal Impact[1]	**1997/98 $m**	**1998/99 $m**	**1999/2000 $m**
Operating Balance	(1.0) to (3.7)	(1.0) to (3.4)	(1.0) to (3.4)
Net Worth (Cumulative)	(1.0) to (3.7)	(2.0) to (7.1)	(3.0) to (10.5)
Cash flows	(1.0) to (3.7)	(1.0) to (3.4)	(1.0) to (3.4)
Net public debt (cumulative)	(1.0) to (3.7)	(2.0) to (7.1)	(3.0) to (10.5)

[1] A positive number indicates an improvement in the fiscal position

Practical Implications

7. The cost of establishing Regional Employment Committees is minor in comparison to the fiscal pressure that may arise from expectations created within their regions. It has been assumed that the function of the Regional Employment Committees is confined to planning. It is, however, likely that these groups would become focal points for other activities ranging from employment related projects to regional economic development schemes. This will result in additional fiscal risk to the Government.

8. The key to effective implementation of such a policy would be clarity regarding the accountabilities of the Committees. Experience with other bodies which are representative in nature is that there is a tension between representation of their constituencies and their accountability to Government.

Local vs regional focus

9. A large number of RECs will be better able to respond to the needs of individual communities and labour markets than a small number of RECs operating on a regional basis.

National co-ordination

10. The experience from the Regional Employment Access Councils suggests that the more RECs established the greater will be the desire from them to establish some form of national co-ordinating mechanism to facilitate networking and sharing examples of good practice.

11. This has not been allowed for in the costings.

1 November 1996

RESPONSE TO REQUEST 505, FROM HON JENNY SHIPLEY

RE POLICY ADVICE ON SUPERANNUATION: COMPULSORY SCHEMES, ISSUES FOR WOMEN AND MAORI

The Ministry of Women's Affairs has been approached to provide information on equity issues and also the impact of compulsory superannuation schemes on minority groups and, in particular, Maori women and Maori in general.

In response to this request, I have outlined a brief summary of the key issues below. I am also providing the following documents which discuss these issues in more depth both in the New Zealand context, and to some extent from an overseas perspective.

The documents enclosed are:

"The Changing Situation of Women and their Opportunities to Save for Retirement" Judy Lawrence, Chief Executive of the Ministry of Women's Affairs. Keynote Address to the Women and Retirement Income Conference, Wellington, 5 June 1996

"Retirement Issues for Women" Susan St John, Senior Lecturer, Economics Department, University of Auckland. Address to the Women and Retirement Income Conference, Wellington, 5 June 1996

"Into the twenty-first century: Where to for Women?" in *Private Pensions in New Zealand: Can They Avert the 'Crisis'?* Susan St John and Toni Ashton, Institute of Policy Studies, Victoria University of Wellington, 1993, pages 191 - 216

Maori Women and Private Provision for Retirement. Te Whakarite Whai Oranga mo te Wa e Kuia ai te Wahine Maori. Paper prepared by Te Ohu Whakatupu, Ministry of Women's Affairs, January 1993

"The Compulsory Option", from *Private Provision for Retirement. The Way Forward.* Final Report of the Task Force on Private Provision for Retirement. December 1992. Pages 49 - 62

Women and Superannuation. A Comparative Analysis: NZ, the USA, Australia and the UK. Paper prepared for the Ministry of Women's Affairs by Susan St John. November 1992

Retirement Income Issues for Women Paper prepared for Prime Minister's Conference on Superannuation. Ministry of Women's Affairs, Wellington, April 1991

Income Security for Older Women Marion Bywater. Ministry of Women's Affairs, 1989

Discussion

a) Compulsory superannuation schemes and their impact on women

The references above discuss the impact of compulsory superannuation on low income people, which includes many women, Maori and other minority groups. The 1992 Task Force identified that a compulsory scheme would need to provide a minimum level of provision, despite the level of payments from individuals. Contributions would be similar to an additional tax for those low income people, without additional benefit.

The 1992 Task Force also noted that solutions to the treatment of people who do not earn income and therefore cannot contribute because of their unemployment, or disability or illness, or their responsibility for caring for others, would be administratively complex.

A further issue raised by the Task Force and also St John (1996) was the differential levels of annuities which a compulsory scheme would deliver to women and men, and to Maori and non-Maori, because of their differences in life expectancy.

b) The impact of superannuation on minority groups and Maori, and in particular Maori women

The response to a) above canvasses the most relevant issues for Maori in general and particularly for Maori women as these are over-represented among people with lower income levels and lower life expectancy, compared with the general population.

c) Overseas material

The papers by St John (1992 and 1996) and the extract of the book by St John and Ashton (1993) all refer to retirement issues for women in a selection of overseas countries.

St John (1992) explains how the regimes in these countries differ. The USA has a compulsory private scheme, with a supplementary security income payment, Australia introduced compulsory superannuation in 1986, and the UK has had an earnings related pension scheme since 1978.

The report concluded that:

> "In the USA, ironically, as more women participate in the workforce and gain rights to substantial pensions, there is the danger that some couples will be over-pensioned especially if they also have substantial private pensions. Many others, however, face inadequate pensions and stigmatising social assistance top-ups. Overall, social security in the USA is far less redistributive in its impact than the state pension in New Zealand, both in the way that it is funded and in its earnings-related benefits. It appears far less successful in ensuring all women a fair and adequate retirement income."
>
> and
>
> "The Australians and British have tried to forge a partnership between the state and the private sector, with complex compulsory earnings related superannuation. In both cases, if the fundamental inequalities that women face in the workplace and their lower participation are not addressed, such an approach is likely to disadvantage women who must rely on state provision which may become much less adequate over time."

NOTE:

This information has been provided within a twentyfour hour period and is therefore not in the nature of a full policy briefing. No attempt has been made to provide an analysis of the information attached setting out advantages and disadvantages of the issues raised. The Ministry would be happy to provide a further briefing on this subject should questions of clarification arise.

8 November 1996

POLICY ANALYSIS AND COSTINGS - HEALTH QUESTION 506

Part A Child Health

Introduction and Costing Request

1 On 1 November 1996 officials received a request to:

2 "advise on the pros and cons of removing the part-charges for doctors' visits and on prescriptions so that both are free to the user for the following age groups:

- 0-5 years
- 0-7 years
- 0-12 years

3 In doing so please provide accurate costings for each of the above."

4 The original request is attached.

Summary

5 Child health is currently identified (along with Maori health and mental health) as one of the Health Gain Priority Areas which RHAs have been asked to give particular emphasis to over the medium term by improving outcomes through the purchase of cost-effective health and disability support services.

6 Removing the part-charges for doctors visits and on prescriptions so that they are free for children of certain age groups would remove actual or perceived affordability barriers. Utilisation will increase and some of the increased utilisation will be appropriate and will improve health outcomes and reduce hospital admissions. However some of it may be inappropriate, in that it does not provide any additional health improvement. With a greater understanding of the particular access issues which are causing concern for particular groups of children, it may be possible to develop policies which target need with more precision and achieve the same gain in health outcome in a more cost effective manner. Some of these may involve alternatives other than GP services.

7 Of the three age bands presented for costing and analysis, the greatest health benefit would be derived from targeting the under 5 age group. The additional health gain of extending the age group from five year olds to age twelve is expected to be less than removing user part-charges for pre-schoolers. The main reason for this is that children require primary health care for prevention, diagnosis and treatment reasons more frequently in the pre-school years.

8 There are some major implementation issues which need to be considered:

- the most significant issue is the need for additional contracting, regulatory or other mechanisms for ensuring that GPs provide their services free to the users, and continue to do so over time. In essence, this would require price regulation and could involve significant opposition from GPs. Other approaches might take significant time to implement and might not guarantee that all GP services were free to children.

- consideration of the manufacturer's premium on some pharmaceuticals - in order to make every prescription item free for children, some consideration would need to be given to manufacturers' premiums. The objective of free prescriptions on the one hand would need to be balanced against compromising the PHARMAC negotiating strategy on the other.

- consideration of actions that would need to be taken to ensure that the funding of the ACC for this purpose is reduced accordingly. It is expected that this would impact mostly on the non-earners account. Further work is required to assess the process details and amounts involved.

- some GPs are already providing free visits to children to meet perceived need. Implementation plans would need to take this into account.

9 The fiscal impacts of the policies on the operating balance (excluding GST) are summarised in the following table.

Fiscal Impact[1]	1997/98 $m	1998/99 $m	1999/2000 $m
Impact on operating balance			
Children 0-5			
GMS	(55)	(55)	(50)
Pharmaceuticals	(10)	(10)	(10)
Finance Costs	(0)	(5)	(10)
Total	(65)	(65)	(70)
Children 0-7			
GMS	(65)	(65)	(65)
Pharmaceuticals	(10)	(10)	(10)
Finance Costs	(5)	(10)	(10)
Total	(80)	(85)	(90)
Children 0-12			
GMS	(80)	(80)	(85)
Pharmaceuticals	(15)	(15)	(15)
Finance Costs	(5)	(10)	(15)
Total	(100)	(110)	(115)

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

[1] A positive number indicates an improvement in the fiscal position.

10 The following risks are associated with the costings:

- the costings may underestimate utilisation
- GPs may not accept the "average" fee of $35
- future pressure on the Government (or purchaser) to inflation-adjust payments.

Assumptions

11 Several standard assumptions have been used:

- intangible costs are not included
- the full year costing of the policy is given, starting in 1997/98
- expenditure costs are GST exclusive
- the costing is for the *initial* fiscal impact of the policy change. Any second-round effects with fiscal implications (for example, macro economic effects, interaction with other policy changes etc) have been excluded
- finance costs are included where the initial fiscal impact of the policy is $50 million or more per year.

12 The following additional assumptions have been made:

Key assumptions

13 It has been assumed that:

- the scope of the request relates to primary care. For this reason children's visits to hospital specialists have not been included in the scope of this exercise.
- GP visits for children would be made free by increasing the general medical services benefit (GMS), or RHA-paid equivalent, to the equivalent level of the average GP fee so that the GP's user charge would be expected to reduce to zero.
- other mechanisms would be required to ensure that the total cost to the user is free and remains so over time (eg purchaser contracts with providers, regulation and purchaser contracts, or funding agreements with the Crown). These mechanisms would be critical to the successful implementation of the policy.
- pharmaceutical user part-charges would be removed, but any manufacturer's premium (the difference between the PHARMAC subsidy and the manufacturer's price, paid by the user) would remain. This issue is covered in further detail further in the paper.
- in order for *all prescriptions* to be free for children, the manufacture's premium would need to be addressed. It has not been possible to address this issue within the scope of this request for information and analysis.

- children's visits to private specialists are outside the scope of this exercise, as private specialists do not provide publicly-funded services (although prescriptions generated by private specialists are included in the costings as they are currently publicly funded).

14 Technical (costings) assumptions

- Fees charged by doctors and prescription prices have been kept constant over the outyears at forecast 1997/98 levels. No CPI adjustment has been included.

- For the purposes of costings, the age groups have been interpreted to mean:

  0-5 years = under 5 years (ie children aged 0-4 inclusive)[2]
  0-7 years = 7 years and under (children aged 0-7 inclusive)
  0-12 years = 12 years and under (children aged 0-12 inclusive).

  The reasons for excluding children aged five years from the first age group are:

  - current GMS benefit coding classifies children 0-4 in one group and this data is considered to be more reliable for costing purposes than estimating for those 0-5
  - the age group 0-4 captures pre-schoolers accurately.

- The average cost of a GP visit used in these costings includes GPs working in 'regular' practices. It is not clear from existing data what proportion of GP visits are made to After Hours Clinics.

- This costing excludes any assumptions about additional subsidies paid for children's visits in addition to GMS subsidies. ACC payments are excluded and this issue is discussed further in the text.

- These costings assume that for every 10% reduction in price, a person will go to the GP 2% more often. This assumption is based on New Zealand and overseas experience.

- It is assumed that the demand for prescriptions for CSC-holder children is more responsive to price changes than that for non-CSC children. For CSC children, 10% reduction in price leads to 0.75% increase in demand. For non CSC children, 10% reduction in price results in 0.5% increase in demand. The assumption is based on Australian experience.

- Potential savings in hospital costs - as a result of earlier attendance at a GP or use of prescription items - have not been factored into the cost estimates.

- Second-order costs (such as time off work for sick children, child care, transport) are not included.

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2 0-4 years inclusive includes children up to their fifth birthday.

Policy analysis: pros and cons and costings

Description of the current regime

15 Children currently have access to some free services:

- "well-child" services, of the type provided by Plunket
- immunisations.

16 General practitioner visits and prescriptions attract user part-charges.

17 Targeting assistance for GP visits and prescriptions is achieved through the Community Services Card (CSC), which is based on family-income, and the High Use Health Card (HUHC), which is issued to individuals who visit the GP or outpatient clinic 12 times in a year for the same condition (or conditions). The HUHC offers the same benefits as a CSC.

18 The following charges and subsidies apply for children:

	General medical services (GMS) subsidy	Prescription charge per item	Prescription charge once annual 20-item family stoploss is reached
Child under 5 (CSC)	$25	$3	$0
Child over 5 (CSC)	$20	$3	$0
Child under 5 (no CSC)	$15	$10	$2
Child over 5 (no CSC)	$15	$10	$2

19 GPs may set their own fee on top of the subsidy. There is a lack of reliable information about GP charges. However, the average GP fee is assumed in the costings to be around $35. Hospital emergency departments charge non-CSC holder children $16. Visits to hospitals are free for cardholders.

20 GPs derive part of their income from RHAs (through fee-for-service arrangements, or via capitation or other contracts) and part of their income from open-ended user co-payments[3]. GPs still, in the main, have complete discretion over the level of their own fees. This makes it difficult to draw conclusions about any previous relationship between subsidy changes and patient charges. We do, however, know the following:

- GPs often charge less than their "list" price
- almost 20% of consultations result in no charge (Tilyard 1995)

21 RHA payments are not inflation-adjusted and GPs are generally free to increase their charges.

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3 A co-payment is a user part-charge.

22 Based on the table above, families currently have the following costs associated with a child's single visit to the doctor and collecting one prescription:

- CSC holder child under 5: $13 total ($10 GP plus $3 prescription)
- CSC holder child over 5: $18 total ($15 GP plus $3 prescription)
- non-CSC child under 5: $30 total ($20 GP plus $10 prescription)
- non-CSC child over 5: $30 total ($20 GP plus $10 prescription)

23 Using current average utilisation rates and the costings above, this equates to the following average level of expenditure over the course of a year:

- CSC holder child under 5: $111 total (8.50 visits)
- CSC holder child over 5: $50 total (2.76 visits)
- non-CSC child under 5: $185 total (6.18 visits)
- non-CSC child over 5: $78 total (2.60 visits)

24 As noted above, in addition to user part-charges, some prescription items attract a "manufacturer's premium", payable on some pharmaceuticals, where the manufacturer's price is higher than the price PHARMAC pays for other drugs in the same therapeutic group. These charges are borne by the user.

Criteria for assessing the pros and cons

25 The following criteria are the standard criteria currently used to assess the benefits of health policies:

1. *Health Gain:* To what extent does the proposal improve, maintain or restore New Zealanders' health, wellbeing and independence?

2. *People Centred:* Does the proposal provide more choice for consumers, make health services more responsive to individual need, or give consumers more influence over what services are provided? Does it protect consumers' rights and safety?

3. *Effective use of Resources:* Is the proposal cost-effective and is it the best use of resources at the margin?

26 The second criterion is considered not to be relevant to these proposals, as it does not change the type of primary health care services which might be made available.

Children 0-5 years (cost 1997/98 $65 million)

Key issues for this group

27 There are two main issues relating to child health which make it quite different from adult health:

1. The nature of disease in children is quite different from that of adults. Disease is difficult to diagnose in children and deterioration occurs more rapidly in children than in adults. A child under 1 is likely to have between 8-17 infections during the course of a year. Each time a

child becomes sick a caregiver has to make a decision, often in ignorance, about which infection is important and requires medical attention. If a caregiver lacks diagnostic skills and does not wish to pay for primary care, the health of the child may suffer.

2. The importance of development. Some untreated childhood illness (such as undiagnosed or untreated ear infections, or a sore throat which turns into rheumatic fever) have a permanent impact on a child's development.

28 The combination of these two issues can lead to serious health problems which are costly both in terms of loss of enjoyment of good health and resulting use of high-cost health services. An example is rheumatic fever. A disease acquired in childhood, rheumatic fever can start out as an ordinary "strep throat", easily treated with antibiotics by the GP. Untreated, the "strep throat" can lead to rheumatic fever which leads to hospitalisation, damage to the heart, and lifelong medication and poor health status. New Zealand's rheumatic fever rates are three times that of other developed nations (particularly amongst Maori and Pacific Islands people).

29 Another example is meningococcal disease. One of the key factors known to affect infection rates and subsequent outcome is access to medical treatment. During September 1996, 78 cases were reported, compared with 62 in the September 1995. The total number of deaths from meningococcal disease this year so far is 16. There were no fatalities among those seen by a doctor prior to hospitalisation who had also taken antibiotics. Recent publicity has encouraged parents to seek medical attention if their child displays symptoms which could cause suspicion of meningitis.

Pros

30 Of the three proposed groups, the greatest health benefit would be derived from targeting the 0-4 age group.

1. Remove affordability barriers

31 Several recent New Zealand studies have suggested that some families, particularly those on low incomes, may be facing affordability barriers in accessing primary care. The following data is pertinent:

- Results from the 1992/93 New Zealand Household Health Survey showed that five percent of 0-9 year olds didn't see a doctor when they should have. For over 60% of these children (3% of all children), cost was the reason. The survey also identified that 11 percent of children aged 0-4, and six percent of children aged 5-9 failed to collect a prescription in the previous 12 months. For 70 percent of these families (8% and 4% of all families, respectively), cost was the reason.

- Data from the Auckland Starship Accident and Emergency Department shows that approximately 40% of children who present have not been referred by a GP and are brought in by a family member.

- The majority of hospital admissions for children are for respiratory infections, and diarrhoea and vomiting. These are conditions which can usually be adequately managed by the GP and need not result in hospital admissions.

- The WaiMedCa study which surveyed a number of Waikato general practices during 1991/92 found that fewer than one percent of children's visits to the GP resulted in hospital admissions (results published in the New Zealand Medical Journal in 1994).

32 Anecdotal evidence, from GPs and pharmacists and consumers suggest that the numbers of people not being able to pay for primary health care is increasing. Even amongst families on average or higher incomes, there may be perceived financial barriers to seeking medical attention. The issues relate to a lack of understanding or information about health risks and illnesses or the parent's own values and priorities with respect to health care.

- Removing affordability barriers for children to GP visits and prescriptions is likely to result in fewer instances of people:

  - deferring taking a sick child to the doctor
  - not collecting prescriptions
  - sharing prescriptions
  - not finishing course of antibiotics and "saving" them for the next illness.

- It may encourage people (particularly CSC holders) away from using hospital accident and emergency (A and E) departments.

- Areas of particular concern such as preventable deaths from injury and infectious diseases such as meningococcal disease may reduce. People may also be more likely to visit the doctor for prevention activities.

- Making services free for all children would assist those average income households with two or more children who do not have a CSC or a HUHC, but whose combined use of GP services is high.

- It would ensure that all households with children receive a subsidy because of universal coverage - including those households who are currently eligible for CSC but do not take it up.[4]

[4] Although take-up rates of the CSC are close to actual eligibility rates (around 76 percent of the population who are eligible actually hold cards), recent research (Gribben 1995) suggests there are geographical pockets where uptake is significantly lower.

2. *Improving health outcomes and reducing hospital admissions*

33 Making services free so that people do not have to think about the price (and make assessments about other uses of their money) is likely to increase utilisation. This assumption is included in the costings. It is very difficult, however, to identify how much of the increased utilisation is beneficial in terms of health outcomes. In some cases, increased utilisation is likely to be effective over the longer term (in terms of reduced hospital admissions and better health outcomes). An example is encouraging people to self-manage their conditions (eg managing their children's asthma) through regular GP checkups and adherence to treatment regimes.

3. *Some IPAs are already providing free visits*

34 Since the introduction of the health reforms a number of umbrella groups representing GPs in a particular area have emerged. These are known as Independent Practitioner Associations (IPAs).

35 There appears to be an increasing identification by IPAs of free visits (or additional assistance) for children under 5 as the best use of savings derived from prudent budget-holding[5]. This indicates that this group is assessed to be a high priority by GPs themselves and that positive health outcomes will result.

36 The advantages of central implementation of this approach are:

- remove disparities between GPs providing free visits and GPs who charge children
- increased likelihood that the zero co-payments would be sustainable over time, rather than subject to fluctuations in GP budget-holding gains.

37 As the costings assume that GPs currently providing free services would also receive fee increases, this would free up resources for GPs to direct to other priorities.

Cons

1. *Would benefit those who can already afford to visit the doctor most*

- The change would provide greatest financial benefit to those families without a CSC. As shown previously, the annual cost of visiting the doctor is greatest for a non-CSC holding child under five. The lowest average cost per year is for CSC holders over five.

  It is difficult to identify the extent to which removing charges on a universal basis would simply be providing additional (and perhaps unnecessary) assistance to those on higher incomes.

- Some prescriptions attract a manufacturer's premium which, for reasons outlined earlier in this paper, has been excluded from the costings. Some degree of affordability barrier may, therefore, still exist - mainly where doctors choose to prescribe higher priced medicines.

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5 Budget-holding, like fund-holding in the UK is a system where GPs are given bulk-funding (based on historical expenditure) to purchase referred services such as pharmaceuticals and laboratory tests.

- Many low income adults face a number of other barriers to accessing health care, of which the cost of the doctor's visit and prescription are but one. There is considerable international evidence which points to a range of social and economic barriers to accessing health care. Discussion of these issues is beyond the scope of this analysis.

