ISSN 1176-4643

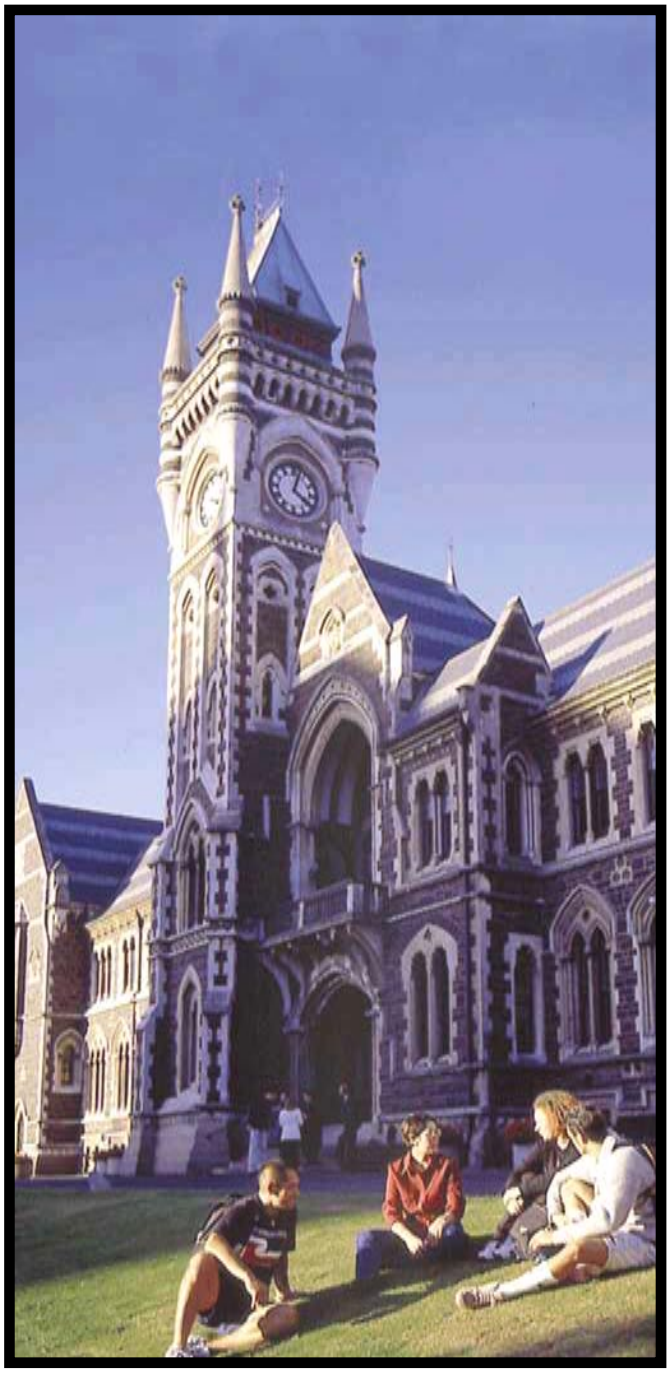
UNIVERSITY of OTAGO

SAPERE AUDE

Te Whare Wānanga o Otāgo

OTAGO MANAGEMENT GRADUATE REVIEW

Volume 8
2010



OTAGO MANAGEMENT GRADUATE REVIEW

ISSN 1176-4643
http://www.business.otago.ac.nz/mgmt/research/omgr.html

Published annually by the Department of Management,
University of Otago

Business address: Department of Management
University of Otago
PO Box 56
Dunedin
New Zealand

OTAGO MANAGEMENT GRADUATE REVIEW **Volume 8 2010**

CONTENTS

OTAGO MANAGEMENT GRADUATE REVIEW **Volume 8 2010**

CONTENTS

EDITORIAL

This journal is once again proud to publish some of the best pieces of work by graduate management students at the University of Otago.

The articles in this volume were written by students taking 400 level papers, either for BCom (Hons), Post-graduate Diploma or for MBus (papers plus thesis).

Full time honours students took combinations of 18 and 36 point papers totalling 108 points, plus a 20,000 word research paper worth 36 points; MBus students took a combination of 18 and 36 point papers totalling 144 points, plus a thesis. An 18 point paper normally requires two essays of around 4,000-5,000 words, and a 36 point paper four such essays.

All students at this level are free to submit papers for this Review, subject to the supervising staff member having graded the paper at A or A+.

The editorial board each year comprises staff whose students have work represented in the Review.

Alan Geare
Editor

Clash of the Titans: Boeing, Airbus and the WTO

Yujin Baskett

Purpose

"America's decision [to file a complaint] will, I fear, spark probably the biggest, most difficult and costly legal dispute in the WTO's history"
- Peter Mandelson, EU Trade Commissioner (Mathis, 2006).

On October 6th 2004, the United States government, on behalf of Boeing, filed a complaint at the World Trade Organisation (WTO) against the European Union's conglomerate Airbus. Boeing claimed that the European Union had given illegal subsidies to Airbus which violated international trade policies and distorted the commercial aviation's competitive landscape. 24 hours later, the European Union, on behalf of Airbus, retaliated with their own complaint against Boeing. This case, however, goes further than a simple fight between two companies.

A distinguishing characteristic of the commercial aviation industry is that the intense competition extends beyond airline operators themselves and into the realm of international trade disputes. One of the most high-profile and recurring disputes between the United States and Europe concerns the rivalry between two of the world's biggest aircraft manufacturers, Airbus and Boeing. The dispute over illegal subsidies extends beyond the companies; they have drawn in their respective governments and the WTO. This saga has dragged on for more than four decades and has been described as the biggest commercial dispute between the United States and the European Community – and one of the most difficult to resolve (Verghese, 2009).

The purpose of this report is to conduct an analysis into the ongoing dispute between Airbus and Boeing. The background behind the allegations, the different perspectives and role that governments have played will be examined. Most importantly, the effects of this dispute on the WTO and its ability to find a resolution between the two sides will be discussed. The question is not whether this case is a clash between companies or countries, but whether there is an end in sight to, as Mandelson (2005) described, the biggest, costliest and most difficult legal dispute in the WTO's history? With the stakes so high, who will be the biggest loser of this showdown?

