

Reference: 20180336

30 August 2018



Dear 

Thank you for your Official Information Act request, received on 20 August 2018. You requested the following:

“... more information regarding comments from the Treasury in a Cabinet paper regarding Fair Pay Agreements. I asked if those comments made up the substance of a larger document aside from the Cabinet paper.

You called me back on Friday and said that the Treasury comments on Fair Pay Agreements did make up the substance of a larger document, however that document has not been released to the public. You then offered to release the document to me via a OIA request. This email is to confirm that I would like to go ahead with the OIA request to acquire that document.”

Information Being Released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	3 May 2018	Treasury report about the Cabinet paper relating to Fair Pay Agreements	Release in part

I have decided to release the relevant parts of the document, subject to information being withheld under the following sections of the Official Information Act, as applicable:

- personal contact details of officials, under section 9(2)(a), to protect the privacy of natural persons, and
- direct dial phone numbers of officials, under section 9(2)(k), to reduce the possibility of staff being exposed to phishing and other scams. This is because information released under the Official Information Act may end up in the public domain, for example, on websites such as the Treasury's.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed document may be published on the Treasury website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Andrew Rutledge
Manager, Skills, Employment, and Enterprise

Treasury Report: Upcoming Cabinet Paper: Fair Pay Agreements

Date:	3 May 2018	Report No:	T2018/957
		File Number:	SH-2-2

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	<p>Discuss the timetable for Cabinet consideration of this proposal with the Minister for Workplace Relations and Safety</p> <p>Refer a copy of this report to the Minister for Workplace Relations and Safety.</p>	Before the Cabinet paper is lodged on Thursday 17 May 2018

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Jennie Marjoribanks	Senior Analyst, Labour Market, Immigration and Tertiary Education	s9(2)(k)	N/A (mob)	✓
Andrew Rutledge	Manager, Labour Market, Immigration and Tertiary Education	s9(2)(k)	s9(2)(a)	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Refer a copy of this report to the Minister of Workplace Relations and Safety, if agreed by the Minister of Finance.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Upcoming Cabinet Paper: Fair Pay Agreements

Recommended Action

We recommend that you:

- a **note** that you will shortly be consulted on a paper recommending Cabinet agree:
- i. in-principle to introduce a Fair Pay Agreements system (subject to a Cabinet report back), and
 - ii. to establish a working group to make recommendations on the scope and design of the agreements
- b **note** that the policy development process for the new system is in its early stages, and the working group is being asked to develop foundational elements of the policy
- c **note** that in light of the significance of the proposal, we recommend extending the departmental policy development process to enable Cabinet to make decisions with a clearer view of the purpose, scope, and impacts of the proposal, and ensure the working group's terms of reference are tied to this purpose and Government priorities
- d **note** the Cabinet paper contains a Treasury comment that reflects the position outlined in recommendation c above
- e **discuss** the proposal with the Minister for Workplace Relations and Safety before the paper is lodged on 17 May, with a view to extending the departmental policy development process
- Agree/Not agree*
- f **indicate** whether you would like to discuss this report with officials
- Yes/No*
- g **refer** a copy of this report to the Minister for Workplace Relations and Safety.
- Refer/Not refer.*

Andrew Rutledge
Manager, Labour Market, Immigration and Tertiary Education

Hon Grant Robertson
Minister of Finance

Treasury Report: Upcoming Cabinet Paper: Fair Pay Agreements

Purpose of Report

1. This report provides advice on a Cabinet paper, *Improving the Employment Relations and Standards System: Fair Pay Agreements*, on which the Minister for Workplace Relations and Safety will be consulting shortly. The paper recommends that Cabinet agree:
 - in-principle to introduce a Fair Pay Agreements system (subject to a Cabinet report back), and
 - to establish a working group to make recommendations on the scope and design of the system.
2. The Minister is intending to take the paper to the Cabinet Economic Development Committee (DEV) on 23 May.
3. We recommend further departmental policy analysis before Cabinet considers the paper's recommendations. The proposed changes are significant and still in the early stages of development. Extending the policy process would better position the policy to achieve its objective of supporting productivity and wage growth, while managing risks that the policy could exacerbate existing labour market issues.
4. We suggest that you discuss the proposal with the Minister for Workplace Relations, with a view to extending the departmental policy development process.