2. Increasing utilisation may result in no additional health gain

38 Some of the increased utilisation is likely to provide no additional health benefits. Assessments of the extent of "additional benefit" are largely subject to value judgements. No attempt has been made to quantify them.

39 With a greater understanding of the particular access issues which are causing concern for particular groups of children, it may be possible to develop policies which target need with more precision.

3. Some IPAs are already providing free visits

40 Some GPs are using budget-holding savings (or are cross-subsidising patients through their fee structure) to provide free visits for children[6].

41 Reasons for allowing this to continue without central intervention are:

- encourages IPAs to continue to make savings through responsible prescribing and other budget-holding activity

- many IPAs (and other GPs such as union health clinics) are already providing free services for (low income) children under five. Funding these providers through a central policy change may result in paying them for something they are doing anyway.

- decisions about who is unable to pay may be more appropriately be made at the local level.

- GPs have been prepared to relinquish the right to determine the partial co-payment through the IPA and budget-holding approach, whereas in the past they have strongly resisted Government control of the co-payment levels (as opposed to subsidy levels).

Children 0-7 years (cost 1997/98 $80 million)

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6 Examples of IPAs with free care for under fives include: PHI Whanganui, approximately 45 GPs; WestView - Auckland, serving 7 500 patients; South Link Health Inc, 11 GPS (at time of reporting), a policy of "using savings to provide extra subsidies for children".

In addition, the following practices provide free and improved care to under fives: South Med - South Auckland, 51 GPs - serving an estimated 60 000 patients; Wellington IPA, approximately 120 GPs, this IPA is providing free wellchild checks to children in its area; Pegasus, approximately 190 GPs, Christchurch, waives fee for under-fives consultations for disadvantaged groups.

42 The children in the 0-7 group who would benefit most from the proposal are those children aged 0-4. Therefore all the advantages and disadvantages discussed in the option above also apply to this group for those under five.

43 While many of the reasons continue to be valid for those aged 5-7, the additional benefit of extending the age group beyond five years is that children in their first couple of years at school would continue to be covered. Thus, families would be more likely to take children to the GP for prevention and diagnosis, especially where schools identify and refer cases of hearing loss, vision loss and infectious or preventable illnesses.

44 The additional health gain of extending the age group to age seven is expected to be less than removing user part-charges for pre-schoolers. The main reasons for this are that children get sick less often in this age group.

45 There is no particular rationale for limiting/or extending free visits specifically to age seven (rather than, say, 10 or 16). This group can be split into the particular issues concerning children under five (covered above) and issues which relate to all children, into their teens such as ongoing primary care to treat infections and illnesses, to diagnose behavioural, developmental and learning disorders, hearing and vision problems and other health problems which manifest themselves in school-aged children).

Children 0-12 years (cost 1997/98 $100 million)

46 Again, the children in the 0-12 group who would benefit most from the proposal are those children aged 0-4. Therefore all the advantages and disadvantages discussed in the option 0-4 above also apply to this group for those under five.

47 While many of the reasons continue to be valid for those aged 5-12, or 8-12, the additional benefit of extending the age group to twelve years would be to continue coverage and protection for families as children enter adolescence. There is no particular rationale for limiting/or extending free visits specifically to age 12. The specific issues affecting 12 year olds which would suggest a reason for providing free access (contraceptive advice and sexual health, diagnosis and treatment of depression, prevention and diagnosis of drug and alcohol abuse) affect young people well into their teens.

Implementation issues and risks

Contracting/regulatory mechanism

48 The requirement for GPs to impose no co-payment would represent a move away from the status quo where GPs have historically set their own fees.

49 The most significant implementation issue, therefore, upon which the success of such a policy would be dependent, is the need for additional contracting, regulatory or other mechanisms. These are required to ensure that GPs provide their services free, and continue to do so over time. There are two broad mechanisms for achieving the objective of keeping GP services free for children:

- A central, Government-directed approach which would require price regulation. Such an approach is likely to draw opposition from GPs (as has been the experience in the past), but

would be quicker and simpler to implement. The extent to which GPs would support or oppose such a mechanism is unknown, and so the intent of providing access to free medical care may not be achieved.

- A local solution approach (eg through RHA contracts). Such an approach would take much longer to achieve full implementation (and providers would have the option of "opting out"), but would allow for contracts with willing participants and would continue the current momentum in GP contracting. Transitional pathways would need to be identified. To implement this approach, the Government would need to require purchasers to contract with providers who are able to deliver on the policy (the current mechanism for doing this would be through the RHA Statements of Intent and the Funding Agreements between RHAs and the Minister of Health). This approach could be used to ensure that at least some GP services in each geographical area were free to children in the target group.

50 A comprehensive implementation plan would need to be identified prior to implementing the preferred policy approach to ensure services are truly free to the user.

51 Note that some GPs are already providing free visits to children to meet perceived need and a plan for managing this situation may need to be developed.

Manufacturer's premia

52 The manufacturer's premium, payable on some prescription items, represents the difference in between the PHARMAC subsidy (set, through PHARMAC's reference pricing strategy, at the level of the price of the cheapest drug in each therapeutic group) and the manufacturer's price. Through this negotiating/pricing mechanism, manufacturers face pressure to keep prices down. These premia are not user part-charges; they are set by the manufacturer, not the Government or RHAs.

53 Whilst PHARMAC endeavours to ensure that at least one drug in each therapeutic group is free to the user, there are some drugs (including some drugs prescribed to children) that currently attract a manufacturer's premium. This means that for such drugs, the user can face an additional charge. An example of such an additional charge is a Ventolin Inhaler for asthma which attracts a premium of $6 to $12 per inhaler (depending on the dose). Many other drugs, such as the commonly prescribed antibiotic Augmentin, attract no premium.

54 In order to make every single prescription item free for children, some consideration would need to be given to manufacturer's premiums. The objective of free prescriptions on the one hand would need to be balanced against compromising the PHARMAC negotiating strategy on the other.

55 Manufacturer's premia have been regarded as beyond the scope of this request as they are not, strictly speaking, "part-charges" and are not set by the Government or RHAs.

ARCI payments for children's GP visits

56 The costing model excludes any assumptions about additional subsidies paid for children's visits in addition to GMS subsidies. At present, ACC also 'tops up' subsidies for children who are claimants (for those with a CSC this is $15, for those without it is $11). This means that some children's visits to GPs are currently free or 'virtually' free. The effect of removing charges would

be a gain to ARCI. Consideration would need to be given to actions to ensure that the funding of the ACC for this purpose is reduced accordingly. It is expected that this would impact mostly on the non-earners account. Further work is required to assess the process details and amounts involved.

Risks around costings

57 The policy costings are subject to the following risks:

- the costings may underestimate utilisation and demand may be greater than anticipated

- the policies may not be implementable at the average GP fee (some GPs charge considerably more than $35 per consultation) and the worst-case scenario would be paying somewhat higher than the average fee

- services being free to the user may place provider pressure on the Government or purchaser to increase level of payments due to inflation or other pressure. (The PHARMAC reference pricing strategy described above is designed to resist this type of pressure from manufacturers.) Experience in negotiating fees for other services which attract no charge to the user (maternity benefits, dental benefits) indicates that providers place considerable pressure on price increases to compensate the effects of inflation.

Specific costings

1. Free visits for children 0-5

58 The above policy will have the following estimated fiscal impact:

Fiscal Impact[7]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance			
GMS	(55)	(55)	(50)
Pharmaceuticals	(10)	(10)	(10)
Total	(60)	(60)	(60)
Finance costs	(0)	(5)	(10)
Total impact on operating balance	(65)	(65)	(70)
Net worth (cumulative)[8]	(65)	(130)	(200)
Cash flows	(65)	(65)	(70)
Net public debt (cumulative)	(65)	(130)	(200)

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

Risks around costings

59 The policy costings are subject to the following risks:

- the costings may underestimate utilisation and demand may be greater than anticipated
- the policies may not be implementable at the average GP fee (some GPs charge considerably more than $35 per consultation) and the worst-case scenario would be paying somewhat higher than the average fee
- services being free to the user may place provider pressure on the Government or purchaser to increase level of payments. (The PHARMAC reference pricing strategy described above is designed to resist this type of pressure from manufacturers.) Experience in negotiating fees for other services which attract no charge to the user (maternity benefits, dental benefits) indicates that providers place considerable pressure on price increases to compensate the effects of inflation.

7 A positive number indicates an improvement in the fiscal position.

8 These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

2. Free visits for children 0-7

60 The above policy will have the following estimated fiscal impact:

Fiscal Impact[9]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance			
GMS	(65)	(65)	(65)
Pharmaceuticals	(10)	(10)	(10)
Total	(75)	(75)	(75)
Finance costs	(5)	(10)	(10)
Total impact on operating balance	(80)	(85)	(90)
Net worth (cumulative)[10]	(80)	(160)	(250)
Cash flows	(80)	(85)	(90)
Net public debt (cumulative)	(80)	(160)	(250)

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

Risks around costings

61 The policy costings are subject to the following risks:

- the costings may underestimate utilisation and demand may be greater than anticipated
- the policies may not be implementable at the average GP fee (some GPs charge considerably more than $35 per consultation) and the worst-case scenario would be paying somewhat higher than the average fee
- services being free to the user may place provider pressure on the Government or purchaser to increase level of payments. (The PHARMAC reference pricing strategy described above is designed to resist this type of pressure from manufacturers.) Experience in negotiating fees for other services which attract no charge to the user (maternity benefits, dental benefits) indicates that providers place considerable pressure on price increases to compensate the effects of inflation.

9 A positive number indicates an improvement in the fiscal position.

10 These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

3. Free visits for children 0-12

62 The above policy will have the following estimated fiscal impact:

Fiscal Impact[11]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance			
GMS	(80)	(80)	(85)
Pharmaceuticals	(15)	(15)	(15)
Total	(100)	(100)	(100)
Finance costs	(5)	(10)	(15)
Total impact on operating balance	(100)	(110)	(115)
Net worth (cumulative)[12]	(100)	(210)	(325)
Cash flows	(100)	(110)	(115)
Net public debt (cumulative)	(100)	(210)	(325)

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

Risks around costings

63 The policy costings are subject to the following risks:

- the costings may underestimate utilisation and demand may be greater than anticipated
- the policies may not be implementable at the average GP fee (some GPs charge considerably more than $35 per consultation) and the worst-case scenario would be paying somewhat higher than the average fee
- services being free to the user may place provider pressure on the Government or purchaser to increase level of payments. (The PHARMAC reference pricing strategy described above is designed to resist this type of pressure from manufacturers.) Experience in negotiating fees for other services which attract no charge to the user (maternity benefits, dental benefits) indicates that providers place considerable pressure on price increases to compensate the effects of inflation.

11 A positive number indicates an improvement in the fiscal position.

12 These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

8 November, 1996

POLICY ANALYSIS AND COSTINGS - HEALTH QUESTION 506

Part B: Income and Asset Testing

Introduction

1 On 1 November 1996 officials received a request to:

"advise on the pros and cons and detailed cost implications of:

1. removal of income and asset testing of all public hospital long stay geriatric beds;
2. removal of asset testing of private long stay geriatric beds;
3. removal of the domestic house, which was owned and had been occupied, from the asset test, however retain the income and asset test over all for this group;
4. totally removing the income and asset test from all groups, however retaining the obligation for people to pay their superannuation to meet the cost while retaining a personal allowance".

2 The original request is attached.

Summary

3 For all of the options and for the majority of people affected by each policy, there will be no improvement in health outcomes. However there will be a positive health impact for a relatively small number. This will occur where people who are currently being cared for inappropriately at home are encouraged to use residential care as a result of reduced charges. The main impact of the options is to reduce the costs borne by people in need of residential care, which provides financial benefits to those individuals and their families. Some of the options favour one form of care over another or create incentives to shift assets into particular forms.

4 For the group of people that are already accessing residential care, health outcomes will not be affected by any of the options.

5 Options 1 and 2 create disparities in the contributions individuals make towards the cost of their care according to the care setting (towards public and private long term residential care respectively) and result in an increased cost to the Government.

6 Option 3 does not differentiate on the basis of the care setting but does differentiate between different forms of asset; it maintains financial targeting as a mechanism for ensuring that Government resources are used for those with least ability to pay for the "hotel" costs of their long term residential care; and is one of the less expensive options.

7 Option 4 is likely to result in the most behavioural change. This is because the current income and asset test may have discouraged some older people from accessing care and Option 4 removes all income and asset testing. It provides a consistent regime across all forms of care but is easily the most expensive of the four options.

8 Options 1, 2 and 4 are likely to create additional demand for places in long term residential care services. If realised, this additional demand is likely to drive up prices for services.

10 Each of the policies has been costed on a stand-alone basis and the fiscal impacts on the operating balance (excluding GST) are summarised in the following table. Finance costs have been included where the policy costs more than $50m in 1997/98. Further details of the costings are provided in the body of the paper.

Fiscal Impact[1]	1997/98 $m	1998/99 $m	1999/2000 $m
Option 1			
Remove income and asset testing - public			
- hospital and rest home	(20)	(15)	(15)
- hospital only	(15)	(15)	(15)
Option 2			
Remove asset testing - private			
- hospital and rest home	(145)	(135)	(135)
- hospital only	(30)	(25)	(25)
Option 3			
Remove house from asset test	(20)	(25)	(30)
Option 4			
Remove income and asset test - public and private	(240)	(235)	(245)

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

11 It is important to note that the costings do not take account of behavioural changes such as:

- increased use of residential care resulting from lower user charges
- changes in the types of care used (public/private, hospital/rest home) that would be likely if different income and asset testing regimes applied in different care settings
- changes to income and asset profiles as a result of income and asset test avoidance.

12 All of these factors will tend to make the actual costs of the policies higher than the estimates shown here.

13 Further, it should be noted that the costings are estimates which have been derived using information from a sample of older people in residential care rather than from a detailed

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1 A positive number indicates an improvement in the fiscal position.

knowledge of the income and assets of all those in care at present. Accordingly there is a significant margin for error in the figures provided.

14 The tables also show estimates of the numbers of people in residential care who would have a change in their subsidy as a result of the proposal. The total number of people in residential care in 1997/98 is estimated at 30,000.

Description of existing policy

15 The purpose of the Residential Care Subsidy (RCS) is to target assistance to those older people who are assessed by an Assessment Treatment and Rehabilitation unit of a CHE as requiring long term residential care, but who are unable to meet the cost of care themselves. When an older person enters RHA-purchased residential care, if they wish to access the RCS for that care, they must undergo an income and asset test. The income and asset test for a RCS would not be applied unless the older person had already been needs assessed as requiring long term residential care.

16 The income and asset test is different for single and married people and people with dependent children. The costs of pre-paid funerals are exempt from the test.

17 People 65 years and over:
Single - the threshold for the income and asset test is assets worth more than $6,500 (including a car, home, savings and investments), and income they receive.
Married couple where one is in residential care - the threshold for the income and asset test is assets worth more than $40,000 and income over $28,927. The family home and car are exempt.

18 Married and both in residential care - the threshold for the income and asset test is for assets worth more than $13,000 (including the home, car, savings and investments) and income they receive.

19 People 50-65 years:
Single - for those with the same support needs as those over 65 years of age, the threshold for the income and asset test is assets over $6,500 (including the home, car, savings and investments) and income they receive.

20 Married and single people with dependent children - no income and asset test. Beneficiaries are required to contribute their benefit towards the cost of care, less a weekly personal allowance. Non-beneficiaries are not required to contribute.

21 No one accessing RHA-purchased services is required to pay more than $636 per week towards the cost of their care. Individuals are required to contribute their New Zealand Superannuation (less a weekly personal allowance which they retain) towards the cost of their care. Recipients of the RCS are eligible for the annual clothing allowance (assigned in April each year).

22 If individuals have an assessed level of need but do not qualify for the RCS because of their income and assets, and are not prepared to sell their home to contribute towards the cost of care, then they have the option of entering into an interest free loan agreement with the Crown. If an older person enters into a loan agreement with the Crown, a caveat is placed against the

title of the property. When the person in care dies, or the house is sold, the loan is repaid. Where there is a non-core family member living in the home they have the option of entering into a new loan agreement.

Assumptions

23 Several standard assumptions have been used:

- intangible costs are not included
- the full year costing of the policy is given, starting in 1997/98
- the costing is for the *initial* fiscal impact of the policy change. Any second-round effects with fiscal implications (for example, behavioural changes, macro economic effects, interaction with other policy changes etc) have been excluded.
- expenditure costs are GST exclusive
- finance costs are included where the initial fiscal impact of the policy is $50 million or more per year

24 The following key assumptions have been made:

25 It has been assumed that current policies and prices apply. That is:

a. the individual is liable for a $636 maximum weekly contribution (except option 4)
b. the individual contributes their New Zealand Superannuation less a weekly personal allowance ($27.67 per week) towards the cost of care
c. no account has been taken of likely behavioural responses (eg increased demand for residential care) or of any changes to administration costs incurred by RHAs or NZISS
d. rest home residents and hospital-based residents with partners in the community are allowed $11,000 deducted from their available income where applicable (ie income test is applicable)
e. where the asset test is removed but an income test retained, all income above the threshold is included in the test (under the current regime, income earned on cash assets that are exempt under the asset test is excluded from the income test)
f. costings are at 1995/96 prices and these remain unchanged in the out years
g. under each proposal, it is assumed that existing grand-parented[2] residents will continue to receive their current subsidy level where this would be to their advantage
h. costings are compared with the cost of the current policy regime

26 In addition the following technical assumptions have been made to generate the costings:

27 It has been assumed that:

a. overall growth in demand is 3% per annum (includes demographic and long term trend data but not behavioural changes resulting from policy change)

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2 Residents in care as at 30 June 1993 who would have been disadvantaged by the regime introduced from that date.

b. death rate for hospital residents is 30% per annum
c. death rate for rest home residents is 20% per annum
d. average rest home fees assumed to be $490.50 per week
e. average hospital fees assumed to be $920 per week

Policy Analysis: pros and cons and costings

28 The following is a set of criteria for determining pros and cons:

1. *Health Gain:* To what extent does the proposal improve, maintain or restore New Zealanders' health, wellbeing and independence?

2. *People Centred:* Does the proposal provide more choice for consumers, make health services more responsive to individual need, or give consumers more influence over what services are provided? Does it protect consumers' rights and safety?

3. *Effective use of Resources:* Is the proposal cost-effective and is it the best use of resources at the margin?

(a) Pros and Cons common to all options

29 Pros

- will improve health gains by increasing the safety for any persons inappropriately cared for at home in order to protect "their inheritance" (there is some anecdotal evidence to suggest that some people are in this situation, but it is probably a small group).
- availability of assets and/or income for inheritance from this group of older people
- simplification of administrative procedures (eg. fewer people will be asset and/or income tested, loan arrangements no longer required)
- will remove or reduce the perceived inequity of requiring people to use their income and assets to finance care for relatives while other forms of care are provided free (eg operations in public hospitals). The perception of unfairness may be particularly pronounced where a relative has been caring for an older person themselves over a protracted period, possibly saving costs to the government, before residential care is sought.
- will remove or reduce the inequity between those who are avoiding the current income and asset tests (eg through use of trusts) and those who are paying for their care.

30 Cons

- will create increased demand for beds and could generate waiting lists
- will create cost shifting from those leaving/receiving inheritance to the tax payer
- will result in a decrease in existing user contributions creating an increase in cost to the Government
- will reduce incentives for people to choose lower cost community based services over residential care services

- will embed expectation of universal assistance for this age group, which may not be available for other age groups in social assistance, and which may not be sustainable over time because of behavioural change
- with the elimination of the income and asset test, the needs assessment process becomes the sole gate keeping mechanism and this may result in pressure to lower thresholds for the RCS
- the capacity of the sector to satisfy increased demand at current prices is not known
- older people in long term care may have lower living costs than their peers living in their own homes

(b) Specific pros, cons and costing for each option

1. Removal of income and asset testing of all public hospital long stay geriatric beds

31 For the purposes of analysis, the term "public hospital" is assumed to mean:

(a) both publicly owned long term geriatric hospital and rest home beds; and

(b) solely publicly owned long term geriatric hospital beds.

32 Additional Pros

none

33 Additional Cons

(a) both publicly owned long term geriatric hospital and rest home beds

- weights care so there is differential access to publicly and privately provided long term care for older people with similar support needs
- disparity in individuals' contribution towards "hotel" costs between hospital based and rest home based services
- there would be geographical disparities in availability of older people accessing services as not all CHEs currently provide long term hospital beds
- if costs to individuals in public long term hospital beds decrease, those above the income and asset test threshold may be directed to (free) public services, and those below the income and asset test threshold to private long term hospital beds (to attract the Residential Care Subsidy)
- will create demand for additional long term public hospital beds - an area which CHEs have been exiting due to higher cost structures than private providers.

(b) solely publicly owned long term geriatric hospital beds

- demand for public hospital services would create additional pricing pressures because of their more favourable position.

Costings: Public hospital residents and public rest home residents

34 Assumptions specific to this costing: no asset or income testing for public hospital residents and public rest home residents

Fiscal Impact[3]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(20)	(15)	(15)
Total impact on operating balance	(20)	(15)	(15)
Net worth (cumulative)	(20)	(35)	(50)
Cash flows	(20)	(15)	(15)
Net public debt (cumulative)	(20)	(35)	(50)
Number of residents affected[4]	1,200	1,100	1,100
As a % of total population over 65	0.3	0.2	0.2

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

3 A positive number indicates an improvement in the fiscal position.

4 This is the estimated number of people who would contribute less under the proposal than under the current regime.

Costings: Public hospital residents only

35 Assumptions specific to this costing: no asset or income testing for public hospital residents

Fiscal Impact[3]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(15)	(15)	(15)
Total impact on operating balance	(15)	(15)	(15)
Net worth (cumulative)	(15)	(35)	(50)
Cash flows	(15)	(15)	(15)
Net public debt (cumulative)	(15)	(35)	(50)
Number of residents affected[4] As a % of total population over 65	1,100 0.2	1,000 0.2	1,000 0.2

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

36 Note: The cost of the proposal could be higher than shown if CHEs respond to increased demand for their free services by providing more geriatric beds. It would also be higher if residents with significant income and assets are channelled toward the free public care while those with less resources are placed in the private sector. On the other hand, the cost will be lower if CHEs continue to reduce their provision of these services.