With the threat of increased protectionism hanging over the world and governments accusing each other of unfair trade practices, the need for clear resolution is more important than ever. The industrial dispute between the two may already have been documented at length, but the specific implications and threats for the WTO are, in this author's mind, an overlooked area. Such implications could have long-lasting effects that extend beyond the aviation industry; by involving the WTO, this case has huge stakes not only for the companies involved, but could also sour relations between the European Union and the United States and has the potential to damage the WTO itself.

This assignment was for MANT 436 Advanced International Management 2
Supervised by Assoc. Prof. André Everett

Background Context

The commercial airline industry is regarded as one of the most competitive and difficult industries in the world. Investor Warren Buffett once noted that the airline industry has not made a single dollar for investors following a century of manned flight (Kay, 2005). In fact, the airline industry as a whole is said to have made a cumulative loss since the Wright Brothers, once the costs include subsidies for aircraft development and airport construction (Mathis, 2006).

In no other industry has the phrase "subsidies" been more contentious than in aircraft manufacturing (Spradlin, 1995). Accusations are nothing new in this highly competitive industry, where countries, not just companies, fight for superiority. The current and most high-profile Airbus/Boeing clash stems from the alleged illegal aid used to fund the launch of Airbus's A380 aircraft. However, cases of conflict have been documented stretching back over 40 years; in fact, many of the arguments detailing the extent of government support and their supposed market distortions are derived from analyses published back in the early 1990s (Hayward, 2005). The fight between Airbus and Boeing is not novel. Pavcnik (2002) viewed the aerospace industry as "a textbook example of an industry where governments use trade policy to alter the strategic interaction between the domestic firm and the foreign rival with the goal of shifting market share and profits from a foreign to a domestic firm".

But what is a subsidy? The definition provided by the Agreement on Subsidies and Countervailing Measures (ASCM), as drafted by GATT (now the WTO), had three elements: a financial contribution, by a government or public body within the state, and that confers a benefit. All three elements must be present in order for a subsidy to exist, and action taken only if a subsidy has been specifically provided to an enterprise or industry (Mathis, 2006). The ASCM did not actually ban subsidies, but sought to differentiate between specific aids to companies that were protectionist or unfairly promoted exports, and general support for societal or economic development. Thus, subsidies were considered detrimental only if they tilted the "level playing field" of international trade.

There is absolutely no question whether the battle between Boeing and Airbus is a thinly-veiled battle between the United States (US) and the European Community (now the European Union, or EU). In fact, at the WTO, it is their respective governments that have represented Airbus and Boeing, as companies cannot represent themselves. The question over why they are so involved, however, is not so simple.

Origins of Current Dispute

Trade tensions between the US and Europe in aircraft manufacturing are nothing new. Research has shown that the implications of trade policies are sensitive to the mode of "oligopolistic" competition among firms in the aviation industry in particular (Pavcnik, 2002). The benefits for governments of engaging in trade intervention were clear; Brander and Spencer (1985) believed export subsidies shifted profits from foreign to domestic producers and increased national welfare.

In 1992, after a decade of sniping and threats, the US and EU negotiated a formal bilateral agreement covering the development of large aircraft, outlining a number of contentious issues about support policies. It stipulated that production subsidies were to be limited, direct government support was to be capped at 33% of development costs, and that support could only be given to projects likely to repay the loan within 17 years, among other conditions.

The threat to involve the WTO in a dispute between Airbus and Boeing has arisen many times before, but it took until 2004 for the US to initiate the first stage of dispute settlement proceedings before the WTO by filing a complaint. The origins of the current fight lay mainly with Boeing's steady loss of market share to Airbus and more specifically the launch of Airbus's new A380 aircraft. Airbus fired back that Boeing's initial answer to the A380, the Sonic Cruiser, had benefited extensively from NASA programmes and that technology developed for defence programs had been routed into the B787 Dreamliner.

The WTO requires proof of damage; "a measurable injury to competitors", before government assistance can be labelled as a subsidy. Boeing claimed that its loss of more than 20% market share since 1992 was clear evidence of such damage (Carbaugh & Olienyk, 2004). Airbus, in their counter-allegation, cited the value of Boeing's indirect subsidies.

Industry Background

Competition in the aircraft industry has attracted attention not just because of the controversy surrounding subsidies, but because of the industry's unusual structure. It has extremely high barriers to market entry, due to the economies of scale and scope and the huge capital requirements, making it extremely difficult for newcomers to compete successfully. Another characteristic is the long investment cycles; large numbers of aircraft are needed to be sold to recover R&D and production costs. The uncertainty surrounding the success or failure of developing new aircraft combined with the large amount of capital invested means manufacturers tread a fine line when developing new products. The industry also has high exit barriers, due to financial considerations and the fact it is difficult to use investments already made for alternative purposes (Deutsche Bank Research, 2007).

The efficient industry theory suggests that if an industry looks particularly attractive, then companies will seek entry, while unattractive industries will see more companies leaving. However, this often does not take into account industries which governments consider strategic; the value and numbers affected in the US by aircraft manufacturing only serve to highlight the necessity of state support, affecting the attractiveness and number of companies exiting. Furthermore, airline operators worldwide have enjoyed much the same state sponsorship as manufacturers due to similar reasons. Most of the US airline operators have been in bankruptcy (and subsequently Chapter 11 protection) at least once. One could say that bankruptcy court judges are as essential to keeping planes in the air as pilots.

Even manufacturers are not immune to failure. The industry is littered with examples such as Lockheed and Convair in the USA, and Dornier and Fokker in Europe, pulling out of civil aviation manufacturing after disappointing sales and continual economic problems.

Changes in the industry dynamics have been dramatic. During its early days, the industry was characterised by competition among a large number of sophisticated, entrepreneurial firms. Survival risk was low because of guaranteed access to national airlines and a rapidly expanding market. Technological advances were often financed by states in deference to their defence industries. Since WWII, however, the industry has transformed into an oligopolistic production structure, extremely high survival risks, and intense competition for sales in a global market (Irwin & Pavcnik, 2004). Technological advances have extended development lead times, increased launch costs, complicated marketing, and lengthened the time between initial research and revenue earning (Irwin & Pavcnik, 2004). During the 1940s and 1950s, a return-on- investment cycle required four to five years for new products; by 1992 the return on investment timeframe had expanded to 10 to 15 years (Golich, 1992).