Analysis

Fair Pay Agreements are one of several Government initiatives to lift pay and conditions

5. The Fair Pay Agreements policy is one of several initiatives focused on improving employment conditions and pay, and supporting a broader sharing of the benefits of productivity gains. A number of initiatives to lift economy-wide minimum standards are well-advanced, such as the Employment Relations Bill, increased funding for the labour inspectorate, and minimum wage increases. Initiatives like Fair Pay Agreements that seek to remediate particular labour market concerns are also progressing, with work underway focused on pay equity, gender pay, and low pay in the core public service.

The Cabinet paper makes a high-level, theoretical case for Fair Pay Agreements

6. The Cabinet paper seeks in-principle agreement to a policy direction, rather than to the design elements of a new bargaining system. It makes a theoretical case for this direction: it suggests employer monopsony power may be creating a 'race to the bottom', as some employers use their significant bargaining power to compete through reducing or stagnating wages and conditions. This in turn could limit employer and worker incentives to invest in physical and human capital, leading to low productivity.
7. The paper suggests industry- or occupation-wide bargaining could address these concerns.

The paper does not identify empirical evidence for the problem or policy response

8. The paper does not, however, identify empirical evidence indicating that imbalances in bargaining power are causing the highlighted wages and productivity concerns.
9. Nor does the paper make a strong case that a system of industry- or occupation-level bargaining would be the most effective policy response to address these concerns. It suggests higher minimum wages may support productivity growth by encouraging firms to invest in training and capital, and by incentivising resources to shift to their most productive uses. It also suggests the system may reduce information asymmetries within and between industries, improving co-ordination. The overall impact could be improved wages and conditions, greater ability for firms to invest in long-term productivity enhancements (with associated higher profits), a more stable employment relations environment, and a more level playing field across competitors.
10. However, the paper does not refer to an evidence base for these potential impacts. Initial work by officials from the Ministry of Business, Innovation and Employment (MBIE) has not identified an occupation or industry in which the proposed system would address the highlighted wage and productivity concerns.

The paper instead proposes a working group to undertake the foundational policy design...

11. As the proposed system is currently in the early stages of development, the terms of reference ask the working group to develop foundational elements of the policy. The terms of reference are extensive and ask the working group to make recommendations about the criteria and process for initiating agreements, who could bargain agreements, the scope of agreement coverage, and the role of third parties in bargaining and enforcement of agreements.

... and this approach comes with risks

12. This policy process requires the working group to make complex policy judgements with only a high-level diagnosis of the problem and limited policy guidance from Cabinet, and at some distance from related policy activity. These judgements could in turn make substantial structural changes to the labour market, as highlighted in the bullet points below.
13. A recent OECD review highlighted the challenge of effectively reforming collective bargaining systems, noting past experience shows even well-crafted reforms can have very variable effects or lead to major unintended shifts in bargaining behaviour.¹ While the performance of collective bargaining systems is hard to isolate from other labour market and economic settings, overseas examples point to particular risks to the conditions and employment of people who are not covered by such agreements. The working group, with secretariat support from MBIE, will need to overcome these challenges to ensure its recommendations align with existing policy and wider government reform priorities.

¹ OECD (2017), *Employment Outlook 2017*.
T2018/957 Upcoming Cabinet paper: Fair Pay Agreements