2. ***Removal of asset testing of private long stay geriatric beds***

37 For the purposes of analysis, the term "private hospital" is assumed to mean:

(a) both privately owned (including "religious and welfare") long term geriatric hospital and rest home beds; and

(b) solely privately owned (including "religious and welfare") long term geriatric hospital beds.

38 Additional Pros

None

39 Additional Cons

(a) both privately owned (including "religious and welfare") long term geriatric hospital and rest home beds

- creates incentives for individuals to switch assets into forms that do not produce income which is assessable under the income test (eg their own home or art works)

- weights care so there is differential access to publicly and privately provided long term care for older people with similar support needs
- if costs to individuals in private long term beds decrease, those above the income and asset test threshold may be directed to (free) private services, and those below the income and asset test threshold to public long stay hospital beds (to attract the Residential Care Subsidy)

(b) solely privately owned (including "religious and welfare") long term geriatric hospital beds.

- introduces differential between hospital and rest home services regarding an individuals contribution to "hotel" costs
- demand for private hospital services would create additional pricing pressures
- some older people in private hospitals will contribute less to cost of their own care than those in private rest homes

Costings: Private hospital residents and private rest homes residents

40 Assumptions specific to this costing: no asset testing for private hospital and private rest home residents.

Fiscal Impact[5]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(140)	(125)	(115)
Finance cost	(5)	(15)	(20)
Total impact on operating balance	(145)	(135)	(135)
Net worth (cumulative)[6]	(145)	(280)	(420)
Cash flows	(145)	(135)	(135)
Net public debt (cumulative)	(145)	(280)	(420)
Number of residents affected[7]	15,000	15,000	15,000
As a % of total population over 65	3.4	3.4	3.4

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

5 A positive number indicates an improvement in the fiscal position.

6 These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

7 This is the estimated number of people who would contribute less under the proposal than under the current regime.

Costings: Private hospital residents only

41 Assumptions specific to this costing: no asset testing for private hospital residents.

Fiscal Impact[5]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(30)	(25)	(25)
Total impact on operating balance	(30)	(25)	(25)
Net worth (cumulative)	(30)	(55)	(80)
Cash flows	(30)	(25)	(25)
Net public debt (cumulative)	(30)	(55)	(80)
Number of residents affected[7] As a % of total population over 65	3,000 0.6	3,000 0.6	3,000 0.6

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

42 Note: The cost of the proposal could be higher than shown if residents switch their assets into forms which do not produce income that is assessable under the income test (eg their own home or art works) or give away income-generating assets to family. It will also be higher if more people seek residential care as a result of the reduced charges. Further, the cost will be higher if residents are channelled towards the services that best suit their income and asset profiles, eg those with minimal income, but perhaps significant assets, are placed in the private sector where there is no asset test, while those with significant income and assets are placed in free care.

3. ***Removal of the domestic house, which was owned and had been occupied, from the asset test, however retain the income and asset test over all for this group***

43 Additional Pros

None

44 Additional Cons

- perceived inequity for those older people who have already sold homes to pay for the cost of residential care
- creates incentives for older people and their families to tie their resources into domestic housing

Costings

45 Assumptions specific to this costing: domestic house not considered an asset in the asset test

Fiscal Impact[8]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(20)	(25)	(30)
Total impact on operating balance	(20)	(25)	(30)
Net worth (cumulative)	(20)	(45)	(75)
Cash flows	(20)	(25)	(30)
Net public debt (cumulative)	(20)	(45)	(75)
Number of residents affected[9] As % of total population over 65	2,100 0.5	2,600 0.6	2,900 0.6

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

46 Note: The increasing cost of this policy is expected to stabilise from 1999/2000. The "no behavioural response" assumption is particularly critical for this policy option. If one form of asset is exempt from an asset test then there will be a strong incentive to hold assets in that form. So, instead of a home being sold once the owner is in care, there would be a strong incentive to retain the house or even invest in a more expensive home. It is very difficult to anticipate the extent of these practices, however the fiscal impact of removing the house from the asset test could well be significantly larger than shown here.

47 There are provisions in the Social Security Act 1964 relating to deprivation of means of support which under current policy would be applied to prevent this practice of investment of more expensive home. If this Option was to be adopted, the Government would need to consider the extent to which it would want these measures to be utilised.

48 The cost of this policy would also be higher than shown if more people are encouraged to use residential care as a result of reduced charges through the asset test.

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8 A positive number indicates an improvement in the fiscal position.

9 This is the estimated number of people who would contribute less under the proposal than under the current regime.

4. ***Totally removing the income and asset test from all groups, however retaining the obligation for people to pay their superannuation to meet the cost while retaining a personal allowance***

49 Additional Pros

- older people have common access criteria across all long term residential care settings, (public and private hospital and rest home)
- decreased administration and associated costs for NZISS in particular (for example, loan arrangements no longer relevant), other than NZ Superannuation (aside from transitional issues)
- alignment of policy with user-charge regime for younger people in residential care (where beneficiaries currently contribute their benefit less a weekly personal allowance towards the cost of care)

50 Additional Cons

- Vote: Health meets accommodation costs as well as medical/nursing costs
- there will be an expectation that the Government will cover all the costs for long term residential care for all older people, which may not be sustainable over time, and which may lead to increased demand for universal provision for other areas of social assistance.

Costings

51 Assumptions specific to this costing: no asset or income testing for all hospital residents and rest home residents.

Fiscal Impact[10]	1997/98 $m	1998/99 $m	1999/2000 $m
Policy impact on operating balance	(230)	(215)	(210)
Finance cost	(10)	(25)	(35)
Total impact on operating balance	(240)	(235)	(245)
Net worth (cumulative)[11]	(240)	(475)	(720)
Cash flows	(240)	(235)	(245)
Net public debt (cumulative)	(240)	(475)	(720)
Number of residents affected[12]	17,000	16,000	16,000
As a % of total population over 65	4.0	3.6	3.6

Note: All numbers have been rounded to the nearest $5m. Totals may not add due to rounding.

10 A positive number indicates an improvement in the fiscal position.

11 These figures include finance costs where the policy's fiscal impact is $50 million or more per year.

12 This is the estimated number of people who would contribute less under the proposal than under the current regime.

52 Note: The cost of this proposal will be higher than shown if more people are encouraged to seek residential care as a result of the reduced costs to them. For example, if the number of people entering care each year was 5% higher than we have assumed, this policy's impact on the operating balance would increase by an estimated $4m in 1997/98, $12m in 1998/99 and $24m in 1999/2000.

Transitional and Implementation Issues

53 There are a range of important transitional and implementation issues which need to be considered, these include:

54 Legislative issues

- the Social Security Act 1964 (principally section 69F) would require amendment to reflect any change in policy. This section provides for legislative basis in which the income and asset test is used.

55 Policy issues

- treatment of existing Residential Care Subsidy recipients, including treatment of debt (including debt secured by loans/caveats) incurred prior to a policy change.

56 Operational issues

- increased demand for places in hospitals and rest homes could create pressure on Assessment Treatment and Rehabilitation units, and waiting lists may be established for assessments
- capacity of service providers to accommodate increased demand is not known. Waiting lists may be established for residential services

57 Administration

- the New Zealand Income Support Service (NZISS), the responsible agency for administering the income and asset testing regime, would have to make the necessary changes to operational procedures. These changes may incur some costs.
- RHAs contracts with service providers would need to be amended to reflect a policy change. There may be costs associated with this re-negotiation process, both to RHAs and to providers.

58 Communication

- a communication strategy for any policy changes would be needed to ensure people were aware of their changed entitlement.

Note on Costings and Trends in Costs

59 It is important to note that the costings are estimates which have been derived using information from a sample of elderly in residential care rather than from a detailed knowledge of

the income and assets of all those in care at present. Accordingly there is a significant margin for error in the figures provided. This is in addition to uncertainty about the impact of behavioural responses to the suggested policies such as increased demand for services.

60 For nearly all of the policies discussed above, the estimated fiscal costs decrease over the three years shown. The exception is the costing for removal of the domestic house from the asset test, where the costs increase quite strongly. The reason for the decrease seen for most policies is as follows:

- under the current regime the Government's subsidy costs increase over time as people's assets are run-down and they are less able to contribute to the cost of care;
- when asset tests are removed for a group of people this no longer occurs so the subsidy costs are higher and more constant over time;
- as a result, the difference between the Government's contribution under the current and proposed regimes declines over time.

61 On the other hand, costs and the number of people affected increase for the domestic house option because:

- some residents have other assets, besides their home, which enable them to contribute to the cost of care in the short term - this keeps the impact of the proposal below its long-run level
- as these other assets are run-down, the average subsidy increases, which increases the cost to the Government over time to the long-run level.

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POLICY ASSESSMENT – MACRO ECONOMIC IMPACTS OF ADDITIONAL GOVERNMENT SPENDING

Introduction

On 31 October 1996, you requested an assessment of the macro impacts of additional Government spending.

Questions

1. *Would increasing the level of Government spending, including any tax reductions (e.g. removing the surcharge), by 1-1.5 billion per year from 1997/98 impact on inflation?*

2. *Does the impact differ depending on the area of Government expenditure? What difference does it make if the fiscal change is spread over three years?*

3. *What would be the implications of offsetting a 1-1.5 billion increase in Government spending by:*

   (a) *deferring the second round of tax reductions indefinitely or until 1998/99?*

   (b) *keeping the second round of tax cuts and introducing a compulsory savings scheme with contributions of about the same size.*

4. *Apart from new policy initiatives, what are the other key fiscal risks and what could be their extent and their impact on the fiscal position?*

Assumptions

Quantitative results in the answers to questions 1 and 3(a) are based on recent modelling work using the NZM model. NZM is a small model of the New Zealand economy used by Treasury to assess the impacts of different economic scenarios.

Assumptions used in the modelling work include:

1. An increase in the level of Government consumption of $1.5 billion per year, commencing in the June 1997 quarter.

2. No other area of Government spending was increased.

3. The baseline scenario included the second round of tax cuts. These were removed to answer 3(a).

4. Monetary policy was maintained. This meant monetary settings were altered to offset any change in inflation pressure. That is, underlying inflation is kept at roughly the same rates as baseline.

Policy Assessment

1. ***Would increasing the level of Government spending, including any tax reductions (e.g. removing the surcharge), by 1-1.5 billion per year from 1997/98 impact on inflation?***

An increase in Government spending increases public consumption demand, and leads to an increase in economic activity in the short term. The increase in economic activity raises household disposable incomes, causing private consumption demand to increase as well.

The increase in demand leads to higher inflation pressure if the economy is at or close to capacity. Recent inflation, wage, and current account information, and interest rates and exchange rates suggests the New Zealand economy is operating close to capacity. Furthermore, a second round of tax cuts and some additional spending is currently scheduled for the 1997/98 fiscal year, which will add to domestic demand. Any further fiscal stimulus is almost certain to add to inflation pressure.

This means that if there is a further easing in fiscal settings, the expected easing in monetary policy is likely to be postponed or reversed. Monetary policy would need to remain firm, with increases in short term interest rates and the exchange rate, maintaining pressure on exporting and import-competing firms. Past experience suggests that monetary policy needs to maintain a tighter stance for a number of years to counter increased inflation pressure.

By the second year Treasury estimates that firmer monetary conditions could take the form of either a 1.4 percentage point increase in the 90-day interest rate, or a 2.8% appreciation in the exchange rate. These figures are on top of what would otherwise have happened, and use the rule-of-thumb that a one percentage point rise in the 90-day rate is equivalent to a 2% rise in the exchange rate. In practice, tighter monetary conditions would take the form of combination of interest and exchange rate increases, which would persist for a number of years. Experience suggests that an increase in interest and exchange rates could occur before any fiscal easing occurs, as financial markets adjust their expectations to reflect any announced policy changes.

There is uncertainty surrounding the exact amount and speed of any tightening in monetary conditions. These depend on how households, firms, and investors respond to the policy change, which itself is affected by how credible the Government's commitment to fiscal control remains.

The Government's commitment to fiscal control and low inflation is assumed to remain credible. Should the increase in spending instead signal that the Government has a higher propensity to spend, then interest rates are likely to rise by more than would otherwise be the case, increasing the cost of capital to firms operating here.

2. Does the impact differ depending on the area of Government expenditure? What difference does it make if the fiscal change is spread over three years?

Given the pressure the economy is currently under, an increase in Government spending is likely to have a similar inflationary impact, regardless of its composition. An increase in spending on investment which raises the productive capacity of the economy could increase the economy's non-inflationary growth performance, but in the short term an increase in investment spending is likely to be as inflationary as an increase in consumption spending.

Additional spending is likely to be more inflationary than a tax cut of the same size because spending results in a bigger increase in domestic demand. Increased spending either directly feeds into increased demand, or is transferred to lower-income New Zealanders who have a higher-than-average propensity to spend. In comparison, tax cuts are received by a greater proportion of middle- and higher-income earners, who have a greater propensity to save. In policy advice presented last year on the effect of tax cuts, it was assumed 25% of the tax cut would be saved. In addition, a reduction in tax rates can encourage more people into work, increasing the economy's capacity and mitigating inflation pressures. More specifically, removing the surcharge may result in a higher proportion being saved than some other forms of fiscal easing.

Phasing in a spending increase or a tax cut over three years could lead to less initial inflation pressure than if the total package was implemented in the first year. This is because the increase in domestic demand would be reduced. While spreading the fiscal loosening over a number of years reduces the initial inflationary impact, successive loosenings can result in a build-up of inflationary pressure over time.

3. "What would be the implications of offsetting a 1-1.5 billion increase in Government spending by:

(a) deferring the second round of tax cuts indefinitely or until 1998/99?

Deferring the second tax cut indefinitely could be less inflationary than if taxes were cut. Public saving doesn't fall as much, and private consumption doesn't rise as much. Hence domestic demand and inflation pressure do not increase by the same amount as under the tax cuts.

However increasing spending by $1.5 billion per year while deferring the tax cuts indefinitely is more inflationary than the current policy of tax cuts with no spending in addition to that already announced.

- A spending package of $1.5 billion would outweigh the estimated $1.1 billion size of the second round of tax cuts.

- Even if the components of the package were the same size, additional spending has a bigger impact on demand and inflation pressure than has a tax cut of the same size, for reasons outlined in the response to question 2.

Treasury estimates that by the second year, the increase in inflation pressure resulting from the spending package with the tax cuts deferred, would lead to either a 0.7% increase in the 90-day interest rate, or a 1.3% appreciation of the TWI. In practice, as before, a combination of interest rate and exchange rate increases is likely for a number of years.

Postponing the tax cuts to 1998/99 is likely to lead to a slower pick-up in inflation pressures than in the answer to question 1. However inflation pressure would be higher than if the tax cut was deferred indefinitely. Postponing the tax cut for one year simply phases in the package described in question 1 over a number of years. As pointed out in the answer to question 2, this would reduce the initial inflation impact, but the cumulation of successive easings in fiscal policy would maintain upward pressure on prices.

(b) keeping the second round of tax cuts and introducing a compulsory savings scheme with contributions of about the same size.

In order for any fiscal package to have a neutral short-run macroeconomic impact, private savings would have to increase to offset any fall in public saving. Officials cannot see how any compulsory savings scheme could fully offset a fiscal easing of comparable size over the next three years.

If a compulsory savings scheme managed to raise private savings sufficiently to fully offset the fall in public savings from the tax cut, then the macroeconomic impact of the whole fiscal package would be the same as in the answer to 3(a), i.e. interest rates 0.7 percentage points higher or an exchange rate appreciation of 1.3 percent. If however the savings scheme resulted in no increase in private savings above the 25% assumed to be saved from the tax cuts, then the macroeconomic impact would be the same as in the answer to question 1, i.e. interest rates 1.4 percentage points higher or an exchange rate appreciation of 2.8 percent.

On the basis of the arguments set out below, we think that the actual result could be somewhere in between those two scenarios, but closer to the answer to question 1, with little savings above that assumed for the tax cut. A compulsory savings scheme would take a considerable amount of time to set up properly. It is not possible to set up such a scheme in time to offset the second tax cut in July 1997. Therefore in the short term, domestic demand and inflation pressures will increase by closer to the full amount of the fiscal expansion.

A well-designed compulsory savings scheme could increase private savings above the 25% assumed to be saved from the tax cuts. However, international evidence suggests any increase is likely to be a great deal less than 100% of the tax cut. Private savings is unlikely to rise by the full amount because many people already voluntarily save more than what may be the minimum required under the savings scheme. This saving is in many forms, including people building equity in their own businesses. These people are likely to substitute compulsory savings for voluntary savings, and hence their total savings will rise by less than the full amount of the compulsory contribution.

A compulsory savings approach could have longer term impacts on overall economic performance. These impacts would depend on the design of the scheme itself including how the savings are invested, and on any other fiscal risks or regulatory issues raised by the scheme.

4 Apart from new policy initiatives, what are the other key fiscal risks and what could be their extent and their impact on the fiscal position?

The major risks to the fiscal position not relating to new policy initiatives arise from unanticipated changes in:

- economic activity;
- tax revenue;
- expenditure pressures; and

- other circumstances affecting the Government's finances.

(i) Economic activity

Economic conditions affect the fiscal position through both revenue and expenditure. General risks in revenue forecasting are discussed below. However, economic growth has the greatest influence on tax forecasts. To illustrate, if real GDP growth was 1% lower in each year to 1999/2000 than the figures incorporated in the Pre-Election Economic and Fiscal Update (PreEFU), we estimate tax revenue could be almost $1.4 billion lower by 1999/2000.

On the expenditure side, key economic influences are the Consumers Price Index (CPI) and employment forecasts. CPI growth will increase expenditure of CPI-indexed expenses, such as most Social Welfare benefits. The employment outlook also impacts on estimates of Unemployment benefit expenditure.

(ii) Tax revenue

Changes in economic growth aside, predicted tax revenue is based on a number of key judgements about taxpayer behaviour. For example, business taxes tend to move in line with profits. However, profits themselves are exceptionally sensitive to changes in the economy so that small changes in incomes can lead to much larger changes in profits and taxes paid. The use of tax losses to offset current tax liabilities also increases variability in business tax payments.

Historically, tax revenue forecasts for one year ahead have sometimes shown variances of up to 3%, or more than $1 billion.

(iii) Expenditure pressures

Aside from new policy initiatives, unexpected outcomes relating to *existing* policy may create sizeable fiscal risks. Some examples of the types of discretionary spending pressure the Government has faced in recent years include:

- unanticipated demographic changes. Rising school rolls and population movements have led to spending pressure in the education sector, particularly in the Auckland area. A similar trend has occurred in health. Superannuation expenditure is also expected to increase significantly in coming decades as the population ages;

- output price increases. Many sectors of government have requested additional funding to pay for existing activities. Much of this pressure comes from wage and salary rises. Wage settlements for primary and secondary teachers have increased education costs significantly. There are also a variety of projects underway reviewing sustainable funding levels in areas such as health, defence and the police which may result in additional spending pressure in the near future; and

- changes in the uptake of demand-driven items such as benefit entitlements and superannuation. These are expenses which the Government cannot control in the short term. As total welfare benefits (including New Zealand Superannuation) total over $11 billion, relatively small forecast changes can lead to substantial increases in spending in dollar terms. For example, benefit expenditure is now expected to be around $40 to $50 million more per year than forecast in the PreEFU. Around three-quarters of this is due to higher numbers of Unemployment beneficiaries.

The following table provides an indication of how overall forecasts of expenditure for any given year tend to increase over time reflecting the various expenditure pressures a Government faces. For example, expenditure for the 1995/96 year turned out to be $773 million higher than was forecast in the 1994 Budget. NB these figures *include* the impact of new policy initiatives such as the new social spending introduced in the 1996 Budget.

Table - Outyear Expenditure: projections and revisions

Projection/*actual* ($ million)	**1995/96**	**1996/97**	**1997/98**
1994 Budget	30,970	30,825	
1995 Budget	31,635	31,489	30,867
1996 Budget	31,226	32,874	32,764
1996 PreEFU	**31,743**	32,917	32,779
Variance from first projection	**773**	2,092	1,912

(iv) Other circumstances

The Crown has a number of contingent liabilities and assets which vary in size, and likelihood of realisation and timing. Over the forecast period, some of the larger negative contingencies which may be realised include:

- the Maui Development claim (unquantified);

- Synfuels contract dispute ($98 million); and

- the West Coast Accord Appeal ($423 million).

A full listing of contingent liabilities as at 30 June 1996 was included in the PreEFU.

There are also a number of possible fiscal risks which are not forecast as a matter of policy. These include revaluations, for example, in the year to 30 June 1996, an unrealised loss of $267 million was recorded for forest devaluations.

REQUEST FOR INFORMATION: EMPLOYMENT CONTRACTS ACT [508/1]

INFORMATION REQUESTED

What are the implications of amending the Employment Contracts Act to:

1. Ensure a neutral bargaining environment between employer and employee by extending good faith bargaining provisions to all employers and employees (ie, to apply to all contracts, collective and individual, and all bargaining agents);

2. Ensure that employers recognise the duly elected bargaining agents chosen by the employees;

3. Allow reasonable access for bargaining agents to address employees at their work site;

4. Identify the occasions, since passage of the ECA, where lack of "good faith" bargaining provisions has led to problems;

including the implications for sustainable rates of economic growth, and improving labour market performance.

Executive Summary

This paper notes the prominence of bargaining in the operation of the labour market and the importance of the arrangements relating to bargaining for the efficient operation of the labour market.