The value of the industry is also staggering. Since the late 1950s, aerospace has been the leading industrial contributor to US export earnings and since 1982, aviation exports have increased at an average annual rate of US$1 billion per year (Gresser, 2004); small wonder the governments sees the returns from state sponsorship. The exact current value of the industry is difficult to ascertain; airplanes are among the most valuable export products of international trade, but some have forecasted a US $2 trillion export market over the next 20 years (Gresser, 2004). Former American Airlines president Robert Crandall made the observation that civil aviation was the largest component of the travel and tourism business, which at US $21.2 trillion annually was considered the largest industry in the world by 1990 (Golich, 1992), although questions can be raised as to how that amount was quantified.

Civil aviation is the largest export industry in the US (Meier-Kaienburg, 2005). Boeing controls nearly 100% of the civil aviation manufacturing industry in the US, while Airbus occupies much the same space in Europe. Aircraft production affects nearly 80% of the United States economy (Levick, 1993) and is the largest of any manufacturing sector, according to the US Department of Commerce. Including suppliers and defence, the industry directly employed 818,000 people in 2009 and supported more than 1.8 million jobs in related fields.

This industry is quite different compared to other major industries such as automotives. With the aviation industry considered a strategic industry and the spill-over to military ties, there will always be government interest shaping this industry's structure. With controls on market access, ownership, various legal outlets to avoid bankruptcy, and state aid, the civil aviation industry will never be fully liberalised (Carbaugh & Olienyk, 2004).

The Players

Founded in 1916, Boeing is headquartered in Chicago and employs more than 158,000 people, of which almost 96% are located in the US (Boeing, 2010). Boeing is organised into two business units: Boeing Commercial Airplanes and Boeing Defence, Space & Security. In addition to commercial aircraft, Boeing designs and manufactures rotorcraft, electronic and defence systems, missiles, satellites, launch vehicles and advanced information and communication systems. Boeing is the largest exporter by value in the US,

the largest global aircraft manufacturer by revenue, orders and deliveries, and the third largest aerospace and defence contractor in the world based on defence-related revenue (Boeing, 2010).

Airbus's formation was quite different to Boeing, beginning in 1970 as a consortium between France's Aerospatiale and Deutsche Airbus, with Spain's CASA joining shortly after, before British Aerospace joined in 1979. Each company operated fairly independently until 2001, when Airbus became a single, fully integrated company. Now 80% owned by the European Aeronautic Defence and Space Company (EADS), Airbus is considered a merger of the French, German and Spanish interests and employs around 57,000 people across four European Union countries: Germany, France, the United Kingdom, and Spain (Airbus, 2010). Airbus has recently expanded into military hardware with the development of the A400 military transport aircraft.

Boeing aircraft currently flying today outnumber Airbus 3 to 1; however, Airbus entered the civil airliner market much later - 1972 against 1958 for Boeing. When Airbus was formed, Boeing was a de-facto monopoly civilian aircraft supplier. By 2004, Airbus outstripped Boeing in terms of number of aircraft delivered and orders taken. The product ranges between the two are very similar; nearly every model available from one manufacturer has a direct rival made by the other, right from the smallest aircraft (the A320/B737 family) to the largest (the A380/B747 family).

Boeing is traditionally preferred by US and Japanese airlines, while Airbus fares better in Europe and a number of other markets such as the Middle East (Deutsche Bank Research, 2007). Successful aircraft sales depend on a number of factors, including price, performance, politics, and timing (Golich, 1992). Airlines seek the best price and financing package to reduce capital costs. Governments assist private firms in financial arrangements needed to facilitate aircraft sales, leading to purchasing decisions often be politicised. It is not unusual for airlines to be owned or supported by the government, and aircraft acquisition negotiations nearly always involve at least one government. Thus, policymakers have been said to encourage airlines purchase off manufacturers that share production with domestic firms (Golich, 1992).

According to an economic analysis by Hayward (2005), the formation of Airbus has generally been beneficial for international competition, with research suggesting that aircraft prices would have been 40% higher without Airbus's entry in the late 1970s and would have increased over time. From Boeing's perspective, this has only been achieved through price discounting consistent with subsidisation. However, it is worthwhile to note that due to data constraints, no empirical evidence exists on how government support affected the firms' strategic interactions and profits (Pavcnik, 2002).

Clash of ~~Civilisations~~ Ideologies

The case of subsidies and launch aid between Airbus and Boeing is more than an industrial dispute. It is a clash of philosophies about the limits of state intervention. Some have described the Boeing/Airbus case as an example of competing political ideologies.

The EU and the US represent the two largest economic trading blocs in the world, with very different market philosophies, illustrated by their attitudes towards subsidisation. In the US, government encroachment is seen

as suspicious and is acceptable only under rare circumstances. Any intrusion by the state is seen as a disruption to free market principles, although many would be quick to point out that the US do dabble in intervention whenever it suits domestic firms (as can be illustrated in an earlier trade dispute involving the steel industry). Boeing's behaviour could also have been affected by the American political military ideology, which historically has placed a higher priority on political-military security than on economic relations (Golich, 1992).

In the context of the aviation industry, the policy of the US has been guided by a political philosophy that presumes subsidies distort resource allocations, influence international trade flows and flout the law of comparative advantage by enabling the survival of otherwise uncompetitive industries (Meier-Kaienburg, 2005). European political systems, on the other hand, have traditionally mingled public and private sectors. This can be seen during Europe's emergence from WWII, when government support was needed to rebuild Europe's devastated economy and infrastructure (while the US was relatively intact).The EU perceived limits on domestic subsidies as interference on the rights and responsibilities of European governments (Meier-Kaienburg, 2005).

One observer noted that "on the surface, the dispute appears to be about boosting jobs and exports. But really it's a magnification of the European/US culture clash over the role of government" (Spadafore, 2008). Airbus's climb from upstart to outselling Boeing in the commercial aerospace market is said to vindicate Europe's philosophy towards industrial policy. However, Boeing's lost market share could equally be described as a result of poor corporate strategy and decision-making, inadequate investment in research and the vulnerability of a notoriously long-term business to rampant shareholder value (Irwin & Pavcnik, 2004).