14. Examples of design choices and issues the working group will need to resolve, and some of their attendant risks, are outlined below. These are drawn from reviews of other countries' experiences with different models of bargaining and employment protection:
- the relative weight to give to the interests of workers covered by Fair Pay Agreements and to the interests of people trying to find a job. Stricter terms and conditions would enhance the protection of workers covered by agreements, but could lower firms' incentives to hire workers on permanent contracts and encourage a move towards temporary work contracts with more limited employment protections. Low-skilled workers tend to be most adversely affected by these types of 'two-tiered' labour markets.² Higher wages and conditions may also encourage employers to invest in labour-replacing technology, or outsource overseas.
 - the relative weight to give to the interests of 'insider' and 'outsider' (small or new) employers, where the interests of insider firms could lead to minimum wages or conditions that are unsustainable for outsider firms, anti-competitive, or embed inefficient business models.³
 - designing for resilience. A recent OECD review suggests highly centralised or co-ordinated bargaining can limit the short-term unemployment impact of economic downturns relative to countries with either intermediate levels of centralisation and co-ordination, or with decentralised or uncoordinated systems (though the impact is quite small).⁴ The OECD notes that more research is needed on the effects of collective bargaining over the longer term, particularly on the degree to which centralisation affects the efficiency of labour reallocation in the medium term. Recent research on the effects of the Great Recession attempts this in the context of an economic shock. It suggests that – relative to firm-level bargaining - centralised wage bargaining limits firms' ability to maintain competitiveness after a shock via reductions in labour costs, which leads to layoffs and reductions in profits.⁵
15. As part of its work, the working group will need to take account of the policy's impact on the regions. Misapplication of the policy could lead to a concentration of unintended consequences in regional labour markets, and conflict with broader regional development objectives.

² Gal and Theising (2015), "The Macroeconomic impact of policies on labour market outcomes in OECD countries: a re-assessment," OECD Economics Working Paper 1271.

³ OECD (2017), *Employment Outlook 2017*.

⁴ OECD (2017), *Employment Outlook 2017*. The OECD suggests highly centralised or co-ordinated forms of bargaining may help by reducing transaction costs involved in negotiations, and by making adjustments more acceptable to workers by making them broad-based. Decentralised and uncoordinated wage bargaining systems do not appear more or less resilient in terms of unemployment than systems with intermediate levels of centralisation or co-ordination.

⁵ Di Mauro and Ronchi (May 2017), 'Wage bargaining regimes and firms' adjustments to the Great Recession', European Central Bank Working Paper 2051.

Next Steps

We recommend extending the policy development process

16. Given the significance of the proposal and the early stages of its development, we recommend extending the policy development process ahead of Cabinet consideration of the recommendations in the Cabinet paper. This would allow further analysis of matters such as:
 - the causes of the wage and productivity concerns identified in the paper
 - the range of options to address those concerns. This could include exploring labour market-specific options such as changes to economy-wide minimum employment standards, the labour inspectorate, or firm-level collective bargaining, or broader options such as competition law or immigration settings
 - the conditions for the success of industry- and occupation-level bargaining (eg, the relevance of firm size, the strength and representativeness of employer associations, union density, and industry exposure to international competition⁶).
17. This further work would enable Cabinet to make decisions with a clearer view of the purpose, scope, and impacts of the proposal, and ensure the working group's terms of reference are tied to this purpose and Government priorities. We have included a Treasury comment recommending this approach in the Cabinet paper. The comment is attached as Appendix 1.
18. We suggest you consider raising this with the Minister for Workplace Relations.

⁶ OECD (2017), *Employment Outlook 2017*.
T2018/957 Upcoming Cabinet paper: Fair Pay Agreements

Appendix 1

Treasury comment in the Cabinet paper

The Treasury considers more departmental policy work is required ahead of Cabinet's consideration of, and agreement to, the recommendations in this paper. The policy proposal is significant: Fair Pay Agreements could make substantial structural changes to the labour market and – as referenced in this paper – misapplication of the policy could have large negative effects on productivity, worker terms and conditions, and employment. The policy is also in the early stages of development: Cabinet's in-principle agreement is being sought to an outline of the policy direction; initial work by officials has not identified an occupation or industry in which the proposed system would address wage or productivity issues; and the working group is being tasked with answering foundational policy design questions.

Given the significance of the proposal, we recommend extending the departmental policy development process to enable further analysis of the causes of the wage and productivity concerns identified in the paper, options to address those concerns, and the conditions for the success of industry-level bargaining. This would enable Cabinet to make decisions with a clearer view of the purpose, scope, and impacts of the proposal, and ensure the working group's terms of reference are tied to this purpose and Government priorities.

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