This response discusses the range of possible good faith bargaining mechanisms and identifies the issues arising with each of them. To take those issues through to a full analysis of their implications for labour market and economic performance would require more explicit specification of the options to be explored and of the problems they are intended to solve.

The principles underlying the present bargaining framework mean the parties to employment relationships are responsible for the negotiation of arrangements that best suit the needs of their particular workplaces. This framework has allocated to parties the responsibility to negotiate settlements and appears to have assisted in reducing industrial conflict, improving productivity and aiding economic and employment growth. There are perceptions that some employers use the lack of compulsion to negotiate to resist claims considered legitimate by employees but the extent of this cannot be assessed because of a lack of reliable data.

Alternative approaches to fostering the development of the bargaining relationship have been adopted in some other countries. " Good faith bargaining " provisions can incorporate a range of requirements including:

- recognition of bargaining agents chosen by employees
- requirements for parties to meet
- requirements to supply information
- prohibiting the use of dilatory tactics
- requirement to make genuine effort to reach agreement
- regulation of the content of bargaining

Section 12 of the Employment Contracts Act already requires recognition of the representative authorised by the employees. The Courts have subsequently clarified residual uncertainty around this provision.

The other provisions outlined above as sometimes being incorporated in good faith bargaining are intended to foster constructive negotiations and assist with the management of conflicts. To this end they could assist in redressing some of the perceived concerns currently about parties exploiting bargaining power in the negotiating environment. However, it should be noted that regulations are not always successful in affecting people's behaviour. Rather they may encourage game playing around the rules rather than the development of the employment relationship.

In addition, the provisions outlined carry with them a number of risks for employment and economic growth:

- good faith bargaining provisions increase the likelihood of third party interventions in the bargaining process. This may reduce the degree to which agreements reached reflect the needs of local situations;

- greater prescriptiveness over bargaining arrangements risks reducing flexibility and adaptability to changing circumstance;

- greater prescription over the process is also likely to increase the costs associated with bargaining and the degree of litigation involved;

The degree to which these risks are realised would depend on the exact detail and extent of any good faith bargaining provisions. However, experience overseas has suggested that once good faith bargaining provisions are established there is the potential for their coverage to extend over time, partly through judicial decision making.

A final question relates to making greater provision for reasonable access for bargaining agents to address employees at their work site. Bargaining agents already have this right in respect of employees who have authorised the agents to represent them. The only meaningful extension of access rights would be for the purpose of recruitment. While on the one hand this proposal could improve the quality of the representation of employees, it also risks proliferation of bargaining agents. Options to minimise disruption to the work place may lead to disputes around freedom of association or alternatively the reintroduction of a union registration process. The latter would risk undermining the contestability of employee representation which is an important feature of the current framework.

Introduction

Bargaining is a central part of the industrial relations framework, but the level of bargaining can vary in different circumstances. In an environment of voluntary negotiation, the parties may choose not to bargain. In addition to the negotiated outcomes, bargaining can also have direct effects on the participants and is affected by the environment in which the negotiations are carried out. Both the outcomes of bargaining and the way it is carried out also have significant effects on the functioning of the labour market, and through those effects contribute, together with other factors, to the government's overall economic and social goals.

Thus where employers and employees are free to negotiate solutions which respond directly to the circumstances they face, those solutions are likely to facilitate the appropriate allocation of resources across the economy and the efficient use of those resources. This will result in increased productivity, enabling appropriate rewards to employees which will tend to encourage employees to move to jobs in the more competitive sectors of the economy.

At an immediate level, bargaining can be an essential part of the employment processes that collectively comprise the labour market:

- it can be present at the start of the employment relationship which continues through the life of the contract, any disputes about its application, and its termination.
- it can be a mechanism for setting the price of labour: At the most basic level, bargaining consists of an offer and acceptance of employment at a particular wage rate and with a particular package of other terms and conditions of employment

What is good faith bargaining?

An important distinction needs to be drawn between good faith bargaining as a goal, and the means used to achieve it. As a goal, the aim is to ensure a reasonable standard of care is exercised.

A reasonable standard of care or good faith bargaining is one that is most likely to:

- ensure the proper functioning of the labour market in order to support overall economic and social goals; and
- protect or enhance the quality of the employment relationship.

A number of choices can be made about the design of mechanisms to promote the goals of good faith bargaining:

1. *Range of issues regulated*

Mechanisms aiming to achieve good faith bargaining can focus on various stages of the employment relationship:

(i) *To compel the parties to negotiate*

Imperatives to negotiate may be more pressing for one party than the other, with the result that one party may be unable to persuade the other to consider claims for renegotiation of a contract. Good faith bargaining requirements may be imposed to encourage or require negotiations.

(ii) *To reduce or manage conflict*

Good faith bargaining may aim to reduce the incidence of conflict. For example:

- disputes may arise about representation. As a result, good faith bargaining may be associated with the determination of the representative of the employees, as part of the legislation;
- good faith bargaining may also aim to minimise conflict about negotiations by endeavouring to foster rational informed discussion between the parties before and during the course of the employment relationship. In this sense, good faith bargaining can be seen as a means of addressing the incomplete nature of the employment contract and facilitating the employment partnership, by providing for the parties to continue to communicate effectively and understand each other's position on an ongoing basis.

(iii) *To influence bargaining outcomes*

Good faith bargaining may or may not extend to influencing bargaining outcomes. In some jurisdictions, this approach is used to address outcomes perceived as inequitable, or as an income policy to control inflationary labour costs. Attempts to influence bargaining outcomes would limit the freedom of the parties to determine their own outcomes.

2. *Who is covered*

In most overseas jurisdictions, good faith bargaining has been treated as a collective bargaining issue. However, it can also apply to individual bargaining.

Maintaining the principle of choice between individual and collective employment contracts would ideally require that good faith bargaining interventions apply equally to individual and collective bargaining. Imposing individual good faith bargaining requirements would however impact to increase:

- the substantial institutional infrastructure required to make good faith bargaining available to individual employees and employers, which would impose a significant cost on the state;
- the compliance costs for each individual employee or bargaining agent, and for employers dealing with a number of individual employees. The compliance costs could act as an incentive to negotiate collectively.

3. *Degree of compulsion*

Good faith bargaining provisions could take the form of mandatory requirements, or of default provisions when the parties do not come to their own arrangements.

4. *Prescriptive or permissive*

The present preference is for permissive legislation which allows the parties to work out their own outcomes. The basis of this approach is that imposed solutions are not always the best ones and that greater flexibility and innovation are possible when the parties take into account the factors relevant to their own situation. The more generalised the provision, the greater is the need for interpretation by the courts.

5. *Ensuring compliance*

Good faith bargaining provisions would require effective remedies for non-compliance. Examples could include financial sanctions such as fines, or arbitration. The choice of remedies has implications for the institutional arrangements needed to support particular good faith bargaining provisions.

From this range of options it is evident that good faith bargaining is not a single clearly identifiable concept, but a general term used to describe a variety of mechanisms. The extent and nature of the impact of good faith bargaining provisions depends on the choice and design of the elements of any good faith bargaining system, as does the extent and nature of the costs and benefits of good faith bargaining.

Existing provisions in Employment Contracts Act

There is a range of provisions in the Employment Contracts Act which set some limits on bargaining behaviour, and which may contribute to the establishment of good faith bargaining. These include:

Part I, particularly sections 7 and 8 which protect employees' membership/non-membership of employees organisations.

section 10 which gives employees the right to choose their own representative.

section 12 which requires employers to recognise employees' authorised representatives. Court of Appeal decisions have clarified that an employer must bargain with the authorised representative or not at all. The rights of employers to freedom of speech under the NZ Bill of Rights Act and employees' rights of representation under section 12 must both be given sensible and practical effect. It is, however, incompatible with recognition of the authority of the bargaining agent to attempt to persuade employees to withdraw an authority or otherwise to act in such a way as effectively to deny or call into question the agent's authority to represent the employees.

section 14 which gives authorised representatives the right of access to workplaces to discuss matters relating to negotiations.

Response to question on ensuring a neutral bargaining environment between employer and employee by extending good faith bargaining provisions to all employers and employees (ie, to apply to all contracts, collective and individual, and all bargaining agents).

The following discusses the effects of specific good faith bargaining mechanisms chosen from the range of possible mechanisms. The selection reflects the most commonly discussed options.

Requirement for the parties to meet

The requirement to meet is a fundamental condition for engaging in bargaining, if the objective is to compel the parties to negotiate. A general requirement to meet need not require detailed prescription of behaviour. Instead, a more generalised process would leave more potential for differences of interpretation by the parties and the development of case law by the courts would need to be minimised.

Provisions that aim to achieve this include:

- a requirement for the parties to meet with a third party as a witness, for example, a mediator;
- defining the role of the witness and criteria for involvement;
- establishing where the costs of a witness should fall: for example, on the Government, on the employer, or shared by both parties;
- defining who would be able to make complaints about the procedures and how complaints would be made.

The involvement of a third party in this context need not imply involvement in determining or influencing outcome, thus minimising the impact on the principle that the parties themselves should be responsible for their own bargaining outcomes.

Provision might need to be made for formally signalling when the obligation to meet was to take effect, for example:

- the applicant party might need to make a formal claim for a new contract;
- notice might be given to the witness or an independent body responsible for administering good faith bargaining.

Imposing a requirement on the parties to meet raises a number of flow-on issues. Specifically, introducing a third party to the bargaining process risks shifting "ownership" of the bargaining process away from the parties involved, who have the best information and incentives to resolve a dispute. Second, establishing whether the requirement has been met still begs the question whether this obligation has been discharged in a genuine manner. Finally the requirement may be counter productive if the requirement kicks in before the bargaining process has reached a stage where such a meeting would be useful.

Requiring the parties to supply relevant information for negotiations

This mechanism is intended to address issues over willingness to negotiate and to maintain a partnership, and can be considered to facilitate discussion and exchange of proposals. The primary issue is to define the nature of the information. For example, it could require the disclosure of:

- general information about the position of the company;
- information about pay structures;
- information to substantiate claims made by the parties, for example, claims that increased pay rates are unaffordable.

The potential for litigation over the nature of the information to be provided is a risk that would be difficult to minimise.

Compliance costs of providing information will also arise, and with more complex operations could be substantial.

Requiring parties to supply relevant information would raise concerns about the need to supply commercially sensitive information in an increasingly competitive environment. It would raise significant issues about what constitutes "relevant" information for the purposes of the bargaining. Firms will have a big incentive to take steps to circumvent the requirement. Requiring firms to substantiate claims of "affordability" raises a significant issue about what constitutes affordable and who determines whether a claim is affordable or not.

Discovering or attempting to prohibit the use of dilatory tactics in negotiations

Provisions of this nature would focus primarily on procedures, and regulation might focus on procedural issues by:

- introducing time limits, for example for the presentation of proposals following the initiation of bargaining and the response to initial proposals;
- requiring the parties to agree on a timetable for negotiations, to achieve a balance between the aim of avoiding delays and the inflexibility of restricting parties to rigid time frames which could reduce the potential for constructive solutions.

If undefined, there would be potential for the parties to address the issue of delaying tactics, for example by taking industrial action, or challenging the other party on the basis of its non-performance of one of the other provisions (attending a meeting or producing proposals). Legal challenges could result in court action and resulting case law, if the institutional structure allowed this.

The impact of such provisions would depend on the type of provision introduced. A general provision is likely to shift the emphasis in bargaining toward procedural issues. In addition, it would lead to greater litigation over whether dilatory tactics are being used. This is always likely to be subjective and difficult to establish. It is important to recognise that bargaining involves robust interactions between two

parties. More specific provisions could lead to superficial compliance with the requirements without any genuine intent to resolve the issues concerned.

Imposing a duty on the parties to make a genuine effort to reach agreement.

This concept would raise significant issues of enforcement, given the difficulty of assessing the attitudes and state of mind of the parties and what constitutes "genuine effort". Procedural provisions might focus instead on the behaviours of the parties likely to contribute to reaching an agreement, such as a requirement to meet and exchange proposals

Content of bargaining

Some mechanisms would attempt to regulate the content of bargaining beyond procedural matters and concentrate directly on influencing bargaining outcomes. This would generally require the scope of bargaining to be defined. Regulation could direct that proposals should be exchanged on matters considered central, such as wages and certain other conditions of employment.

Regulation may also provide for some minimum conditions to be included in the contract. This may comprise fixed minimum standards, such as the minimum wage and holidays provisions, or framework minima which allow the parties to negotiate provisions that suit their needs. Present New Zealand legislation, for example, includes a requirement that personal grievance and disputes procedures be included in all contracts, and the Parental Leave and Employment Protection Act allows the parties to address parental leave issues provided all aspects are addressed and the overall result is not less favourable to the employee.

Depending on which approach is taken, these good faith bargaining provisions would have varying degrees of impact on the employment relationship, and consequently on economic growth and labour market performance. One common feature of the above approaches is that they tend to be prescriptive. This potentially limits the ability of the parties to make their own arrangements, impacting on the rate of adjustment.

Ensuring compliance

The sanctions that would be needed to enforce compliance with good faith bargaining requirements must take account of:

- the objectives of the good faith bargaining requirements: if these focus on procedural matters, it would be important to avoid sanctions which influence bargaining outcomes;
- the extent to which the court is able to develop its own interpretation of provisions and thus impose further requirements.

Primary forms of sanctions are:

(i) *Financial sanctions such as fines for breach*

This raises issues of:

- the levels at which such penalties are set. Different levels of income of employers, employees and representatives result in different levels of effectiveness of any financial penalty. This issue is generally addressed by allowing the courts discretion up to a maximum penalty;
- the effectiveness of sanctions if the costs faced by employers as a result of penalties for not complying with good faith bargaining requirements are less than the costs of paying the increased wages gained by union negotiators. A US study concludes that employers have a financial incentive not to comply or to delay compliance, and argues that penalties should be increased to make the legislation more effective. This behaviour may, however, be a product of the US court system, which has resulted in the ability to delay decisions on complaints for long periods of time.

(ii) *Arbitration*

If the objective of good faith bargaining is to ensure that an outcome is achieved, arbitration is the final means of guaranteeing this. Any form of arbitration, however, runs contrary to the principle that agreements reached by the parties themselves, without third party intervention, are more likely to reflect the needs and circumstances of both parties and to enable the enterprise to adapt to market pressures. Final offer arbitration risks arriving at a settlement to which one party feels little commitment, and over time, may erode sanctity of contract.

Regulation may attempt to provide a balance between these issues, usually achieved by setting guidelines for the arbitrator, to provide some constraints.

(iii) *Strikes and lockouts*

While some jurisdictions allow strikes and lockouts throughout the period of negotiations, as legitimate bargaining tactics, industrial action may be seen as inconsistent with bargaining in good faith. Currently strikes are unlawful during the term of a collective contract, but are not unlawful in support of negotiations for a collective contract once the existing contract has expired. Options for limiting strikes and lockouts could include:

- allowing strikes only in the interval between lodging claims for a new contract (even if the previous contract was still in effect) and beginning the negotiation period;
- allowing strikes when either party withdrew, or when the meetings ceased;
- requiring a period of notice of any industrial action.

Response to question on ensuring that employers recognise the duly elected bargaining agents chosen by the employees.

As noted in the description of the Employment Contracts Act, section 12 already requires recognition of the representative authorised by the employees and case law has clarified the requirement to negotiate, if at all, with the representative.

The courts have clarified the interpretation of section 12, specifying the nature of the communications permissible between employers and employees. Codifying the principles in legislation more explicitly may facilitate more efficient bargaining

behaviour by enabling the parties to be better informed over what forms of communication with employees are, and are not, acceptable. This, however, would not necessarily preclude further debate about interpretation of the legislation, and issues may continue to arise, depending on how the regulation is defined.

Response to question on allowing reasonable access for bargaining agents to address employees at their work site.

Bargaining agents may seek access to workplaces for two main reasons:
- a bargaining agent may seek access to its existing members;
- to recruit new members.

Under the Employment Contracts Act, any authorised bargaining agent has the right of access to existing members, but may have access to recruit new members only with the agreement of the employer.

Issues

The question of bargaining agents being given absolute rights of access to recruit members raises three main issues:
- proliferation of bargaining agents: the risk that an unlimited number of agents with no previous role in the workplace use the opportunity to try to acquire or increase membership;
- the need to minimise disruption;
- the acceptability of this access to both employers and employees.

Options for addressing the first two issues include:
(i) the employer could decide which bargaining agent to recognise, or could allow several agents to present proposals for access which the employer could approve;
(ii) a bargaining agent recognition or registration process for the purpose of filtering out *bona fide* agents. Recognition or registration in this context does not imply any concept of monopoly bargaining rights and is not linked to any of the other mechanisms under the discussion of good faith bargaining. As noted, it is raised in the context of access as a means of filtering in order to address proliferation.
(iii) the employees could decide which bargaining agents could have access, perhaps by majority vote.

Options (i) and (iii) present problems in terms of freedom of association and free collective bargaining. The experience in the US and UK with disputes over union recognition, or arrangements for union 'beauty contests', suggests that similar undesirable disputes may appear in the New Zealand system under a similar regime.

Option (ii), registration of bargaining agents, presents the least difficulty in terms of its administrative incorporation into the present industrial relations system. It would be designed to ensure that only *bona fide* bargaining agents which are democratic, solvent and independent (from any employer) have access. The incentive for bargaining agents to register would be the automatic right of access (to recruit/organise) which would accompany registration. Bargaining agent registration

would require the State to set up some form of registration system (as it did before 1991), with associated administrative costs.

Extending statutory rights of access to enable bargaining agents to seek authorisation from employees is an intervention made prior to bargaining between employers and employees. It could be argued that it does not impact on the ability of the employers and employees to reach their own arrangements. There are, however, costs to employers in providing wider access to bargaining agents. Recognition in this context would also alter the degree of contestability with regard to the choice of employee organisation that underpins the Employment Contracts Act.

Conclusion

The perceived benefits of introducing mechanisms to promote good faith bargaining would be:

- it facilitates more efficient bargaining;
- it increases the potential for more constructive negotiations and of settlements occurring; and
- it assists with the management of conflict.

Any system that pursues these benefits will incur risks. There is a large range of alternative mechanisms that could be used to encourage good faith bargaining. The particular features of the mechanisms used will affect the nature and extent of the resulting costs and benefits. For instance, mechanisms that are highly prescriptive could limit the ability of parties to negotiate contracts that suit their particular needs, and thus impede the process of labour market adjustment, leading to slower economic growth and poorer overall labour market outcomes.

In addition, any changes that aim to promote good faith bargaining may affect other aspects of employment contracts. This may lead to the need for further changes in other areas, and may have additional impacts on the functioning of the labour market. Any initiatives thus need to be approached with care, and with a careful examination is needed of their implications.

Other impacts relate to the costs associated with the institutional infrastructure. The nature of the infrastructure needed would depend on the nature of the mechanisms used, but in any event would incur additional costs to the state, alongside any further costs associated with enforcement and complaints through the existing court system.

The effectiveness of legislation to implement and enforce mechanisms designed to achieve good faith bargaining depends on speedy resolution of disputes. In the US, the delays, costs, and the capacity to keep appealing decisions to higher courts have been seen as a weakness of the system, as enforcement through the courts can be used to extend the negotiating process rather than to promote effective bargaining. The ability of the parties to negotiate agreements which reflect changing circumstances may be impaired by complex procedures or an inability to resolve disputes quickly and effectively.

Compliance costs for the parties would depend on the complexity of the procedures required and on the nature and level of the enforcement processes. Both compliance costs and the costs to the state of the institutional infrastructure would be substantial in any system which made good faith bargaining available to individual employees and employers. Compliance costs for individuals may act as an incentive to bargain collectively.

Finally, the perception that there are problems associated with a lack of good faith bargaining procedures should be seen in the context of the voluntary nature of the bargaining framework which is designed to facilitate a range of outcomes and bargaining structures. Some of the provisions in the Employment Contracts Act which set limits on bargaining behaviour, and have been confirmed by case law, may also be found in good faith bargaining frameworks.

APPENDIX 1

Good Faith Bargaining Provisions Overseas and in New Zealand

The provisions in other countries are premised on the different structures operating there. For example, in the North American countries, the legislation is strongly influenced by issues of union recognition, and is associated with procedures for identifying a single union to represent a particular "bargaining unit".

United States

The US National Labour Relations Act provides employees with a statutory right to bargain collectively where the majority of employees in the bargaining unit agree. Only one union may represent the bargaining unit. Collective bargaining is defined as the mutual obligation of the employer and employees' representative to meet at reasonable times and confer in good faith. The National Labour Relations Board (NLRB) has developed a number of procedural requirements based on this provision:

- the duty to meet employee representatives;
- the duty not to deal directly with employees who have appointed a bargaining agent;
- the duty to make a genuine effort to reach agreement;
- the duty not to employ dilatory tactics;
- the duty to prove claims of inability to pay (but claims on unwillingness to pay need not by supported by financial information).

Other case law relates to the distinction between mandatory and voluntary subjects for bargaining and the relationship with managerial prerogative.

Enforcement is through the NLRB, with appeal to the civil courts, and remedies include compliance orders, penalties and damages.

Canada

The Federal legislation requires that:

- the parties or their representatives meet and commence to bargain collectively in good faith;
- they make every reasonable effort to enter into a collective agreement.

At provincial level, the requirements vary. Four of the provinces also require both good faith and reasonable effort, while some refer only to reasonable effort. One refers only to good faith, and another requires the parties to meet and bargain towards a collective agreement and prohibits a failure or refusal to bargain with union representatives.

The Provincial Labour Relations Boards deal with complaints, awarding remedies such as compliance orders and damages. All have interpreted the matters to be

included in the collective contract widely, to include any matter the parties agree to be bound by. The duty is triggered by either party giving notice to bargain, and all specify the timing of the notice. The duty is therefore not ongoing, in general, though there may be a continuing duty to consult and deal with a trade union over significant changes.