Spadafore (2008) confirmed in her research that the interaction of corporate and state interests in the aviation industry greatly affected the current Airbus/Boeing dispute, with corporate interests (in the form of commercial interests of the firms) providing the main catalyst and politics (the interests of the state) providing the process for taking the dispute to the WTO. The interaction of the political environment and corporate interests in the commercial aircraft industry was concluded to have directly affect the decision of both the EU and US to advance their complaints to the WTO. However, trade disputes between the US and EU are not limited by any means to just the aviation industry.

A History of Disputes

Given the level of commercial interaction between the US and EU, trade tensions are not unexpected. Previous US/EU disputes have arisen many times, usually followed by a successful settlement. Resolution in recent years, however, has become increasingly difficult. Ahearn (2005) suggested part of the problem was due to the fact that the US and EU are of roughly equal economic strength, with neither having the ability to impose concessions on the other. Another factor suggested was that issues now involve clashes in domestic values, priorities, and regulatory systems, where international rules can no longer provide a sound basis for an effective and timely resolution (Ahearn, 2005). By 2005, a year after the US first filled complaints on behalf

of Boeing, the EU was already involved in 27 WTO disputes - 15 of them involving disputes with the USA (Breuss, 2005).

Aviation-related trade tensions between the United States and the European Union have been around since the subsidised entry of the A300 in the early 1970s, where the A300 was Airbus's very first product. The first round of hostilities started in 1978 when Boeing accused Airbus of predatory pricing in order to secure a deal with Eastern Airlines (Irwin & Pavcnik, 2004). The rivalry between the two intensified after Airbus introduced the smaller, advanced A320 aircraft during the 1980s. When Airbus offered steep discounts on the A320, airlines like Air India cancelled their orders for Boeing 757's.

As Airbus steadily made inroads into Boeing's prized markets, the US government was compelled to level allegations that Airbus benefited from subsidies which resulted in Boeing's lost ground. Airbus were quick to strike back, using the EU to allege that Boeing too enjoyed the benefit of illegal subsidies. Paul Sheridan, an aviation analyst, commented: "You could take the WTO report about Airbus and take Boeing's response and switch the names and it would probably look pretty similar. They seem to be both accusing each other of the same thing." (James, 2010).

The upshot of the US government's intervention and negotiation with the EU was the creation of the 1992 bilateral agreement on trade and subsidies for civil aircraft. As outlined earlier, the agreement established clear limits on the direct and indirect subsidies used for financing development of new aircraft.

However, this "truce" did not last long; in 2004, the US government filled complaints against the EU in the WTO citing breaches of the 1992 civil aviation trade agreement. Although the focus was on the A380, the complaint included those relating to the entire family of Airbus products, from the A300 through the A380 (WTO, 2010). The primary intent of the US was to draw a general line through future European launch investment policies. However, Boeing was said to be more worried about potential EU support for Airbus's upcoming A350 aircraft, which intended to target one of Boeing's most lucrative product lines, the 777, as well as its planned 787 Dreamliner. Airbus retorted that while the A350 could be financed privately, if launch investment was available, there was no reason why they should not take advantage of it.

By January 2005, there were signs that Boeing and Airbus were looking to settle their dispute outside of the protracted WTO process. The then newly appointed EU Trade Commissioner, Peter Mandelson, agreed with outgoing US trade representative Bob Zoellick to suspend the WTO process while negotiating the elimination of subsidies. Interestingly, it was Mandelson who stated that Airbus was now clearly capable of competing in the global market place (Hayward, 2005).

Airbus hinted that they might be willing to forgo launch investment if the EU was allowed a comparable level of indirect support, just like Boeing obtained from NASA (Spadafore, 2008). However, Boeing was said to remain confident in its case and that the aim of the negotiations should be to remove direct launch aid in its entirety.

Thus on May 31st 2005, the US requested the establishment of a WTO-appointed panel to investigate their claims. The EU quickly retaliated with their own request for much the same reason. Procedures were initiated by July 2005, but by April 2006 the WTO informed the US and EU that it would not be able to reach a conclusion within 6 months due to the substantive and

procedural complexities involved in the dispute. This was the first of many delays, with another delay announced in 2008. On the 30th of June, the initial report was published, which included rulings on over 300 separate instances of alleged subsidisation covering a period of almost forty years (WTO, 2010).

Different Arguments

The US Perspective

Despite numerous threats, US authorities refrained from taking the case to the WTO because they perceived that the retaliation might jeopardise Boeing's access to European markets, where Airbus had made significant inroads into (Pavcnik, 2002). The 1992 EU/US agreement served only to temporarily put the conflict on hold. By October 2004, however, Boeing had lost its patience.

Boeing inherently believed Airbus could have not developed and successfully launched the A380 ("The most subsidised aircraft in history"), without the direct help from the EU in the form of illegal subsidies, or what was termed "launch aid". The US, on behalf of Boeing, claimed that EU support for the A380 contravened both the 1992 Agreement and the 1994 GATT (subsequently the WTO) Subsidy code. A key issue of contention was whether the A380 was likely to repay its loans within the 17 years specified in the 1992 Agreement (Hayward, 2005). The US contended that, as the government investment would be paid back only if the A380 was commercially successful, Airbus faced a much-reduced level of risk. They argued that as repayments were based on a per-plane principle, Airbus has no financial liability to governments if it fails to sell a sufficient number of A380s. From the US government's perspective, the aid given to the A380 violated the principles of a free and competitive market in which companies must accept the risk of failure in the market place.

The US position has been strengthened by the fact Airbus continuing winning market share has undermined any ‘infant industry’ justification. Boeing used its decreasing market share statistics to show the negative impact the EU's support for Airbus has had on its competitive position, which is required under the 1992 agreement. Above all, the US maintained the EU's launch investment in the A380 violated the principles of a competitive market in which the owners of a company must accept the risk of failure in the market place (Hayward, 2005). Boeing claimed that Airbus has built a product range comparable to its own in a shorter time than if it had been dependent on ordinary commercial sources of funding. In total, some US$35 billion of commercial debt was claimed to have been avoided by Airbus through the EU's launch aid (Hayward, 2005).

The EU's Perspective

24 hours later, the EU retaliated, filing their own counterclaim. While the US was preoccupied with limiting the direct subsidies that benefited Airbus in the past, the EU focused on restraining the indirect support for Boeing through US military and space agencies (Pavcnik, 2002). Airbus/EU countered that the support given for their A380 development conformed to both GATT's 1992 Agreement and the 1994 Subsidy code, so Boeing's case was without merit. In addition, the EU argued that Boeing had benefited by not only US

government support, but also government investment by Japan and Italy. The State of Washington had granted Boeing generous tax incentives to develop a significant commercial aircraft assembly facility in the state. Japan's interest in Boeing's 787 was seen as a national project due to potential supplier contracts for producing critical parts such as the Dreamliner's carbon fibre wings, and was considering a repayable launch investment package for a 35% work share (Hayward, 2005). Boeing, for their part, countered the EU would need to file a separate WTO complaint if they were concerned with aid provided to Boeing by Japan.

In addition, the EU claimed that Boeing's initial response to their A380, the Sonic Cruiser, had benefited extensively from NASA programmes. This allowed for the deferral of technology to the development of technology for the Sonic Cruiser at a much lower cost than in-house development. Boeing's Sonic Cruiser was eventually cancelled due to poor reception from potential customers, who indicated a preference for a more economical solution, and the project eventually morphed into the 787 Dreamliner. However, this did not detract from the fact NASA's programs would still benefit the Boeing 787.

In total, Airbus estimated that the US's contribution to the Dreamliner's own launch costs was around US$4.2 billion, out of a estimated total development cost of around $7 billion. They also claimed that close to 50% of public investment in the 787 was 'actionable' or 'prohibited' under WTO rules, and that European subcontractors had lost potential business due to the preference to use subcontractors from Japan for supplying Boeing's 787 (Pavcnik, 2002). The stage was set for a WTO dispute settlement showdown.

The WTO's Dispute Process

The WTO's mandate is to provide a venue for its members to trade their goods freely. By 2006, more than 90% percent of the world's trade took place between the 148 members of the WTO (Meier-Kaienburg, 2005). Because of this, using the WTO's dispute settlement system quickly became one of the most frequently utilised mechanisms for international dispute resolution. After GATT was succeeded by the WTO in 1995, the internationally accepted Dispute Settlement Mechanism was set up to resolve international trade conflicts. Whether the WTO Dispute Settlement System was more successful than the former GATT is an open question (Breuss, 2005), but not one that will be explored in this report.

The WTO is concerned with setting legal norms and establishing agreed regulatory frameworks (Pavcnik, 2002). However, its process is said to remains highly politicised, reflecting persistent national perceptions and differing economic value-systems (Hayward, 2005). The issue of subsidies have been a thorn in the WTO's side, primarily because they can be either unnecessary or desirable, depending on the circumstances. For example, subsidies to promote research and development that leads to environmental gains may be seen as positive. In fact, Baldwin and Krugman (1988) proposed that aircraft prices would have been 40% higher without Airbus's initial entry into the industry, and that the formation of Airbus enhanced consumer surplus due to both firms producing homogenous products (Pavcnik, 2002). The issue comes with what defines a 'bad' subsidy - intervention is justified only in the case of market failure in order to promote

public good externalities; for example, rectifying persistent market failure to invest in positive scientific research (Meier-Kaienburg, 2005).

Questions of benefit and specificity were the key points in regard to the 1992 US/EU Agreement. The legality of subsidies is assessed by looking at whether subsidies impose illegal conditions or distortions by causing adverse effects on free trade (Meier-Kaienburg, 2005). Under the WTO's Dispute Settlement system, complaints were investigated and ruled on by independent panels. There are three main stages in the WTO dispute settlement process: the consultation stage; the panel procedure (including possible appeals); and lastly the implementation of the ruling. This could include possible countermeasures in the event of failure by the losing party to uphold the panel's rulings.

Implications for WTO Rulings

The showdown between Boeing and Airbus would severely test the WTO dispute resolution process. Many questioned whether the WTO was even equipped to handle a case of this magnitude and complexity. Normally, major challenges were associated with the panel procedure phase. However, in the Boeing/Airbus case, the major criticism of the WTO dispute settlement system concerned the provisions dealing with implementation and compensation. The efficiency of the implementation stage, including compliance, remedies, and enforcement, was predicted to be very challenging and may yield even more problems (Meier-Kaienburg, 2005). Following the panel's decision, the WTO could demand prompt compliance with the recommendations and rulings from member nations implicated in the dispute. The panel also had the power, but not the obligation, to suggest ways that the WTO should implement recommendations.

Many commentators predicted the parties were not likely to comply with a decision made by the WTO due to the high stakes at hand. Rulings made in the Boeing/Airbus dispute could be ignored by each due to the critical importance of the companies to the US and EU respectively. With each providing thousands of jobs, plus prestige, wealth, and power, it was unlikely that the governments would readily comply with a ruling made by the WTO that was not in their favour (Mathis, 2006). Many trade experts believed that a WTO decision of banning some types of subsidies, but allowing others, could be so confusing that it would be difficult for either the US or EU to implement in the first place. With the airplane manufacturing industry playing a crucial role in each countries' economies, it was seen as doubtful that the parties will fully comply with decisions promptly. This was seen as a worst-case scenario; problems that would arise in the event of non-compliance would then have to be addressed by the WTO.

Trade retaliation and compensation are the typical remedies of disputes within the WTO. Not surprisingly, many WTO members consider the issue of remedies a major problem in WTO procedures (Meier-Kaienburg, 2005). Compensation has quite a different meaning under WTO rulings. The term compensation in the WTO context does not refer to payment for trade lost, but rather a forward-looking remedy to ensure a rebalancing of trade concessions (Mathis, 2006). This results in simply levelling the trade field, which runs the risk that violators are better off having broken the rules than

complying with them since no damages for the past can be claimed under current WTO rules - as seen in the previous Bombardier/Embraer case.

Goldstein and McGuire (2004) concluded that both governments may decide the costs of compliance are too high if it meant reversing decades of industrial and technological policy favouring an export-orientated aerospace sector. Governments were expected to carefully weigh the costs of compliance versus the costs of noncompliance. Even worse, the plausible outcome of the imposition of trade sanctions rather than compliance with the WTO's rulings could seriously undermine the effectiveness of the whole WTO system (Meier-Kaienburg, 2005). If governments choose sanctions over compliance, non-compliance may become an acceptable option and the WTO would serve little purpose in the area of dispute resolution. As former United States Trade Representative Charlene Barshefsky noted, "*we cannot have a global, rules-based system if major partners in it do not comply*" (Meier-Kaienburg, 2005).