The case law has developed more in some provinces than in others to prohibit certain behaviour (eg misrepresentation), but generally follows the principle that the parties are best able to determine the content of their agreement and can enforce them through economic sanctions. The labour boards generally avoid reviewing "fairness" or imposing agreements, and allow "power" bargaining to operate.

In Ontario, where the labour board has been most active in relation to bargaining duty, the board has identified two components of the duty:

- recognition of the union's exclusive right to represent the employees - but this is not to be used to redress imbalances of economic bargaining power;
- to foster informed rational discussion between the parties, in order to minimise the potential for conflict.

Australia

These provisions given here will probably be affected by the new industrial relations legislation introduced in 1996.

Australia's 1988 industrial relations reform introduced a good faith bargaining requirement associated with the introduction of enterprise bargaining. It provides for the Australian Industrial Relations Commission (AIRC) to try to conciliate negotiations for enterprise agreements, at its own initiative, and if it does so, to require the parties to participate. It can also make orders for the purpose of:

- ensuring that the parties negotiating an agreement do so in good faith;
- promoting the efficient conduct of negotiations for an agreement;
- otherwise facilitating the agreement.

Under this provision, the AIRC can order a party to take, or not to take, specified action. The AIRC must consider the parties' conduct, including whether they have:

- agreed to meet at reasonable times;
- complied with agreed negotiating procedures;
- capriciously added or withdrawn items for negotiation;
- disclosed relevant information; or
- refused or failed to negotiate with one or more of the parties or with a person entitled to represent an employee.

Case law relating to these provisions indicates that:

- orders are generally confined to procedural aspects of negotiation, rather than the substance of proposals;
- the role of the AIRC is limited to facilitating agreements;
- parties can take protected industrial action during the period of negotiations;

- good faith bargaining does not require a willingness to make concessions; it has been found by the AIRC to be consistent with taking a "hard line" in negotiations, provided the parties consider offers and proposals seriously and take account of arguments.

Japan

Japan's good faith bargaining provisions are based on the American system, with some different features:

- unlike the US, a number of unions can be involved in one workplace;
- this can lead to disputes among rival unions about differential treatment by the employer;
- the provision is one sided, placing obligations on employers but not unions;
- there is no distinction between compulsory and permissive subjects for bargaining.

Sweden's 1976 Co-determination Act requires employers to respond to union requests for negotiation, and to initiate negotiations before introducing major changes in the workplace.

United Kingdom

The UK has no enforceable requirements for bargaining in good faith, in keeping with its voluntary regime in which employment contracts are not enforceable. Some enterprises and their employees have however developed voluntary "procedural agreements" which define bargaining processes before substantive negotiations begin. These agreements may cover some issues which are already defined in legislation in New Zealand such as termination procedures and disputes procedures, and other issues such as procedures for union recognition and derecognition, the structure of the agreement and no-strike agreements.

New Zealand

Before the introduction of the Employment Contracts Act, New Zealand legislation provided for effective good faith bargaining in relation to awards:

- the parties were required to attend a conciliation conference;
- if they did not attend, the aggrieved party could apply for arbitration of the dispute.

In terms of enforcement, arbitration acted as an incentive to attend, and was seldom used in practice. Further, the presence of a third party at the conference provided a "witness" to the conference, thus in effect monitoring the operation of the requirement.

APPENDIX 2

Eketone v Alliance Textiles (NZ) Ltd 2 ERNZ 783, Court of Appeal
Mineworkers Union of New Zealand v Dunollie Coal Mines Ltd, CEC 8/94
Service Workers Union of Aotearoa Inc v Southern Pacific Hotel Corporation (NZ) Ltd, WEC 27/93
Witehira v Presbyterian Support Services, AEC 31/94
New Zealand Medical Laboratory Workers Union v Capital Coast Health Ltd, WEC 45/94
NZ Dairy Workers Unions Inc v Hautapu Whey Transport Ltd, Colgan J, 2 ERNZ 549, 16 September 1994;
Caledonian Cleaners and Caterers (1992) Ltd v Hetariki, CEC 44/94, Travis J, 7 November 1994;
Ivamy & Ors v Air NZ, AEC 16/95, Finnigan J, 23 March 1995;
Talbot & Ors v Air NZ, AEC 17/95, Finnigan J, 23 March 1995;
Davson & Ors v Tasman Pulp and Paper Company Ltd, Travis J, AEC 2/95, 2 February 1995;
Flight Attendants & Related Services (NZ) Association Inc v Air NZ Ltd, Finnigan J, AEC 19/95, 27 March 1995.
Burgess v Command Pacific (NZ) Ltd, AEC 65/94, Colgan J, 13/14 October 1994; *Davson & Ors v Tasman Pulp and Paper Company Ltd*, Travis J, AEC 2/95, 2 February 1995, and AEC 28/95, Travis J, 11 April 1995.
NZ Engineering Union, Communication & Energy Workers Union & Ors & Julian v Air NZ Ltd, Full Court, 12 December 1994, AEC 43E/94;
Davson & Ors v Tasman Pulp and Paper Company Ltd, Travis J, AEC 2/95, 2 February 1995;
NZ Engineering Union Inc & Ors v Shell Todd Oil Services Ltd.
National Distribution Union v Foodstuffs (Auckland) Ltd AEC 33/94
Foodstuffs (Auckland) Ltd v National Distribution Union (Inc), CA 137/94, 30 March 1995.
Craig & Ors v R & P Fraser Pty Ltd & Waikato Beef Packers Ltd, AEC 27/95, Colgan J, Auckland, 12 April 1995;
Talbot & Ors v Air New Zealand, AEC 16/95, Finnigan J, 23 March 1995.
NZ Engineering Union Inc & Ors v Shell Todd Oil Services Ltd.
Capital Coast Health v NZ Medical Laboratory Workers Union Inc & Ors, CA 216/94
Ivamy & Others & the NZ Professional Firefighters' Union v NZ Fire Service Commission, WEC 44/95
Ford v Capital Trusts Ltd, 2 ERNZ 47
Couling and Ors v Carter Holt Harvey, AEC 83A/95
New Zealand Airline Pilots' Association, Dallas Bean & ors v Airways Corporation of New Zealand, WEC 72/95
Ussher v Te Kuiti Meat Processors Ltd, AEC 108B/95
Vining v Air New Zealand, AEC 41/95
Canterbury Hotel, Hospital, Restaurant, Club and Related Trades Union Inc v Healthlink South Ltd, CEC 45/95
O'Dea v Transportation Auckland Corporation t/a The Yellow Bus Co 13/6/94, Human Rights Commission, Wellington c225/94
NZEI & ors v State Services Commissioner, WEC 69/45
Billing v Wellington City Council, WEC 33/95

Roche v Urgent Medical Services Homecare Ltd 2 ERNZ 159
Marsh & Ors v Transportation Auckland Corporation Ltd AEC 80/95.
New Zealand Fire Service Commission v Ivamy and Ors, CA 145/95
Airways Corporation of New Zealand Ltd v New Zealand Airline Pilots Association Industrial Union of Workers Inc and Dallas Richard Bean and Ors, CA 251/95, 24 April 1996
Marsh and Others v Transportation Auckland Corporation Ltd, AEC40/96, 31 July 1996
New Zealand Educational Institute and Others v State Services Commissioner and Others, WEC59/96, 25 September 1996.

REQUEST FOR INFORMATION: EMPLOYMENT CONTRACTS ACT 508/2

Information requested

"NZ First has proposed increasing the adult minimum wage to $7.50 per hour, with teenager worker rates set at 30% of the adult rate for 12-13 year olds, increasing 10% points per year of age, up to 90% for 19 year olds. What are the implications of this proposal; including for sustainable growth and labour market performance (with respect to both adults and youth)?"

Assumptions used in order to respond to request

It is assumed that the New Zealand First proposals are intended to address the effectiveness of the minimum wage as part of the minimum code of employment, by providing an adequate level of income for low paid employees. This paper examines the potential impact of the minimum wage by assessing this objective against a range of criteria (see below).

Substantive answer to request

Background

The minimum wage is currently set by Order-in-Council issued under the Minimum Wage Act 1983. The current statutory adult minimum wage came into effect on 18 March 1996, and is $6.375 per hour, or $255 for a forty hour week for employees aged 20 and over. For employees aged 16-19 years it is $3.825 per hour, or $153 for a forty hour week. The statutory minimum youth wage is approximately 60 percent of the adult rate.

The minimum wage applies to all employees, with the exception of persons undergoing certain types of training in occupations specified by Order-in-Council (generally training in the nature of apprenticeship) and those employees who hold an under-rate workers permit.

Section 5 of the Minimum Wage Act requires the Minister of Labour to review the level of the minimum wage in each year ending on 31 December. Following the review the Minister may, whether in that year or subsequently, make recommendations to the Governor-General regarding the adjustments that should be made to the minimum rate.

Assessing the Impact of the Minimum Wage

An important consequence of the minimum wage will be its impact on the lifetime incomes and opportunities available to people. These depend on the strength of the economy and the ability of individuals to participate in paid employment and to undertake training. Having a job, even a low-paying one, is a key route to developing skills and getting a better job.

This paper examines:

- the impact of the minimum wage rate on employment and unemployment;
- the impact of the minimum wage rate on the provision of on-the-job training, and incentives for enrolment in educational and training programmes;
- the relationship between minimum wages and the macroeconomy.

Impact on employment

It would be expected that the existence of a minimum wage would remove employment opportunities as employers will not employ people whose wages are greater than the value of their contribution to the firm's outputs. This is especially likely given the size of the increase being proposed.

Most overseas empirical studies of the effects of the minimum wage on employment have confirmed that the minimum wage reduces employment. Studies since the 1970s have found that a 10% increase in minimum wage rates result in a 1-3% decrease in employment *among young adults and teenagers*[1]. More recent studies have suggested that these estimates may have been too high and that a 0.6%-1% decrease in employment was more likely[2].

Dr Tim Maloney has conducted the only empirical study on the impacts of the minimum wage in New Zealand. Maloney's study found that a 10% increase in the minimum wage reduces the employment of all young adults (aged 20-24) by 3.5%, and increases their unemployment rate by 3.5 percentage points. However, the size of the impact found in the Maloney study is somewhat higher than the international body of evidence on the employment effects of minimum wages.

A further indication of the potential impact of an increase to the adult minimum wage by 18%, as proposed by New Zealand First, can be gained by examining the distribution of employees currently earning wages at or around the current minimum wage. Data from the Household Economic Survey conducted by Statistics New Zealand shows that for the year to March 1996 approximately 3.7% of adult employees were paid between the minimum rate of $6.25 (current at the time of the survey) and the $7.50 proposed by NZ First. This equates to approximately 43,100 employees.

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[1] Note: this effect on teenage employment is based on countries which do not have a separate youth minimum wage rate.

[2] Charles Brown, *Are Minimum Wage Laws Overated?* 1988; and Alison Wellington, *Effects of the Minimum Wage on the Employment Status of Youths, An Update*, 1991

Distribution of Adult and Youth Wage Rates - Household Economic Survey (Statistics New Zealand- March 1996)

	HOURLY WAGE			
	<$6.25	$6.25-$7.50	$7.51-$8.12	>$8.13
Adult	3.5%	3.7%	3.8%	89.0%
	<$3.75	$3.75-$3.94	$4.51-$4.87	>$4.88
Youth	3.0%	4.8%	1.2%	91.0%

Any potential impact is likely to fall to a greater degree on young adults (20-24 year olds). The Household Economic Survey showed that, during the year to March 1996, 10.1% of young adults earn wages between the adult minimum rate of $6.25 and $7.50. This compares to 2.8% of employees aged 25 years or more. Approximately 14,800 young adults therefore would be affected by this proposal.

Impact on youth employment

In addition to their proposal to increase the adult minimum wage rate, New Zealand First has also proposed the introduction of a scaled youth rate structure ranging from $2.25 (30% of proposed adult rate) for 12 year olds to $6.75 (90% of proposed adult rate) for 19 year olds.

While information on the impact of a scaled youth rate is not readily available, some indication of the potential impact of this proposal can be gained from earnings data obtained by the Department of Labour during a study of youth rates in August of 1995[1].

Within the age groups of 16 -19 years the percentage of employees paid between the youth rate of $3.75 and the relevant level of NZ First's proposed graduated youth rates scale are:

11% of 16 year olds were paid between $3.75 and $4.50 (60% of $7.50)
27% of 17 year olds were paid between $3.75 and $5.25 (70% of $7.50)
23% of 18 year olds were paid between $3.75 and $6.00 (80% of $7.50)
23% of 19 year olds were paid between $3.75 and $6.75 (90% of $7.50)

Overall, approximately 22% of youth aged 16-19 years would be affected by these changes. (There are no data available on the wage incomes of employees aged less than 16 years).

The percentage of employees likely to be affected by the introduction of scaled youth rates as proposed by New Zealand First is clearly significantly higher than the percentage of employees likely to be affected by an increase to $7.50 of the adult minimum wage alone. The proposed scale equates to a 18% increase to the current

[1] This is the most up to date information on earnings of employees broken down by each year group. This level of detail is not available to the Department of Labour through the Household Economic Survey.

youth rate of $3.825 for 16 year olds, a 37% increase for 17 year olds, a 57% increase for 18 year olds, and a 76% increase for 19 year olds.

If, however, the adult minimum rate is increased to $7.50 and the current formula for the youth rate (60% of the adult rate for employees aged 16-19 years) is maintained, the effect on teenage employment is likely to be fairly similar to the impact on adult employment as set out above. According to the Household Economic Survey approximately 4.8% of employees aged 16-19 years were paid between the youth minimum rate of $3.75 (current at the time of the survey) and $4.50 (which is 60% of the $7.50 proposed by NZ First) for the year to March 1996. This equates to approximately 3,900 teenage employees.

Increases in the minimum wage are inconsistent with a policy imperative to getting disadvantaged job seekers into employment.

Concern over potential negative employment effects is heightened by the current macroeconomic situation. Economic indicators show that the New Zealand economy and labour market have slowed down considerably in the past year. GDP growth has slowed from 5.5% per annum in the year to June 1995, to 2.1% per annum for the year to June 1996. Similarly, employment growth has slowed from 4.9% per annum in the year to June 1995 to 3.9% per annum in the year to June 1996. As reductions in employment growth tend to lag behind falls in GDP, employment growth can be expected to slow even further in the coming year.

Impact on training

Increases in the level of the minimum wage may also affect individuals' choices to enrol in educational or training programmes, and employers incentives to provide on-the-job training and the availability of jobs in which people can develop work experience. All are important. When the return for low paid work is increased this may encourage employees to leave educational or training programmes and take up low paying jobs rather than absorb the loss of income incurred while enrolled in a programme.

Any reduction in the level of training can have an on-going impact on training by reducing the long term human capital accumulation of employees. Young employees who leave training programmes to take up low paying jobs are unlikely to accumulate skills over their life-time to the same level as they would have had they remained in training during this critical period.

While an increase in the minimum wage might be expected to increase the number of younger people looking to participate in work rather than education and training, the increase in the minimum is also likely to decrease the availability of entry level jobs. The net effect is uncertain.

Increases in the minimum wage may also affect employers' incentives to provide on-the-job training by raising per unit labour costs. This is because employers may be willing to incur some but not all of the costs of training individuals with low skills given that there is a chance of a worker moving to a better paid job as soon as they are trained. On the other hand, employees may be willing to pay for the training

themselves by accepting lower wages during the training period. The key point is that informal training provided by employers increases the employees' general skills and employability. Informal on-the-job training for the low skilled is not recognised under the Minimum Wage Act so employers cannot pay employees undergoing this form of training less than the minimum wage. This means that employers will want to hire more productive people, leaving few opportunities for the most disadvantaged to find employment.

Other macroeconomic impacts

On the basis of earlier analysis, we expect that increasing the minimum wage will result in some job losses. There will also be an impact on inflation. The first round effect, if there were no job losses, would be to increase inflation by around 0.2 to 0.3 percentage points. Job losses would reduce the impact of the minimum wage increase on inflation.

At the same time, substantial increases in the minimum wage could put additional pressure on wage settlements throughout the rest of the economy by lifting the wage floor. That would increase the potential impact on inflation and inflationary expectations more generally. The additional inflation pressure also means that monetary policy will need to be tighter than it otherwise would be to achieve any particular inflation target, with consequent effects on output and employment. This would mean added pressure on the tradeables sector.

Increasing the minimum wage could improve incentives to be in paid work rather than on a benefit, potentially increasing the supply of labour. However, increasing the minimum wage will reduce the numbers of low paid jobs available, people willing and able to work may not be able to find employment. It is possible that in the long run incentives to participate in paid work may be reduced if job opportunities are not available.

The interaction between the minimum wage and the tax and welfare system also has implications for fiscal costs. With a higher minimum wage, people are likely to earn more in employment, reducing the cost of tax credits such as the Guaranteed Minimum Family Income, and reducing the cost of abated benefits for those working part-time. However, it is likely that the increase in unemployment due to job losses will more than offset those effects, and increase the cost of benefit expenditure.

Impact on employees' incomes

The adverse impacts on employment are unlikely to be offset by big gains in terms of increased incomes for the working poor.

As any increase in the minimum wage will increase labour costs, firms will seek to adjust to this by reducing costs in other areas, such as changing terms and conditions of employment, or reducing employees' hours of work. As the minimum wage is based on an hourly rate, adjustments to hours of work will undermine the net income of affected employees.

In addition, the focus of social policy in recent years has been on the welfare of families rather than individuals. Assessment of the impact of a minimum wage increase on incomes of low income families must take into account the fact that many low-income earners may be members of families that are not poor collectively. This is because some people on the minimum wage are the second income earner or child of a middle or high income family. A study of the likely effect of introducing a minimum wage in the United Kingdom found that introducing a minimum wage is likely to have only limited effects on poverty even if there are no negative effects on the labour market. This is because the large majority of those on very low wages are members of a family or household with other members earnings higher wages[4].

Other issues: Compliance

As a significant increase is likely to result in a higher degree of non-compliance, it is also likely to place greater demands on the resources of the Labour Inspectorate as the state's enforcement agency for the minimum wage.

The introduction of 8 new youth rates could also increase compliance costs because employers and employees will need to have more information in order to implement these additional youth rates.

With any minimum wage, there is the potential to create a "black market", with employees and employers colluding to by-pass the law. The higher the level of the minimum wage, the greater the incentive to by-pass. An increase in the minimum wage of 18% is likely to significantly increase the incentives for non-compliance. Employers and employees agreeing to avoid the minimum undermines the effectiveness of the policy, although may lead to a smaller fall in employment.

[4] Paul Johnson and Graham Stark, "The Effects of a Minimum Wage on Family Incomes" Fiscal Studies, 1991.

REQUEST FOR INFORMATION: EMPLOYMENT CONTRACTS ACT

Information requested

What are the implications of codifying the existing case law relating to personal grievances and procedural issues within the Employment Contracts Act to ensure that all employees and employers have a central legislative reference that outlines their rights and responsibilities?

Introduction

This paper's discussion of the implications of the proposal to codify existing case law into a central legislative reference has been qualified by the absence of an indication of the particular problem the proposal is intended to address. There is a wide range of issues with policy implications arising out of the operation of the current personal grievance framework which would need to be considered in the course of developing proposals.

A second important point to note is that codifying existing case law does not equate to creating a central legislative reference that clearly outlines their rights and responsibilities for all employers and employees. Existing case law has not comprehensively dealt with all areas relating to personal grievances; in some instances case law may be considered to be at best unclear and at worst contradictory; and in other instances case law may have produced outcomes which may not be assessed as contributing positively to the policy objectives of the personal grievance provisions of the Employment Contracts Act. The following assumptions have therefore been identified as the basis for this paper's discussion of the implications of the proposal.

Assumptions used in order to respond to request

The main assumptions made in this paper are as follows:

- codifying existing case law will not by itself ensure that employers and employees have a central legislative reference that clearly outlines their rights and responsibilities. In some areas policy issues would need to be addressed as well as further clarification being needed in addition to case law to provide a clear central reference.
- the objective of the proposal outlined above is in fact to provide a central legislative reference outlining rights and responsibilities in respect of personal grievances, rather than merely codifying case law.
- the proposed mechanism is designed to address the criticisms of the current personal grievance system discussed below, in particular the lack of certainty for the parties in understanding what their respective rights and obligations are.
- the reasons for including personal grievance provisions in the Employment Contracts Act remain valid.
- the procedural issues referred to in the question relate to personal grievance procedures and not to bargaining processes.

- the question is primarily concerned with unjustifiable dismissals as these make up most of the personal grievances which are dealt with formally through the Employment Tribunal.

Objectives of Personal Grievance Procedures

Personal grievance procedures and remedies were included in the Employment Contracts Act in order to:

- limit conflict, particularly industrial action, that might otherwise occur in the absence of such mechanisms;
- enhance employees' freedom of choice in the selection of their employment contracts by ensuring equal access to procedures and remedies where they believe that they have been unjustifiably dismissed; disadvantaged by some other unjustifiable action; discriminated against; sexually harassed; or subject to duress because of membership/non-membership of employees' organisations;
- provide employment protection by ensuring an effective means of redress for employees against discriminatory or otherwise unfair employment practices; and
- ensure that grievances were settled as close to the workplace as possible.