Even worse, the WTO does not have a real enforcement arm. The legalisation of the WTO's settlement process has not been paired with a stronger enforcement mechanism, resulting in a major impediment to the WTO's enforcement of its rulings. Summed up by Trade Commissioner Mandelson: "*nothing would prevent either side from continuing to offer further financial support*" (Mathis, 2006). Other authors such as Breuss (2005) proposed the increasing intra-regional trade within the EU raised the question whether the EU even need the WTO at all. In summary, the Airbus/Boeing case put the credibility of the WTO on the line.

WTO: An Appropriate Arena?

A common question banded was if the WTO was even the appropriate arena for this dispute. While some argue the WTO's dispute resolution system was set up to handle disputes like this, others believed the complexity and stakes involved in the Airbus/Boeing case rendered the WTO forum inappropriate. Meier-Kaienburg (2005) compiled a list of why the WTO was ideal, including:

1. The WTO had an effective mechanism for channelling disputes into a neutral forum where global rules were applied.
2. The WTO could bring needed transparency to what constitutes an unacceptable subsidy.
3. By deciding this case, the WTO could also create a precedent and influence how subsequent cases were to be decided.
4. The WTO could force the two sides to an agreement to avoid WTO-sanctioned tariffs.

However, Meier-Kaienburg (2005) also noted a number of commonly regarded reasons why the WTO was poorly suited to resolve the Airbus/Boeing fight.

1. The WTO lacks the popular backing to resolve political disputes, as was suspected behind the US and EU's filings.

2. The WTO is unsuited to deal with a dispute on this scale, because of the complexity of some of the issues and the huge commercial stakes involved.
3. Some commentated that the WTO has a poor track record in resolving high stakes cases between the United States and the EU.
4. Prescribed penalties could affect thousands of jobs as well as have an effect on suppliers and subcontractors worldwide. Decisions could not only be costly and bad for Airbus and Boeing, but it could also upset airline customers and disrupt the entire aviation industry.
5. An aerospace fight as major as this one has the potential to risks "poisoning" other trade areas. Production subsidies of Boeing and Airbus were not limited to the US and EU, but extended to the likes of Italy and Japan, who would also be affected.

Questions regarding the WTO's dispute settlement process are also said to have led members to approach the WTO not as a remedy to unfair trade practices, but use its settlement system as a short-term solution only (Delaney, 2008). Above all, there was a real risk that the Airbus/Boeing dispute could strain the transatlantic relationship between the US and EU, degenerating into a surrogate for wider differences and at worst even ignite a trade war (Meier-Kaienburg, 2005).

The greatest risk for the WTO was its legitimacy as a final arbiter in international trade relations. By presiding over this case, the WTO risked losing credibility as a forum for resolving large-scale trade disagreements if non-compliance and other problems resulted out of the rulings made. If credibility was lost, upcoming trade disputes may not be able to be adequately resolved through the WTO system and could drag on for years, while potentially setting back the facilitation of global commerce and world stability (Meier-Kaienburg, 2005).

Implications for Boeing / Airbus

The stakes weren't just high for the WTO. Back in 2005, commentators noted the significant dangers for Airbus and Boeing if the WTO ruled both complaints as valid. This potential outcome was described as a "pyrrhic victory at best", with the result that both sides would face higher production costs with fines and sanctions clouding the competitive landscape (Carbaugh & Olienyk, 2004). It would also send the wrong signals to the rest of the world trading community as well as exacerbating US–EU tensions. Commentators predicted that a WTO verdict would probably take years and could be unclear, with no decisive victory for either side (Carbaugh & Olienyk, 2004).With predictions being that both sides were likely to "win" their cases, the question became who will lose the most.

The costs of an escalated trade conflict would be substantial, as both manufacturers rely heavily on each other's markets for consumers. There was concern in Boeing that pushing this issue too far may result in alienating its European customers, which made up 20% of Boeing's fleet (Pavcnik, 2002). Similarly, although Airbus sold most of its aircraft to Europe, it was looking for securing sales to American airline operators, where it had 16% of its active fleet (Pavcnik, 2002). Government intervention could quickly put a halt to this.

The EU's aerospace industry probably had more to lose than the US if the WTO rules against it, but both stand to lose much. In the EU, the risks of collateral damage to other parts of the aerospace industry heavily reliant on Airbus's products were high. In addition, the US's complaints included all of Airbus's products, including its (then) struggling A380 program and the planned A350 product. Boeing doubted Airbus's A380 project could even break even due to the investment required for development - over US $12 billion (Pavcnik, 2002). Any WTO ruling in Boeing's favour, such as prompt repayment of launch aid, could devastate the project described as critical to the company's survival.

Boeing would still be heavily affected; its stake in its 787 was its first new civil airframe in over a decade and, as Pavcnik (2002) commentated, its best (and possibly) last chance to regain ground lost to Airbus. If the support for Boeing from the US and suppliers in Japan and Italy were ruled non-compliant by the WTO, there would be serious repercussions for sales with potential customers deterred by the uncertainty generated by a negative ruling (Mathis, 2006). In fact, Pavcnik (2002) suggested both parties stood to lose much, even if one side gained a clear advantage from the WTO's rulings. The two companies accounted for an estimated 100,000 jobs in rival territory and spend about US $5 billion per year buying parts, components, and services from each other (Pavcnik, 2002). Thus, any negative ruling would adversely affect the other player - something both sides were acutely aware of.

Outcomes

The initial rulings was published by the WTO on June 30th, 2010 - 6 years after formal procedures started. As many predicted, the outcome was not entirely straightforward and from a neutral perspective, there appeared to be no clear winners.

Both Boeing and Airbus claimed victory following the WTO's release of the 1,000 page report. Exact terms of the WTO's findings remain confidential, but Boeing were quick to trumpet that Airbus had received prohibited export-related subsidies for the launch of their A380 aircraft, as well as a range of Airbus's other products. The WTO ruled that the substantial amount of the low-cost loan money provided by the EU was illegal and hurt Boeings sales. Boeing claimed Airbus could now be required to either refinance those loans on commercial terms or restructure them.