Criticisms of Current Statutory Personal Grievance Provisions

The main issues arising from criticisms of the current personal grievance provisions have been that:

- the current system creates too much uncertainty, particularly for employers who are not clear what their obligations are when considering the dismissal of employees. Requirements emerge on a case by case basis from the courts and this information is both difficult to access as well as to apply with any certainty to different factual situations. Employers have expressed concern that this uncertainty limits their ability to know how to act to avoid expensive personal grievance claims and compensation (see Appendix 2 for compensation levels). Examples of employers' concerns include redundancy compensation and fixed term contracts.
- the courts have placed too much emphasis on employers' obligations to follow detailed fair procedures in dismissal cases, so that dismissal is perceived as complex and cumbersome even where there is good cause for dismissal.
- the resolution of grievances has become too legalistic, focusing on legal arguments rather than the pragmatic resolution of workplace level grievances. Increasing numbers of applications to the Employment Tribunal suggest more parties are relying on the Tribunal for dispute resolution rather than settling grievances at the workplace.
- additional resources for the Employment Tribunal are necessary to ensure that the personal grievance procedures are effective.
- statutory grievance procedures are unnecessary and the common law, together with general legislation such as the Human Rights Act 1993 and the NZ Bill of Rights Act 1990 provide a better basis for resolving grievance disputes. Other issues such as the ability to contract out of the Employment Contract Act's personal grievance framework have also been raised (See Appendix 1 and the paper responding to the question "Are there any changes to the ECA that would help to increase sustainable

rates of economic growth, and/or improve labour market performance?"). Grievance procedures act as a disincentive to employment.

Codification: Definition

For the purposes of this note, codification is used to refer to creating a clear central legislative reference for employers and employees. This involves bringing together in statute the various case law requirements relating to dismissals and where necessary simplifying and adjusting these to create a clear and consistent code. By far the majority of grievances dealt with by the Employment Tribunal are claims of unjustifiable dismissal (see Appendix 2). Comparatively few issues have arisen in respect of other types of grievances. Codification would also need to deal with, where and as it was considered appropriate, broader factors such as the New Zealand Bill of Rights Act and international obligations (see Appendix 1).

In practice codification would be likely to focus on clarifying the specific obligations of the parties rather than, for instance, stating that a particular behaviour or action constituted a justifiable reason for dismissal. This is because current case law emphasises the interrelatedness of procedural and substantive concerns in personal grievances. In one set of circumstances, therefore, a reasonable employer might find after proper investigation that a particular action by an employee was sufficient ground for dismissal. In different circumstances, a reasonable employer might properly conclude that the same action was not sufficient cause for dismissal.

Codification could set out, for example, requirements for the giving of warnings; specifying how and when employees have the chance to put their case; what constitutes an impartial investigation by employers; or the carrying out of suspensions. The extent to which codification would address the issues raised in criticisms of the current framework is discussed below.

The note also assumes that codification would be legislative rather than, for example, an administrative code of practice promoted to employers and employees. An administrative code of practice would not have the necessary status in law and may lead to greater inconsistencies of process and outcomes.

(i) Uncertainty

Uncertainty about the precise nature and extent of an employer's obligations when dismissing employees is one of the most frequently and consistently identified issues which has emerged in relation to the personal grievance framework.

Codification aims to make knowledge of the current rights and obligations of employers and employees more accessible to both parties. The courts would also have clearer, more specific legislative guidelines within which to work. The perception of uncertainty in the current system may contribute to higher levels of conflict when employment relationships terminate and parties have competing views about their rights and obligations. Better knowledge of clearer, simpler and where necessary more

specific obligations may conversely encourage more settlements at the workplace level before the parties reach the Tribunal.

Effective codification would aim to clearly and comprehensively specify the nature and extent of the parties' obligations. The status of and obligations on the parties in the event of redundancy; in respect of fixed term contracts; and other terminations of employment would be specifically identified in statute. This would also enable the powers of the courts in respect of grievances to be more explicitly identified.

In some instances codification will need to actively seek to clarify and simplify case law. For example, the courts necessarily take each case on its merits and in the case of notice, where the parties have not agreed on a period of notice, the courts will look at what is appropriate in the particular circumstances. In this example, codification could result in a decision to prescribe a standard notice period, to be varied only by explicit agreement of the parties. Some flexibility is lost in this prescriptive approach, but the parties have a clear and specific obligation towards each other. Sanctions, such as levels of available compensation can also be more explicitly defined and codified if considered necessary.

Codification would not eliminate all uncertainty in relation to personal grievances as legislation can never address every possible individual situation. There is also a real risk that codification would increase the amount of prescription without helping the parties understand their obligations and more efficiently avoid or resolve conflict. Any code would itself be subject to interpretation by the courts and would inevitably create additional areas of law for the courts to explore and develop. A code would need to be periodically reviewed to ensure that it remained relevant, clear, comprehensive and sufficiently specific. Initially considerable technical work would be involved in identifying the areas where codification is possible and where it would positively contribute to the objectives of the personal grievance framework.

(ii) Perceived Emphasis on Procedural Issues

Codification of personal grievance case law would clarify but not remove current requirements of procedural fairness. Codification seeks to define precisely what an employers' obligations are in following a fair procedure to decide whether there is a good reason to dismiss an employee and in carrying out a dismissal. Employers would then be better able to comply with clearer, more specific and more accessible obligations.

Concerns that the current system places too much emphasis on employers strictly following fair procedures, rather than focusing on whether substantive reasons for dismissal exist are therefore not directly addressed by codification. Current case law takes the approach that the questions of procedural fairness and substantive cause are inextricably linked. Unless an employer follows a fair procedure and fairly investigates whether there is a substantive cause for dismissal, the employer will not know that any substantive cause actually exists. This approach is closely linked with the courts' application of the principle of natural justice and would be difficult to address directly legislatively.

(iii) Concerns about excessive legalism

Concerns that the current system is excessively legalistic focus on personal grievances (mainly unjustifiable dismissals) adjudicated by the Employment Tribunal. The objective of the Employment Contracts Act is to settle disputes as close to the workplace as possible. Appendix 1 however shows the increasing number of applications to the Tribunal.

Codification aims to change the emphasis from case law to statute and to make knowledge of the parties' legal requirements more accessible. Clearer and simpler statutory obligations should reduce the need of parties to resort to legal action and encourage the speedier resolution of disputes where they do arise. There is the potential therefore, for codification to reduce the workload of the Tribunal as the parties may be better placed to make an effort to settle at workplace level before reaching the Tribunal. As noted above, however, there is a risk that codification, if not carefully undertaken, may result in increased prescription without effectively clarifying the parties' obligations. This would in turn make personal grievance resolution more, not less, legalistic.

(iv) Resourcing of the Employment Tribunal

The effectiveness of any option, including codification or any of the options briefly outlined below will depend on it being appropriately resourced.

(v) Other Possible Options

Codification of existing case law into statute is one option to deal with the issues that have arisen in relation to personal grievances. There are other possible options to address the issues relating to personal grievances which could also be considered individually or in combination. These include:

- *removing statutory grievance procedures, or introducing entirely different dispute resolution processes*

  Appendix 1 discusses the option of removing statutory personal grievance procedures and allowing employees to rely on common law processes and remedies in more detail. Some criticisms of the current system are likely to also arise in respect of a common law system, in particular the issue of uncertainty about what is expected; the need for employers to follow fair procedures and legalism. In addition concerns are likely to grow about access to the civil courts because of their workload and the cost of the process. Entirely new and different statutory disputes procedures would also have to take into account the developments of case law and expectations of the parties which have developed over the twenty years of grievance procedures.

- *changing the balance of procedural and substantive considerations in grievances.* The paper notes the difficulties in separating these considerations, which the courts have found to be closely interrelated. The Employment Contracts Act currently aims

to manage the balance by requiring the Tribunal and courts to take contributory fault by the employee into account when awarding remedies. It may be possible to strengthen this requirement or look at other ways of managing the balance.

- *examine the institutional arrangements underpinning the grievance procedures and the powers and roles of the Labour Inspectorate, Employment Tribunal and the courts*;

  Options for addressing concerns about legalism in particular could be addressed by examining the institutional arrangements underlying grievance procedures. More rigorous requirements on the parties to seek to resolve disputes themselves before being able to use the Tribunal are one possibility, though there is a risk that additional steps in the process may merely be treated as additional formalities to be completed before access to the Tribunal can be obtained. It may also be possible to consider whether the Labour Inspectorate could be used to help the parties talk to each other and settle before reaching the Tribunal.

  Limiting the grounds of appeal to the Employment Court has also been raised as a way of addressing excessive legalism. However, although the possibility of appeal undoubtedly has an effect on the way cases are conducted, in practice the great majority of Tribunal decisions are not appealed to the Court (see Appendix II for figures). Tightening the grounds for appeal may therefore have only a limited impact on the approach of the parties and their representatives.

- *introducing specific limits within the framework, for example, access to statutory personal grievance procedures and regulating the level of compensation able to be awarded.*

The issues of uncertainty and legalism could also be addressed in specific areas identified as of being particular concern by introducing statutory limits. For example access to the Employment Tribunal and Court could be limited to personal grievance claims under a certain sum; or to employees with income under a certain level; or other criteria could be identified. Other disputes would however end up in the civil system, and the issues identified above would arise in respect of these. In addition, one of the most widely acknowledged benefits of the Employment Contracts Act has been that it has given all employees with disputes based on employment contracts the access to the same processes and remedies. The advantages and disadvantages of changes to this largely consistent framework would need to be carefully considered.

It has also been suggested that concern about the levels of compensation could be introduced by setting limits on compensation. Appendix II provides information about recent compensation patterns, though not compensation for loss of remuneration which is calculated according to an individual's particular earnings and related entitlements. The table shows that just over half of compensation granted is less than $5000 and few people are awarded over $9-11,000. The benefits of certainty to the parties in knowing the extent of their liability or entitlement would need to be weighed with the potential loss of flexibility to deal with exceptional circumstances and incentives on claimants to make civil claims of wrongful dismissal where no such limits would exist.

Conclusion

Codification to achieve a clear central legislative reference for employees and employers is a serious option with a number of advantages. In particular it aims to put the parties themselves in a better position to understand their rights and obligations and so to avoid, and if necessary, resolve grievances. While codification may be effective in addressing the major issue of uncertainty by the parties, particularly by employers. and merits careful and thorough examination, it may have less effect in terms of other concerns which have been raised. These include the need to move to different systems to resolve grievances; concerns about the current perceived emphasis on procedure and about the legalistic nature of the current framework. A risk of codification is that if it fails to genuinely clarify and simplify obligations the increased prescription will lead to greater uncertainty rather than less. Until a code is drafted you cannot tell what it would achieve. There are substantial policy issues to be resolved in the development of any such code.

APPENDIX I

Effect of the Removal of the Statutory Personal Grievance Procedures

Removal of the current statutory personal grievance provisions would leave employees relying on both common employment law rights and some more general statutory rights provided under general human rights legislation.

Common employment law rights

Employees would have access to the protection of those common employment law rights that have developed as statutory personal grievance procedures have become more comprehensive since they were first introduced in the early 1970s. Common law actions were traditionally restricted to the short periods of notice available under contracts and were generally perceived as uneconomic except for highly paid employees. The law has, however, developed to the extent that an increasing emphasis on natural justice and procedural fairness has developed, and the restrictions on damages are less strict.

Common employment law rights are available for those employees alleging that they have been wrongfully dismissed[1]. While it has not yet been conclusively tested, it may also be possible for an employee who remains in an employment relationship, but who believes that they have been unfairly treated, to claim under common law that the requirement of trust and confidence in the employment relationship has been breached. There is, however, currently no specific common law protection for those employees who believe they have been:

- unfairly dismissed;
- disadvantaged by an unjustifiable action by their employer;
- discriminated against;
- sexually harassed; or
- subject to duress in their employment in relation to their membership or non-membership of an employees organisation.

As noted below there are, however, some protections provided by the Human Rights Act and/or the Bill of Rights Act for employees in some of these situations and, further development of the protections available under common law is likely.

An employee taking an action in common law today may be entitled to:

- awards for remuneration based on what the Court finds the loss to the employee to be.

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[1] Unjustifiable or unfair dismissal is not available at common law. Employees who have been dismissed without receiving sufficient notice can, however, take a common law action alleging wrongful dismissal. By way of background common law wrongful dismissal and the statutory concept of unjustified dismissal today both co-exist as alternative employment law actions. The Court of Appeal in Ogilvy & Mather (NZ) Ltd v Turner [1993] 2 ERNZ 799 held that under section 104(1)(g) of the Employment Contracts Act the Employment Court has the jurisdiction to hear wrongful dismissal actions. The High Court also has the jurisdiction to hear cases concerning common law wrongful dismissal. It should be noted that personal grievances and common law wrongful dismissal are in the process of developing in the same direction because of the application of the principles of natural justice.

- damages for undue mental distress, anxiety, humiliation, loss of dignity and injury to feelings.
- while no awards have been made under the common law to date, it is possible that employees may also be entitled to receive exemplary damages or even aggravated compensatory damages.
- there is also no requirement in common law for courts to take the conduct of the employee into consideration when assessing the compensation an employee should receive.
- such actions are also not subject to the 90 day limitation imposed by the Employment Contracts Act. Claimants have 6 years to bring claims in common law.

It is likely that the common law would develop significantly in the absence of statutory regulation for personal grievance dispute resolution. The growing emphasis on the notion of individual rights coupled with a lack of specific regulation could lead to innovative approaches by the courts to issues such as available causes of action and available remedies.

Other statutory rights

In addition to the rights established over the years under common law, employees are also provided with a number of other general statutory protections through the operation of legislation such as the Human Rights Act 1993 and the New Zealand Bill of Rights Act 1990. Employees are, for example, able to seek redress against discriminatory treatment in their employment through the provisions of the Human Rights Act. They may also, through the Human Rights Act, be able to seek the protection of rights contained in the United Nations Covenants on Human Rights such as the International Covenant on Civil and Political Rights (ICCPR) and the International Covenant on Economic Social and Cultural Rights (ICESCR). It is also likely that general rights provided by the Bill of Rights Act, such as the right to freedom of association and to the observance of the principles of natural justice, may be more heavily relied upon in an environment without statutory personal grievance protection.

The existence of the statutory personal grievance regime has meant that employees have not relied heavily on these rights and the courts have not often considered their effect in an employment setting. The scope of these general rights would, like the scope of common employment law rights, be likely to develop over time as they were more heavily relied on and more fully considered in the employment environment.

APPENDIX II - PERSONAL GRIEVANCE STATISTICS

Personal Grievance Disposals in the Employment Tribunal 1991-96

	Unjustifiable Dismissals	Other Personal Grievances*	Total Personal Grievances	Total Tribunal Disposals
1991/92	468	32	500	743
1992/93	1203	39	1242	1568
1993/94	1962	84	2046	2447
1994/95	2511	108	2619	3040
1995/96	2568	133	2701	3220

*Includes disadvantage, discrimination, sexual harassment and duress.

- Approximately 85% of the cases disposed of in the Employment Tribunal were personal grievances, and approximately 95% of the personal grievances were allegations of unjustified dismissal.

Mediated and Adjudicated Personal Grievances in the Employment Tribunal June 1995 to June 1996

	Mediation	Adjudication	Total
Unjustifiable Dismissals	2141	427	2568
Other Personal Grievances	118	15	133
TOTAL	2259	442	2701

- Approximately 84% of all claims for unjustifiable dismissal taken to the Employment Tribunal and 84% of all personal grievances were settled in mediation, while 16% of personal grievances and claims for unjustifiable dismissal were settled in adjudication.

- In the 1995/96 year the Employment Court issued 125 judgments. Approximately 55 of these judgments were decisions about appeals against adjudicated decisions of the Employment Tribunal concerning personal grievances, most of which were appeals against adjuducated decisions of the Employment Tribunal concerning claims for unjustified dismissal.

Compensation Awarded for Humiliation etc Table (s40(1)(c)(i) ECA)
Employment Court and Employment Tribunal
1 January 1995 - 31 July 1996

Awards	Employment Tribunal		Employment Court	
	Jan 95-Dec 95	Jan 96-Jul 96	Jan 95-Dec 95	Jan 96-Jul 96
1-999	15			
1,000 - 1,999	24	16	1	
2,000 - 2,999	36	18	5	
3,000 - 3,999	27	12	1	
4,000 - 4,999	26	10	2	
5,000 - 5,999	20	19	3	
6,000 - 6,999	30	10	1	1
7,000 - 7,999	11	9	5	2
8,000 - 8,999	8	5	1	1
9,000 - 9,999	1		1	
10,000 - 10,999	12	5	2	
12,000	2	1		1
13,500	1	1		
15,000	4	3	4	1
16,000		1		
20,000		1	5	
25,000	2		3	
30,000			2	
35,000	1			
45,000	1			
50,000				1
TOTAL	221	111	36	7

- These figures are for adjudicated decisions of the Employment Tribunal and decisions of the Employment Court. As noted above the bulk of personal grievance cases are disposed of in mediation in the Employment Tribunal, not in adjudication. Settlements reached in mediation are confidential and are reached by mutual agreement between the parties.

- It is estimated that compensation was awarded under s40(1)(c)(i) in approximately 50% of adjudicated decisions of the Employment Tribunal, and in approximately 45% of decisions of the Employment Court.

- It should be noted that employees who are found by the Employment Tribunal or Employment Court to have personal grievances can also receive monetary awards in the form of reimbursement for lost remuneration (s40(1)(a)), or compensation for any other benefit of a monetary kind (s40(1)(c)(ii)). Awards made under these sections are not included in the above figures.

REQUEST FOR INFORMATION: EMPLOYMENT CONTRACTS ACT 508/4

Information requested

i) "Has recent experience demonstrated more or less disruption of essential services since the loss of compulsory arbitration?"

ii) "What are the implications of amending the [Employment Contracts] Act as proposed by NZ First [to introduce compulsory arbitration for "essential services" where industrial conflict could threaten the public good"], including the implications for sustainable growth and labour market performance?

Assumptions used in order to respond to request

- Compulsory arbitration is considered only in relation to essential services, and against the assumption that the key features of the present industrial relations framework are otherwise maintained.

- Figures for industrial action in essential services for extended time series have not been able to be sourced directly from Statistics New Zealand in the time available. Where such figures are used, they therefore represent the "best efforts" made to extract this data from available data, and should be treated with some caution.

Background

1. Historically, the main purposes of compulsory arbitration in New Zealand have been to prevent strikes, help regulate the economy, and ensure that the workforce was treated consistently and fairly by employers. Arbitration and the right to strike are thus generally closely linked. Today, it is mainly the strike avoidance goal that remains, usually focused on the provision of "essential services" (however defined). The core of the argument is that certain groups should either not have the right to strike, or that strikes should be avoided at all costs, because of the serious potential social and/or economic consequences of such actions. While compulsory arbitration is often posed as a viable alternative in such circumstances, the particular means selected to manage such disputes also need to be seen in the broader context of the nature and objectives of the overall bargaining system.

2. Present definitions of essential services derive from a mix of social, political and economic imperatives over time, and have remained largely unchanged despite major social and economic reforms over the last 25 years, particularly the decentralisation of economic activity and reduction in state monopolies. As such, they are arguably outdated, inconsistent, and in need of review. Their relevance in a regime of compulsory arbitration would certainly require further consideration. The current categories relate variously to services concerned with public health, safety, welfare and general economic or environmental interests (see appendix I)[1].

[1] While their functions may also be seen as "essential", neither the Police nor the military are covered by the current definitions, as legislative provisions specific to them override the general statutory framework for industrial relations. The Police are the only case where legislative provision for compulsory arbitration exists, given their statutory and constitutional inability to lawfully strike.

Substantive answer to request(s)

i) "Has recent experience demonstrated more or less disruption of essential services since the loss of compulsory arbitration?"

3. While voluntary arbitration for general bargaining was introduced in 1984, compulsory arbitration remained possible for essential services at the time and under the Labour Relations Act 1987 at the Minister of Labour's direction. As a matter of policy, however, the then Minister of Labour chose not to exercise these powers (i.e. between 1985-1991), which were subsequently removed by the Employment Contracts Act 1991.

4. Generally the level of industrial action over recent years has been comparatively low. While this situation predates the Employment Contracts Act, it has been continued under the Act. Overall, stoppage activity has declined significantly since the 1984 calendar year (when voluntary arbitration was introduced), when 364 stoppages occurred with an estimated loss of $33m in wages and salaries, and further since the enactment of the Act. For the 1995 year there were 69 stoppages with an estimated $6.8m loss in wages and salaries (see appendix II).

5. Essential services, as currently defined, have not featured highly in this generally low incidence. In terms of injunctions sought against such actions figures for the period 1987 - 1995 show that while the overall level rose over the period 1989 - 1992, it has moderated since that time. In absolute terms the highest number of injunctions sought was 24 in 1989, whether in terms of numbers of stoppages, employees involved, or wages lost. For the period 1991-1995 inclusive, essential services disputes accounted for 32% of disputes; employees involved 16%, working days lost 20% and wages lost 19% (See appendix III). Over half of these disputes occurred in the Health sector, with the other main contributors being the meat industry, ports, air transport and prisons.

ii) "What are the implications of amending the [Employment Contracts] Act as proposed by NZ First [to introduce compulsory arbitration for "essential services" where industrial conflict could threaten the public good"], including the implications for sustainable growth and labour market performance?

6. Under the Employment Contracts Act, the parties to employment relationships are responsible for the negotiation of arrangements that best suit the needs of their particular workplaces. Under the bargaining regime introduced by the Act, the key principles are those of non-intervention, the freedom and responsibility of the parties to negotiate settlements, and their accountability for the consequences and outcomes of that process. The corollary is the use of legitimate industrial pressure as an incentive to negotiated settlements. This has assisted in bringing about significant reductions in industrial conflict and improvements in productivity which have in turn aided in marked economic and employment growth. The trend of decreasing levels of industrial action, which began in the mid-1980s, has continued and accelerated since 1991, and work stoppages remain at generally low levels.

7. A range of options for the management of disputes in essential services is possible, from current arrangements through various procedural hurdles, such as pre-strike

balloting, to third party intervention - whether in the form of mediation or arbitration. Which option, or combination of options, is chosen depends on the extent to which either the facilitation of settlements or the prevention of industrial action are seen as primary goals. In considering further regulation in this area, the degree to which current provisions are inadequate in managing conflict and delivering efficient bargaining and general economic outcomes therefore needs to be considered, together with whether different rules should apply in specified industries, given their particular nature.

8. Previous legislative approaches to bargaining have focused on third party intervention in disputes in both the general environment and that of essential services (see appendix IV). Present arrangements extend the disciplines and accountabilities provided by the general framework of essentially free bargaining to essential services, with the proviso of specified advance notice of any industrial action, in order that alternative arrangements can be made and the consequences of the action minimised for the general public.

9. The prospect of a finite deadline for industrial action provided by the notice requirement also tends to focus the attention of the parties, whether in terms of seeking injunctive actions to prevent the action proceeding (such actions are often successful - see appendix II) or allowing a "cooling off' period in which further negotiation or mediation may occur to resolve the dispute. Strikes themselves may also act as "circuit breakers", encouraging progress towards negotiated outcomes. The costs of arranging alternative services may, however, be high as may the inconvenience and other external costs to the general public or selected groups, although most industrial action in essential services is not long running.

10. As well as providing the option of access to voluntary mediation of disputes, the current framework also allows the parties to negotiate specific contractual arrangements regarding the settlement of disputes. This may include recourse to mediation or arbitration. Thus, while there is no general prescription for no strike/compulsory arbitration provisions for essential services, contracts have been negotiated in the Health Sector which provide for compulsory mediation. In addition, in 1994 the Southern Health CHE negotiated a contract with its senior medical and dental staff providing for the adjudication of disputes in event that mediation proves unsuccessful.

11. Generally then, the emphasis remains on providing incentives for the parties to negotiate their own solutions, and to bear the costs of disputes arising when attempting to secure negotiated settlements. Thus, while compulsory arbitration is often posed as a solution to the "problem" of industrial activity in essential services, this can derive as much from perceptions about the relative efficiencies of arbitrated vs. negotiated solutions as from the actual public harm arising from disputes in essential industries.

Compulsory Arbitration - Issues

12. The objectives of compulsory arbitration in essential services may be to promote effective settlements, in the process reducing the likelihood of strikes, or to prevent strikes, in the process making settlements. Arbitration is generally seen to have the following main advantages:

- disputes must be settled - a contract must result from negotiations;
- strike activity is reduced or eliminated through the alternative mechanism provided by arbitration; and
- arbitration may reduce differences of bargaining power, thus resulting in more sustainable results

13. There are, however, also a number of potential disadvantages associated with compulsory arbitration generally, and with its introduction to the current bargaining framework:

- one of the most commonly cited is the so-called "chilling effect", where the likelihood of arbitration reduces the incentives of the parties to resolve their differences through negotiation. Direct negotiation may function simply as a preliminary to arbitration, where positions are outlined, but movement is minimal, given the perceived trade-off that may occur at a later stage in arbitration;

- the parties may become dependent on the system of arbitration over time (the "narcotic effect") as it comes to dominate the negotiating process, and true negotiation atrophies to the point where any difficult issue simply becomes one to be resolved by an outside party. The stakes themselves may be raised in disputes, given the decreased accountability of the parties for resolving their own differences and the "let-out" option of an external decision-maker;

- the benefits of external influence may be outweighed by lack of information of the circumstances, incentives, and interests of the parties. For the arbitrator the objective is to obtain a settlement - not necessarily the settlement most appropriate for the individual circumstances of the parties. This may result minimal movement from the status quo. Changes that might otherwise have been arrived at through bargaining (and possibly industrial action) may take longer to eventuate, resulting in lower flexibility to respond to rapid environmental change. Over half of recent stoppages in essential industries have occurred in the Health sector, where the implementation of successive government reforms has seen major structural change since the late 1980s. While compulsory arbitration may be appropriate for delivering wage-based outcomes, it is unlikely to be an efficient long term instrument in progressing structural and industrial reforms.

- while arbitration is particularly attractive to the weaker parties in the bargaining relationship, economic conditions, which partly determine this, will change over time. This balance will shift in periods of recession and growth - outcomes more favourable to one side in some circumstance will be less so in others, which may compromise the sustainability of settlements; and

- the onus falls increasingly on the State as the source of conflict resolution. Beside the increased administrative costs, the net economic costs of a slower pace of adjustment may also outweigh the net benefit of reduced strike activity, particularly in sectors where the State itself retains a significant funding or provider role.

14. The major disadvantage, however, is the inability of the parties to control the outcomes of the bargaining process, and the devolution of accountability for the final decision and settlement outcomes to a third party. Variants of compulsory arbitration,

such as Final Offer Arbitration (FOA) have been developed to minimise these effects. FOA is essentially a winner take all mechanism - in its most restrictive form, reducing the discretion of the arbitrator to a choice between the total positions of either party. In theory, this provides strong incentives for the parties to narrow their differences or settle without recourse to arbitration, given the all or nothing nature of the final outcome. It thus differs from conventional arbitration, where the exercise of judgement by the arbitrator and movement in the positions of the parties are important. In FOA, the objective is not so much to encourage a settlement through the arbitration process as it is to compel the parties to negotiate their own settlements without recourse to arbitration. Overseas evidence suggests that FOA - particularly in its restrictive form - reduces, but does not eliminate, both the potential "chilling" and "narcotic" effects attributed to conventional arbitration. The overall disadvantages associated with arbitration vs. negotiation are, however, reduced, rather than removed.

Comment

15. The key issue in considering the introduction of compulsory arbitration remains that of the costs associated with the reduction of the freedom of the parties to negotiate settlements reflecting their individual economic circumstances, and the net economic efficiencies which result from that process, vs. the inefficiencies likely to result from third party determination of such issues. While the potential for public harm is an important consideration in the management of disputes in essential services, this needs to be kept in perspective, particularly given the actual nature of "essential services" as currently defined, and the present options for advance notice and substitution of services in managing the consequences of such disputes.

16. While strikes are a feature of bargaining in essential industries, as they are in other sectors, they are not necessarily a symptom of "failed" negotiations, which then require remedying via a third party or specified process. Generally the "essential services" are subject to the same bargaining disciplines as are other parties, and do negotiate settlements. Most disputes do not remain unsettled; most action is relatively short-run in nature. Where action has occurred, coverage has generally been maintained - e.g. via the use of armed force personnel in the prisons dispute, the successful use of voluntary mediation in the Inter-island ferries dispute; use of volunteer firefighters; ability of employers to temporarily replace striking workers or otherwise make alternative arrangements.

17. In addition, under current arrangements, the decentralisation of bargaining has also effectively spread the risk of large scale, concerted industrial action occurring that would affect an entire sector. There is no strong evidence of long run adverse social or economic consequences as a result. This raises as much the question of how special these services actually are, in the sense of needing to be treated any differently to other bargaining parties under current arrangements, as it does whether tighter prescriptions than present should apply.

Other Issues

- *International Obligations*

Current ILO interpretations of the Right To Strike and Freedom of Association Conventions consider restrictions on strike activity such as advance notice, quorums, and secret ballots as generally acceptable, but that compulsory arbitration is acceptable only if at the request of both parties; or if related to the public service; or in essential services, strictly defined as those where interruption would endanger life, personal safety or the health of the populace. Compulsory arbitration is also deemed acceptable in cases where there is a situation of "acute national crisis". There would thus need to be careful consideration of both the groups to whom compulsory arbitration would apply and in which particular circumstances.

- *Definitions/Scope of Application*

As noted above, current definitions of essential services reflect historical and economic factors which have been subject to change. Definitions set for the purposes of strike notice only in an otherwise non-interventionist environment may require significant change if more direct interventions are proposed.

- *Type of Arbitration*

Various forms of arbitration may be considered, ranging from "conventional arbitration" where the objective is to encourage a settlement through compromises reached through the arbitration process to Final Offer Arbitration (FOA), where the objective is to compel the parties to negotiate without recourse to arbitration.

- *Use of Criteria for Arbitration*

Previous forms of arbitration have employed specific criteria which must be taken into account by the Arbitrator, such as supply and demand factors; fairness and equity changes in job content or skills; productivity etc. The relevance of what, if any, criteria might apply would need to be assessed.

- *Choice of the Arbitrator/Arbitrating Body*

The issue of the most appropriate body to arbitrate would need to be considered. This could be a matter determined by the parties or prescribed (either as a default option or as the main provision). The Employment Tribunal is arguably well equipped for the provision of such services, however, resourcing issues would require consideration, given the current workload of the Tribunal in its ordinary grievance and dispute mediation and adjudication functions.

- *Enforceability of Settlements/Sanctions for noncompliance*

Industrial action occurring where compulsory arbitration was prescribed could be simply defined as unlawful and thus subject to fines, return to work orders, exposure to tortious actions etc., or special provisions could be made.

Conclusion

18. Under the Employment Contracts Act, the parties have been given the freedom and responsibility to reach agreements that best suit the needs of particular workplaces. This has assisted in bringing about significant reductions in industrial conflict and improvements in productivity which have in turn contributed to marked economic and

employment growth. The trend of decreasing levels of industrial action, which began in the mid-1980s, has continued and accelerated since 1991, and work stoppages remain at historically low levels.

19. While strikes are a feature of bargaining in essential industries, as they are in other sectors, they are not necessarily a symptom of "failed" negotiations, which then require remedying via a third party or specified process. Nor are they a significant feature of the system overall. Most disputes in such sectors are settled, and there is no strong evidence of long run adverse social or economic consequences as a result of such disputes, given current provisions for advance notice and substitution of services.

20. Compulsory arbitration would reduce or remove the accountability of the parties for both the process and the outcomes of their negotiations. Changes that might otherwise have been arrived at through bargaining (and possibly industrial action) may take longer to eventuate, resulting in lower flexibility to respond to rapid environmental or economic change, particularly in sectors such as Health where the State retains a significant funding or provider role. Compulsory arbitration is unlikely to be an efficient long term instrument in progressing structural and industrial reforms, while the net economic costs of a slower pace of adjustment may also outweigh the net benefit of reduced strike activity.

21. Should a decision be made to intervene in bargaining disputes in essential service industries on public benefit grounds, such intervention should be as consistent as is practicable with the current bargaining framework, and reserved only for the truly "essential" services. This would require a reconsideration of current categories. These might be defined more strictly as those which directly relate to the preservation of public health, safety and order and where no effective substitutes can be found; coverage maintained or alternative arrangements made. *If the objective is to promote effective settlements*, in the process reducing the likelihood of strikes, but preserving current incentives for accountability, one option might be to introduce compulsory *mediation*, but retain the right to strike.

22. If, however, arbitration is a feature of dispute management in essential services, and *the objective is primarily to prevent strikes,* it should be of a type which encourages the voluntary settlement of bargaining disputes before the point at which arbitration actually occurs, thus limiting the costs and inefficiencies that might otherwise result from third party intervention. This suggests some form of final offer arbitration. It would also be preferable for compulsory arbitration to be applied only where a no - strike approach could be fully justified. Outside of the Police, there are arguably few, if any, such cases, given current possibilities for substitution and alternate provision of services.

Appendix I

EMPLOYMENT CONTRACTS ACT: ESSENTIAL SERVICES DEFINITIONS

PART A [Notice period not less than 14 Days]

1. The production, processing, or supply of manufactured gas or natural gas (including liquefied natural gas).
2. The production, processing, distribution, or sale of petroleum, whether refined or not.
3. The production or supply of electricity or the operational management of the Electricity Corporation of New Zealand Limited.
4. The supply of water to the inhabitants of any city, district, or other place.
5. The disposal of sewage.
6. The work of any fire brigade within the meaning of the Fire Service Act 1975 (but excluding the work performed by members of volunteer fire brigades).
7. The provision of all necessary services in connection with the arrival, berthing, loading, unloading, and departure of ships at any port.
8. The operation of any service for the carriage of passengers or goods by water between the North Island and the South Island or between the South Island and Stewart Island or any service necessary for the operation of such a service.
9. The operation of any air transport service, being a service by aircraft for the public carriage of passengers or goods for hire or reward (but excluding an air topdressing service), or any service necessary for the operation of such an air transport service.
10. The operation of any ambulance service for sick or injured persons.
11. The operation of a hospital within the meaning of the Hospitals Act 1957 (including a licensed hospital within the meaning of Part V of that Act) or of a psychiatric hospital within the meaning of the Mental Health Act 1969 or of any service necessary for the operation of such a hospital or psychiatric hospital.
12. The manufacture or supply of surgical and dialysis solutions.
13. The manufacture or supply of any medicine which is specified in the direction known as the Drug Tariff (given pursuant to section 99 of the Social Security Act 1964) and which is described in that Tariff as being available only on the prescription of a practitioner.
14. The operation of any welfare institution or prison.
15. The production of butter or cheese or of any other product of milk or cream and the processing, distribution, or sale of milk, cream, butter, or cheese or of any other product of milk or cream.

PART B [notice period not less than 3 days].

1. The holding and preparation of sheep, cattle, goats, pigs, or deer for slaughtering, the slaughtering of such animals, and the subsequent processing of their meat and smallgoods for the domestic market or the export market.
2. The operation of meat inspection services associated with the slaughtering or supply of meat for domestic consumption.

Appendix II

Industrial Action: All Industries 1984-1995

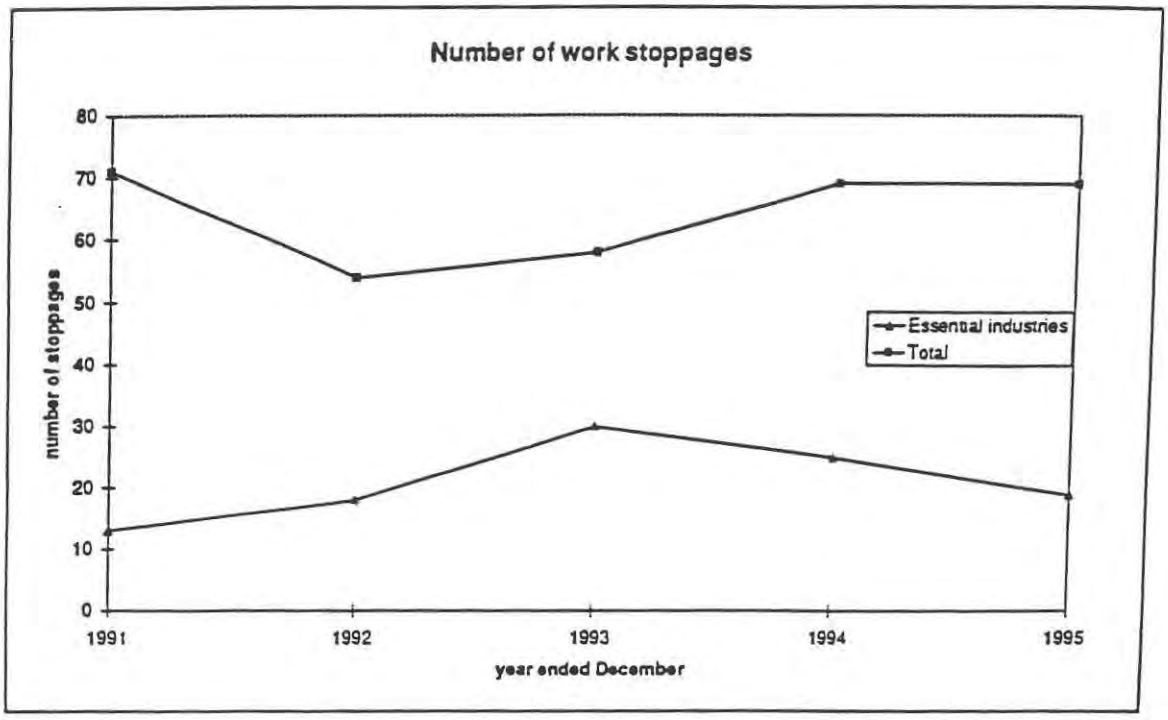
Year (Dec)	Total	Employees involved (000)	Working days lost (000)	Est. loss in wages and salaries $(000)
1984	364	160.3	424.9	33,640
1985	383	182.2	756.4	47,854
1986	215	100.6	1,329.1	119,496
1987	193	80.1	366.3	24,204
1988	172	104	381.7	32,632
1989	171	78.9	193.3	18,763
1990	137	50	330.9	48,433
1991	71	52	99	11,577
1992	54	26.8	113.7	19,372
1993	58	21.3	23.8	2,863
1994	69	16.0	38.2	4,580
1995	69	32.0	53.4	6,813

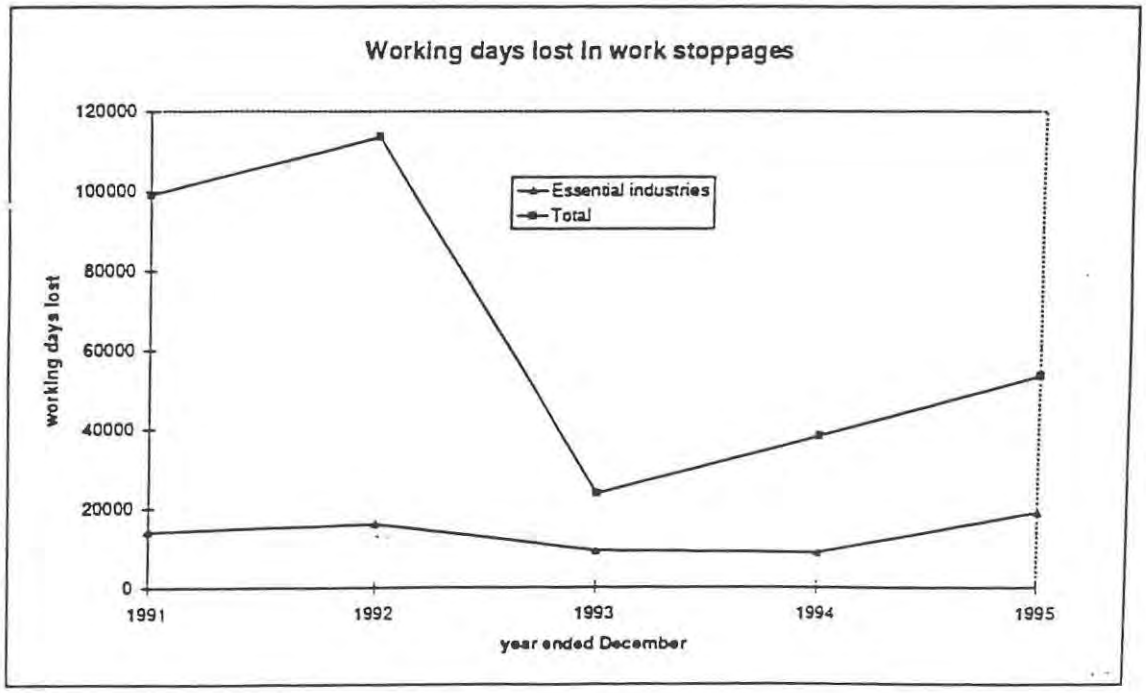
Essential Services: Injunctions/interim injunctions sought/granted: 1987-1995

Calendar year	(n) sought	(n) granted	proportion
1987	5	4	80%
1988	9	6	66%
1989	24	13	54%
1990	13	10	78%
1991	22	10	45%
1992	18	6	33%
1993	9	5	55%
1994	7	7	100%
1995	11	6	55%

Appendix III

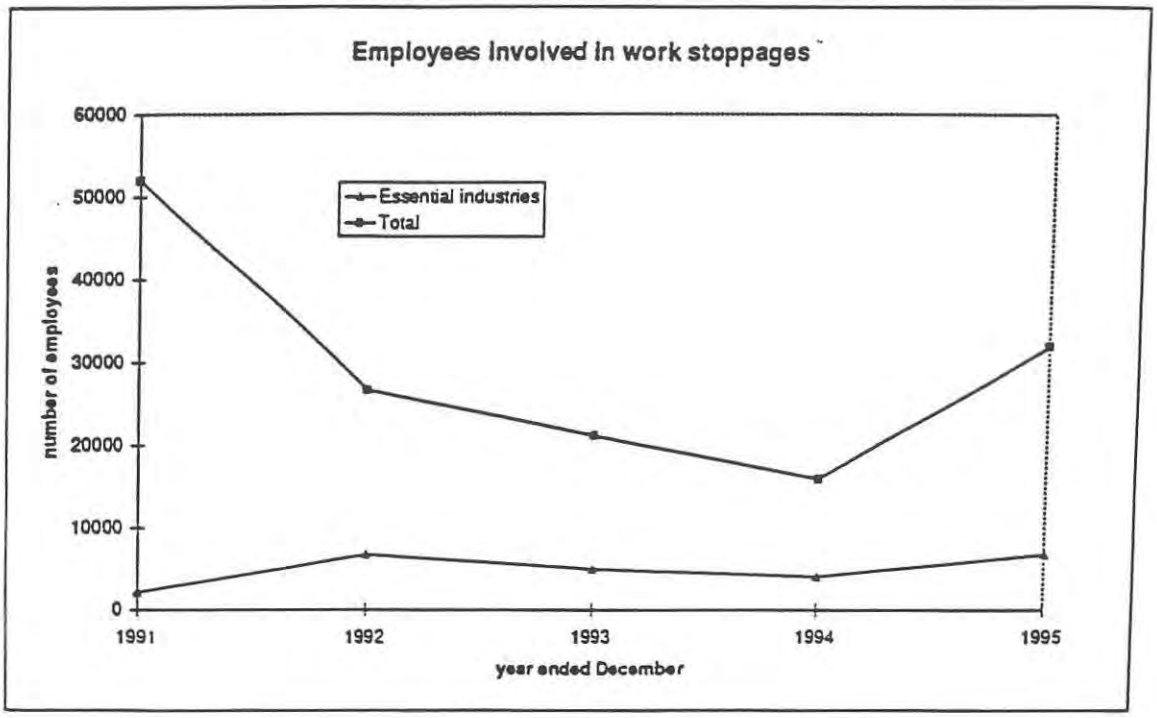
Essential Services - Industrial Action : 1991-1995

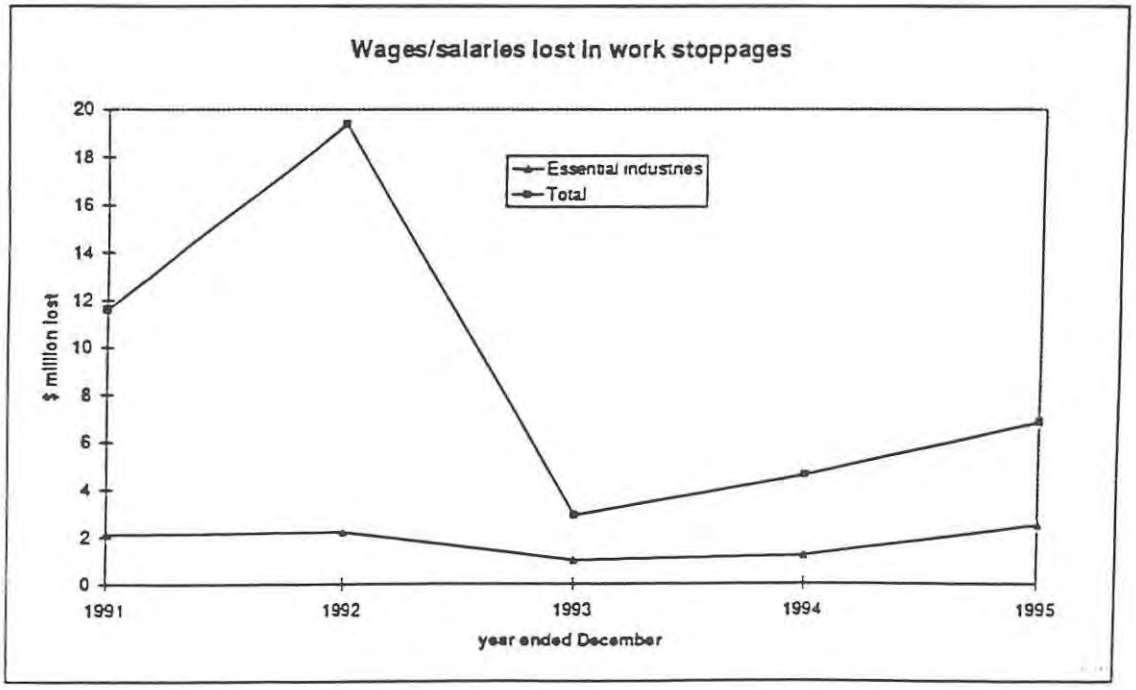




Appendix III (cont.)