Boeing Chairman Jim McNerney announced: "The panel said that without the illegal subsidies it received, Airbus would not have the aerospace market share it now enjoys. This ruling will alter the competitive landscape in the aerospace industry forever, forcing Airbus to compete in the marketplace on the same terms as Boeing." (Cohen, 2010). Boeing Executive Vice President Michael Luttig added: "Airbus must repay the $4 billion in illegal launch aid it received for the A380 or restructure the A380's financing to proven commercial terms. The WTO rejected all excuses for continuing launch aid... Anyone that wants to use government funding arrangements to develop new, competing products must demonstrate that monies are provided on proven commercial terms." (Cohen, 2010).

However, the EU was determined not to have systematically abused trade regulations. Airbus were quick to claim their own victory, showing that

the WTO panel had rejected 70% of Boeing's complaints, rejecting "wild allegations" and claiming Airbus launch aid cost neither jobs nor any profits (Clark, 2010). Airbus countered the panel's findings did not apply to European pledges of loans to help Airbus develop its new A350 aircraft.

Lutz Güllner, a spokesman for the European trade commissioner, announced: "The WTO panel has found that European support did not result in any job losses in the United States or lost profits to the US aircraft industry. The WTO panel has rejected the allegation that support for Airbus caused "material injury" to the US aircraft industry... The panel has found that the use of Repayable Launch Investment as a financing system is fully compatible with WTO rules, as long as the terms of financing are based on market conditions." (Cohen, 2010).

The WTO panel recommended that members granting each subsidy found to be prohibited withdraw it without delay. In this case, the EU must "take appropriate steps to remove the adverse effects or... withdraw the subsidy", specifying that this be within 90 days (WTO, 2010). However, the panel declined to make any suggestions concerning steps that might be taken to implement its recommendations.

This, however, was only half the story. Two months later, the WTO's findings on the EU's complaints were released. While details were again kept confidential, Airbus announced the WTO ruled that Boeing too had received illegal subsidies from the US government, to the detriment of Airbus. The EU claimed the rulings were overwhelming in their favour, with the WTO finding that funding provided by the Department of Defence and NASA constituted actionable subsidies (Miller & Michaels, 2010). The WTO found that Airbus suffered adverse effects from the US's subsidies, which the EU said totalled more than US$16 billion, while Boeing received roughly US $23.7 billion of subsidies that were masked as defence research (EU Business, 2010).

Boeing's supporters, like Airbus's, claimed only a fraction of the funding in question was held to have violated WTO rules. US trade officials also questioned the EU's claim of victory, with a spokeswoman for the US Trade Representative observing "There seem to be a number of significant inaccuracies... none of the alleged subsidies to Boeing have anywhere near the market-distorting effects of the launch aid the EU provided to Airbus" (Miller & Michaels, 2010). For their part, executives at Boeing said they would welcome a framework that coverd emerging rivals in Canada, Brazil, Russia and China.

Airbus indicated they were looking to move on, with Airbus head of communication Rainer Ohler noting: "Now that two reports are on the table, time has come to stop assigning blame." (Clark, 2010). Airbus called on Boeing to end the spat and return to the negotiation table for new funding rules covering the industry. Likewise, the EU insisted that only negotiations at the highest political levels could resolve this dispute and expressed hope that the new report "provides momentum in that direction" (EU Business, 2010).
Regardless of the desire to move on, this saga is far from over. On 21st July, under the 90 day appeal rule, the EU appealed to the WTO over issues of law covered in the panel report and certain legal interpretations developed by the panel (WTO, 2010). On 19th August, the US also appealed to the WTO again citing issues of law covered in the panel report and certain legal interpretations developed by the panel (WTO, 2010).

Potential Resolutions

This report would not be complete with suggesting potential methods of resolution for Airbus and Boeing, aside from continually appealing to the WTO as many suspect. Finding a proper remedy to subsidy disputes is problematic and may result in the return of protectionism. Since its implementation, the WTO's dispute resolution process has come under criticism for treading on national and local sovereignty, and has not always resulted in fairer trade (Mathis, 2006). Both sides here are clearly unwilling to give in or accept liability for their practices. At the core of the dispute is the fact that neither the EU nor the US are willing to classify the aid their respective companies receive as subsidies (Carbaugh & Olienyk, 2004). Authors such as Mathis (2006) questioned whether the US should walk away from the WTO and continue its trend of favouring regional trade pacts like NAFTA if an appropriate outcome could not be reached. As Mandelson himself put it: “What is one man’s launch aid is another man’s subsidy... there is no way you would take the risks involved in that sector without some form of government guarantee" (Spadafore, 2008).

However, it is possible for both sides to adopt either’s mechanisms. Airbus has developed the A400 military transport, indicating their entry into military hardware - a space that Boeing already occupies (and admitted to making use of). In fact, it was noted that the governments owning Airbus earned more revenue from military contracts than did Boeing (Carbaugh & Olienyk, 2004). However, this suggested resolution is unfeasible. NASA's funding for aeronautical research is higher than the total EU equivalent for civil research (Hayward, 2005). In addition, technology and its diffusion is not the only factor separating the US from the EU's approach to state support.

Hayward (2005) suggested the US could adopt a more European philosophy towards state support. One US analyst commented: “The new trade theory indicates that the most effective US response to Airbus may be to provide similar types and magnitudes of financial support to its industry. This would represent a shift of US policy from reliance on negotiation to limit government subsides of Airbus.” (Hayward, 2005, p.7). Again this is unlikely; a change as significant as political ideology when it comes to direct government intervention is not likely to occur in the near future.

Deutsche Bank's research unit in 2007 suggested a series of factors could help resolve the dispute, including stronger transatlantic cooperation in the military segment, citing the upcoming decision of the US military contact for refuelling tankers as an example of a pragmatic decision the US could consider. More rapid progress in other related political stalemates, such as an "open skies" agreement between North America and Europe, could also give a boost to the aviation sector while benefiting both manufacturers (Deutsche Bank Research, 2007). Golich (1992) noted years earlier that the US and EU already cooperated on a number of aviation-related fields, such as safety standards. However, cooperation based on military grounds is likely to be a stretch too far given the sensitivity of military contracts.