Industrial Action - Essential Services: 1991-1995





Appendix IV : Legislative Approaches to Dispute management in Essential Services

Industrial Relations Act 1973

- Strikes and lockouts in "certain essential industries" and "export slaughterhouses" unlawful if 14 days' notice in writing not given.

- Act amended in 1981 to give the Minister of Labour power to deal with disputes in essential industries and export slaughterhouses and those which affect the public interest.

- Where the Minister of Labour was of the opinion that an existing strike or lockout in an essential industry or export slaughterhouse, and that this substantially affected the public interest, the Minister could appoint a conciliator, or mediator, or any other person to inquire into the facts of the dispute and endeavour to settle it.

- If dispute not resolved, Minister able to refer the matter to the Arbitration Court, who would set a date for hearing the dispute as a matter of urgency. If Court satisfied dispute would substantially affect the public interest, could make a determination settling the dispute or prescribing the procedure to be followed in settling the dispute. If no resumption of work following determination by the Court, Court would order a resumption. Penalties able to be imposed if order not obeyed.

- Minister had general power to take action, via calling Compulsory Conferences and Committees of Inquiry, in *any* dispute involving a strike or lockout.

Labour Relations Act 1987

- Strikes or lockouts in "essential services" unlawful if 14 days' written notice not given (3 days' for the "slaughtering of meat" industry).

- Where existing or threatened strike or lockout in an essential service, and the Minister of Labour, or the Chief Mediator, considered that this would affect the public interest, either could request a mediator or other person to inquire into the facts of the dispute and endeavour to resolve the dispute.

- If the dispute not resolved, Minister could refer the dispute to Labour Court for settlement. If Court satisfied the strike or lockout would affect the public interest, it could then settle or prescribe the procedure to be followed to settle the dispute. In the case of a dispute of interest, the Court would refer the dispute to the Arbitration Commission, who had the power to arbitrate without the consent of the parties.

- Any such decision was final and binding on all parties. If such orders were not followed, the Court could order compliance with these decisions if applied for by any of the parties. Penalties were able to be applied if such an order was not obeyed.

- Minister of Labour had general power to take action, via calling Compulsory Conferences and Committees of Inquiry, in *any* dispute involving a strike or lockout.

Employment Contracts Act 1991

- Strikes and lockouts unlawful in "essential services" if 14 days' notice, in writing, has not been given (3 days' for industries involving in slaughtering, processing, and inspection of meat). Provision for voluntary resolution. No ministerial powers to intervene in the negotiation of employment contracts, strikes or lockouts.

REQUEST FOR INFORMATION: EMPLOYMENT CONTRACTS ACT 508/5

Information requested

"Are there any changes to the ECA that would help to increase sustainable rates of economic growth and/or improve labour market performance?"

Introduction

The labour market requires a statutory framework - a set of legal rules which sets the ground rules for employment contracting.

The aim of the statutory framework is to foster a system of employment contracting which contributes to achieving certain outcomes, including sustainable:

- output and employment growth;
- real wage growth;
- productivity growth; and
- low unemployment.

Employment contracting should take place in an environment which ensures equitable treatment.

The ability of the economy in general, and employment contracting in particular, to respond to change is an important factor in achieving these outcomes. Over the past decade, the New Zealand economy and labour market have undergone significant changes, and the need for flexibility and adaptability has been particularly evident.

The statutory framework regulating the labour market, like other legal rules, should conform to particular characteristics:

- *clarity* - the rules should be clear, and should be easily able to be understood;
- *flexibility* - the rules should allow flexible contracting between employers and employees to occur so that they can negotiate contracts that suit their situation;
- *neutrality* - the rules should not confer any particular advantage or disadvantage to any particular individuals, groups of individuals, or types of contract;
- *cost-effectiveness* - the rules should not impose costs or restrict actions any more than is necessary to meet stated objectives.

By conforming to these characteristics, uncertainty and costs are kept to a minimum, and the regulation will not artificially distort the allocation of resources by unduly restricting the ability of firms and workers to tailor contracts to their needs, or by unduly favouring particular actions or individuals. By pursuing these aims, the labour market regulation will support the overall objectives of sustainable growth in employment, wages, productivity, and output, and low levels of unemployment.

The statutory framework regulating employment contracting needs to reflect the following characteristics of employment.

First, employment contracting is often incomplete. This means that, unlike many sales contracts, the parties enter into a relationship where the terms and conditions of the exchange are ill-defined. The relationship needs to be able to adapt and change as the circumstances which the parties face change. Consequently, the law governing employment contracting is therefore likely to deal flexibly with the processes involved in contracting as well as specific requirements relating to the content of contracts.

Second, the parties may choose collective means to negotiate or adapt their contracts, which requires certain provisions that are not necessarily needed in the laws and regulations governing other forms of contract.

In New Zealand, the statutory framework that regulates the process of employment contracting has at its heart the Employment Contracts Act 1991 (ECA). The ECA provides a good deal of flexibility for employers and employees to negotiate agreements that reflect their particular circumstances. The freedoms provided by the ECA are underpinned by a set of minimum conditions, often referred to as the "minimum code", and by a set of legal institutions to govern many employment contracting rules.

The minimum code encompasses minimum conditions defined in the ECA, together with minima specified in other legislation. Appendix One contains a list of legislation that contains mandatory provisions relevant for employment contracting. The aim of these measures is to provide protection for potentially vulnerable workers whose wages and conditions of employment may otherwise fall below the specified minima. More general legislation such as the Human Rights Act also defines some mandatory provisions for employment contracting.

Inevitably, there will be tensions within any regulation that aims to achieve clarity, flexibility, neutrality, and cost-effectiveness, while providing minimum protections. Where a tension exists, judgements need to be made about the appropriate balance between the various interrelated objectives.

For instance, there can be a tension between flexibility and clarity - the more flexible a legal provision is, the more scope for different interpretations and possibly confusion. Similarly, there is a tension between providing protections and maintaining flexibility. Any minimum protections represent a limitation on the flexibility that firms and workers have to set terms and conditions.

Re-examining any of the tensions that are inherent in the current system, and developing proposals to remedy any identified problems is a worthwhile undertaking. The complexity of the task should not, however, be underestimated. This paper will discuss some areas of the ECA where changes to the existing provisions could improve the quality of labour market regulation, and thus increase sustainable rates of economic growth and/or labour market performance. The changes are in the areas of personal grievances, legal institutions, and the treatment of minimum conditions in general. More work will, of course, be needed if a full analysis of the costs and benefits of the suggestions is to be provided.

Personal Grievances

Personal Grievances were introduced in the 1970's. Prior to that the Common Law rules relating to wrongful dismissal governed the lawfulness or unlawfulness of dismissals. Remedies for wrongful dismissal are still available under Common Law and form a parallel cause of action to Personal Grievances which can be pursued in the Employment Court[1]. Because of the existence of personal grievance provisions, the

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1 Ogilvy & Mather v Turner [1995] 2 ERNZ 398, CA, determined that there is a parallel cause of action. While the Employment Tribunal has the power under s 79(1)(g) "To adjudicate on all actions for breach of an employment contract" there is no power to award damages, only for ordering payment of wages or salary that results from the breach. The Employment Court, under s 104(1)(g) has the power "To hear and determine any

Common Law remedies are at present little used. Were the personal grievance provisions to be removed, it is unclear how the Common Law remedies would develop, although there are indications that they may come to resemble the outcomes for personal grievances.

The issue of personal grievances is discussed in a separate paper that is part of the response to this information request [508/3], in the context of a proposal to codify existing case law. In this section, we discuss some other options for changing the current personal grievance provisions.

As outlined in the separate paper, personal grievance procedures and remedies were introduced to:

- limit conflict, particularly industrial action, that was occurring in the absence of such mechanisms;
- enhance employees' freedom of choice in the selection of their employment contracts by ensuring equal access to procedures and remedies where they believe that they have been unjustifiably dismissed; disadvantaged by some other unjustifiable action; discriminated against; sexually harassed; or subject to duress because of membership / non-membership of employees' organisations;
- provide employment protection by ensuring an effective means of redress for employees against discriminatory or otherwise unfair employment practices;
- ensure that grievances are settled as close to the workplace as possible.

Whether or not personal grievance procedures achieve this will depend on their design and operation. Characteristics of an effective personal grievance system include:

- predictability of outcomes;
- low transactions costs to resolve disputes;
- speedy resolution of disputes;
- compensation that reflects the costs of the grievance;
- the parties resolving their own disputes;

Failure to achieve these outcomes has the potential to adversely affect economic growth and labour market performance. Faced with costly or protracted dispute resolution, or excessive uncertainty about the outcomes of personal grievance processes, employers are more likely to be cautious about entering into new arrangements with workers. In the area of dismissals, which account for the bulk of personal grievance cases, employers are more likely to refrain from hiring new workers, or from dismissing existing workers. This caution will limit labour market adjustment and may have an impact on various aspects of the employment contract. Over time, the effects of personal grievance policies will also affect outcomes in other parts of the economy, and may thus potentially slow employment and output growth.

The level and structure of legal compensation in personal grievance cases can also impair the performance of the labour market and economy. If firms are required to pay, or workers receive, compensation that is not related to the true costs of the grievance, there will be either too many or too few personal grievance cases brought.

Thus, any failure to deliver the desired outcomes listed above will result in poorer labour market and economic performance than is possible.

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action founded on an employment contract" with all the powers of a court of record to award damages and grant other remedies like injunctions.

Uncertainty about outcomes

An area where changes to the current personal grievance system may contribute to better economic growth and labour market performance is that of the predictability of outcomes. There is currently a high degree of uncertainty about the outcomes of personal grievance cases.

The uncertainty arises for a number of reasons. The ECA is not prescriptive in providing for what an unjustified dismissal is or what the remedies are that may result from one. An unjustified dismissal is one that is not justified, that is, one that is not in accordance with justice or fairness. While the Courts have fleshed out the provisions of the legislation through their interpretations, existing case law has not comprehensively dealt with all personal grievance issues. In some instances, case law may be considered to be unclear or contradictory; and in other instances case law may have produced outcomes that may not be assessed as contributing positively to the policy objectives of the personal grievance provisions of the ECA.

There is a range of measures that could address the problem of uncertainty about outcomes of personal grievance actions. The proposal for codification of existing case law is discussed in a separate accompanying paper [508/3], as is a discussion of the inherent difficulties with this approach.

Approaches would include:

- *providing a description of good process* - This option encompasses various approaches to specifying what is required. For instance, in the case of dismissals, such a description could provide employers and employees with some guidance about the necessary components of a process to determine whether to dismiss an employee or not. This approach could allow employers and employees to negotiate the detail of processes that were most suitable to their needs. The description could be included in statute, or distributed in the form of guidelines. Either approach may serve to reduce uncertainty and confusion to varying degrees. The former approach would also more directly affect the development of case law, and could be enforced as law. The second approach would not be enforcable in law, though may impact on the law's direction. Specifying greater detail when setting out what is required is likely to reduce flexibility; the approach will not suit all circumstances. Also, the difficulty of this undertaking should not be underestimated - case law in the area is not always easily generalisable to allow for simple codification, and the need for interpretation of any specific provisions could give rise to further ambiguity as implications are developed in case law. In addition, given the nature of the case law, some policy decisions would be required in determining the detailed rules. Specificying the process in less detail would, however, rely to a greater extent on future case law to define detailed requirements.
- *allowing contracting out* - the issue of allowing parties to agree to personal grievance procedures other than the minimum procedures that are required by the ECA is discussed in more detail in the final section of this paper, on minimum conditions in general.

Emphasis on "procedural" rather than "substantive" issues

As noted in the accompanying paper on codification of personal grievance case law [508/3], there is a perceived problem that the current system of treating personal

grievances focuses on procedural issues more than it does substantive issues. A recent review of the operation of judicial influence on the operation of the ECA[2] has stated that the development of the concept of procedural fairness means that even if a dismissal can be justified in substantive terms, the failure to carry out a dismissal according to fair procedures may invalidate a dismissal.

There are three main responses to such concerns about the emphasis on procedural matters.

First, addressing the uncertainty that has arisen around personal grievances, as discussed in the previous section, will reduce the focus on procedural issues, about which there is the greatest uncertainty. It should be noted that the difficulty of codifying a simple process which reduced the need for future legal debate should not be underestimated.

Second, the emphasis that the courts attach to procedural issues could be altered through a legislative amendment which sought to give some guidance on the weight they should give to procedural issues relative to substantive issues. An indication from Parliament could help to redress, although not eliminate, current concerns. Such an amendment would, however, raise some legal issues, as under current law there is no clear distinction between substantive and procedural issues.

Third, changes to the structure of remedies for personal grievances could increase the emphasis that is placed on substantive matters. Remedies could be made to relate more closely to the behaviour of employees. At present remedies for an unjustified dismissal may not be reduced where the employee does not contribute to any *procedural* failing[3] leading to the determination of unjustifiability, even if they have contributed to the reason for the dismissal. The law could be clarified so that the remedies would be reduced where the employee contributes to any of the circumstances of the dismissal.

On balance, there are a number of options that appear to offer potential for improvements to the current arrangements. These include moves to clarify and simplify some of the issues surrounding personal grievance procedures, altering the structure of remedies for personal grievances, or more direct legislative change on the issue of substance versus process. Note, however, that there are still significant issues that would need to be addressed before these options could be adopted.

Labour market legal institutions

Specialist Institutions

Concerns have also been expressed about various aspects of the operation of the legal institutions that support the ECA - the Employment Court and the Employment Tribunal. These institutions are set up as specialist bodies outside the general Courts system. The way that the specialist institutions are set up and operate potentially gives rise to some tensions:

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2 Hodder and Foster, "The Employment Contracts Act 1991: The Judicial Influence", Report to the Treasury, April 1996, p45

3 The law in relation to this issue is in flux, there are conflicting Employment Court decisions

- employment law may develop in isolation from other legal developments and produce results that are at odds with general developments in the law. However, specialist judges will develop an understanding of the area that judges unfamiliar with that specialist law will not have;
- the nature of the work may restrict the pool of talent that can be drawn on in making judicial appointments;
- specialist courts will always face boundary problems at the edges of their and other Courts' jurisdictions;
- specialist jurisdictions may encourage political appointments to judicial office compared with general courts because the position of an appointee on one legal question is more predictable than across all legal questions.

Employment Court

The greatest concerns about the operation of the employment law institutions relate to the Employment Court.

Concerns expressed about the Employment Court have tended to focus on apparent inconsistencies between judicial decisions and the intent of the statute, giving rise to uncertainty and confusion. There are a number of ways that may, in principle, address this issue. These range from ways of selecting judges, to changing the rights for appeal within the current framework, to various degrees of integration of the Employment Court into courts of general jurisdiction.

- Widening the pool of judicial talent from which judges hearing employment contract litigation are chosen;
- Rotating judges between the divisions of a general court could recognise the build-up of specialist knowledge, but also broaden the knowledge and experience in related areas of law;
- used to provide internal forms of quality control on judicial decision-making;
- Widening the scope for appeal from the Employment Court, such as aligning it to appeal rights from the High Court, should place increased disciplines on decision-making in the Employment Court;
- Parties could be given the option of choosing dispute resolution in the general courts, with the legislation specifying the Employment Court as the default option. This would work only if the Employment Court and the High Court were given the same jurisdiction on employment matters;
- The functions of the Employment Court could be transferred to courts of general jurisdiction.

A fully considered choice of which approach would most effectively address concerns about judicial decision-making would require more extensive consideration than has been possible in responding to this information request.

Employment Tribunal

There are some concerns about the ease of access to and the costs of accessing, the Employment Tribunal. The great majority of cases dealt with by the Tribunal are resolved through mediation, which is an inexpensive and relatively simple method of

resolution. In cases that proceed to adjudication, a detailed knowledge is needed of legal matters and of the developing body of case law. The need for expert legal advice makes access more difficult and expensive for the parties.

Mandatory Provisions

The Employment Contracts Act contains certain mandatory provisions, that limit the range of issues over which employers and employees can bargain or the degree of choice that they have. Further mandatory provisions for employment contracts are contained in other parts of the minimum code, and in other legislation. Appendix One contains a list of statutes that contain mandatory provisions.

Mandatory provisions aim to provide protections for employees and employers. Their existence does, however, lead to a tension between providing protections and the pursuit of output and employment growth. If mandatory provisions are greater than what parties wish to negotiate, the parties may either negotiate to alter conditions that are not prescribed, or employers may choose lower levels of employment than they would otherwise have chosen. Generally, providing protections entails some costs, but exist because of perceived benefits of having those protections.

When choosing what is to be specified as a mandatory provision for employment contracts, it is necessary to define the level, the coverage (who is covered), the scope (what is specified), and the means of ensuring compliance. This does require a careful balancing of costs and benefits on each of these dimensions.

Mandatory provisions do not have to be universal. Prior to the ECA, personal grievances were not available to all employees. Under the Industrial Relations Act only those employees covered by awards or collective agreements were entitled to approach their union when they had a grievance. Under the Labour Relations Act, any union member or those who could have been union members but were exempt from membership could bring a grievance through the union or, when exempt, by themselves.

Many legal rules are defaults. This means that, should the parties so decide, they are able to determine different rules. In contrast, mandatory restrictions represent a compulsory restriction on the substantive terms and conditions of employment that the parties are able to agree to, in effect serving as minimum conditions of employment.

Instead of acting as compulsory minima, some or all of the current mandatory provisions could be treated as default conditions for some or all employees. In this case, eligible parties would be able to "contract out" of them if they could reach an agreement to that effect.

One possible criticism of contracting out provisions is that they may reduce protections for vulnerable workers. Limits on the freedom to contract out could help if this were a particular source of concern. For instance, some minimum conditions could be attached to contracting out provisions being included in the contract (e.g.: minimum notice for dismissals or payments in lieu of notice or the range of who is eligible could be limited). Thus, contracting out provisions could still accommodate some protection mechanisms for employees.

As noted above, the option of contracting out may be particularly relevant with respect to personal grievance procedures. The ECA currently prevents employees and employers from contracting out of the provisions of the Act. Section 26(a) of the ECA states that all employment contracts must include an effective personal grievance

settlement process and section 147 proscribes contracting out of the provisions of the ECA. A contracting out provision for personal grievances would increase the abilities of the parties to develop an approach that was particularly applicable to their own circumstances. This could be particularly important if it were decided to increase the degree of prescription in the Act over personal grievance procedures.

Summary

There are currently a number of tensions within the ECA and the Minimum Code. Addressing these tensions could help to increase sustainable rates of economic growth and improve labour market performance. More detailed analysis would, however, be required to identify the full range of costs and benefits of each option.

Growth and improved economic performance require stability in this regulatory framework. It is desirable for any legislative change to create a regulatory framework which is sustainable.

Appendix One: Legislation covering the employment relationship

Employment Contracts Act

Wages Protection Act

Minimum Wage Act

Equal Pay Act

Holidays Act

Parental Leave and Employment Protection Act

Volunteers Employment Protection Act

Health and Safety in Employment Act

Accident Compensation and Compensation Insurance Act

Smoke-free Environments Act

Human Rights Act

Privacy Act

Industry Training Act

Contractual Remedies Act

Illegal Contracts Act

Minors Contracts Act

Fair Trading Act

Disabled Persons' Employment PromotionAct