Meier-Kaienburg (2005) argued that the best way to resolve the dispute lay with improving the WTO's settlement system to handle high-stake cases such as this. He proposed the incorporation of a pernament dispute panel, an inproved complaince and enforcement mechanism where incentives are provided to help achieve the WTO's objective of prompt compliance, and incorporating financial compensation for past harms and greather

transparency in the proceedings. However, Breuss (2005) disagreed, stating the reason for the lack of proposals to improve the WTO's dispute resolution system from an economic point of view was due to the fact that WTO issues were just "a playground for lawyers".

All of these resolutions fail to address the fundamental problem of subsidies in the aircraft manufacturing industry and are unlikely to stop future disputes from occurring. Meier-Kaienburg (2005) agreeded, commenting that regardless of the decisions made by the WTO, Airbus and Boeing needed to start a new agreement governing subsidies because any decision by the WTO would not solve the issue over subsidies. There still is a need for more predictable rules in this industry so that future disputes can be avoided, and to monitor and limit the government aid that aviation companies receive (Meier-Kaienburg, 2005).

Both sides have indicated that they would prefer to renegotiate the original 1992 agreement and settle the dispute outside the WTO. Executives of both firms have stated (when defending their practices), that their respective firms are financially stable enough to develop products without subsidies. Therefore, the real need for subsidies is questionable if both sides come to a mutual agreement regarding financial support.

Airbus head of communication Rainer Ohler commentated that, "Only when we stop litigation and start negotiating will we be able to create a basis for the future level playing field in global aircraft manufacturing, which is not just a trans-Atlantic issue" (EU Business, 2010). However, in order to reach an acceptable solution, both the US and EU must be able to save face. Deutsche Bank's research unit (2007) proposed it was worth considering starting new negotiations with a clean slate, with all past accusations levelled at the other side set aside and the focus of negotiations should be directed towards the future.

However, any resolution would not be limited to just Airbus and Boeing. Pritchard and MacPherson (2003) believed that under the systems integration theory, companies such as Boeing spread their risk across a network of suppliers and production partners around the world; a case exemplified by the production system of the 787 where as much as 70% of value-added work was outsourced. The upshot was that products like Boeing's 787 included both foreign and domestic subsidies (Pritchard & MacPherson, 2003). The implications from any WTO resolution would therefore affect a multitude of partners, and in the case of major Japanese subcontractors, the likes of the Japanese government may get dragged into the row, further complicating outcomes and potential resolutions.

The Future of Aircraft Manufacturing

The policies of a "laissez-faire" nation can create both constraints and opportunities for firms, just as those of interventionist states (Golich, 1992). Government policymakers everywhere today confront the independence-control dichotomy, while it is down to firms themselves to adjust to the political landscape accordingly to take advantage of opportunities created. Golich (1992) noted parties in the aviation industry were likely to pursue familiar policies until a perceived crisis triggers change, as prior policies may have worked in achieving past goals, and their consequences (whether intended or not) may have trapped firms into a particular direction or system.

In fact, Golich concluded most companies were "reluctant innovators", and that only a convergence of political, economic, and technological changes could provoke the necessary change.

Several recent developments have increased the call for greater examination of this dispute, including the imminent entry of developing country-based manufacturers into this industry. China in particular has already demonstrated a willingness to bypass international trade laws in order to establish dominance in new industries (Spadafore, 2008). Airbus CEO Tom Enders agreed, commentating: "If we talk about China, if we talk about Russia or others, does anyone in this room believe that they will step back and say: Now we understand the WTO rules, we will play exactly by the rules? Absolutely not, so this is why I call this an absurdity" (James, 2010).

China, with their state-owned Comac (Commercial Aircraft Corporation of China Ltd) aims to directly compete with Airbus and Boeing's most lucrative and high selling models, the A320 and B737, with its Comac 919 (due on the market in 2016). Canada's Bombardier, Brazil's Embraer and Russia's Sukhoi all pose significant threats to the US and EU's prized industry. While the US and EU are busy squabbling with each other, the aforementioned countries are likely forging ahead with different forms of subsidisation. As an aviation analyst noted, "It is in their interest to end this war and to concentrate instead on the development of their aircraft because competitors are closing in on mid-sized carriers" (EU Business, 2010).

Regardless of whether a solution can be found outside the WTO or not, a primary objective should be to prevent a "subsidy race" in aircraft manufacturing (Pritchard & MacPherson, 2003). Given that the growth in air travel is set to continue in the future, there is sufficient potential sales for both Airbus and Boeing, especially given that the world's major airlines have shown a preference to stick to the two major manufacturers. A subsidy race remains a plausible scenario and such an event would contravene the mandate of the WTO at a time when the drive toward more liberalised international trade is floundering. The risk comes if both sides continue to appeal to the WTO while continuing their reliance on existing development policies. A subsidy race, where each receives more and more support, will only result in a race to the bottom. Such a scenario may only be desirable to upstarts like Comac, who have the full backing of the Chinese government with all its cash reserves, growing domestic market and preference for state-supported intervention.

Yet despite the apparent dangers, Brazilian, Canadian, EU, US and now Chinese governments continue to support their domestic producers with direct and indirect means. The outcome of the WTO's rulings was that both Airbus and Boeing have received government support whether directly or indirectly, but it is difficult to conclusively prove how much each government has benefited in terms of national welfare (Hayward, 2005). Perhaps the last word should belong to notable economist Paul Krugman, who in 1987 cautioned that characteristics such as multi-product firms, market segmentation, and large dynamic economies of scale complicated trade policies, and that an analysis of the actual usefulness of strategic trade policy to increase national welfare was highly recommended in the case of the aviation industry (Krugman, 1987).

Conclusions

Over the past 40 years there has been a continual dispute between the US and the EU involving the world's two dominant producers of commercial aircraft, Boeing and Airbus. Both sides have accused each other of distorting the competitive landscape by receiving various forms of illegal subsidies for product development, with the full backing of their respective governments. This 40 year long conflict has become the most expensive in the WTO's history (Miller & Michaels, 2010), with the stakes high for all players. Given the huge costs of developing and manufacturing new airframes, neither Boeing nor Airbus can afford to concede their existing practices without the other reciprocating. The technologies developed and employment benefits are substantial. Both manufacturers also provide spill-over benefits to the world economy, as both outsource to suppliers worldwide. Thus, this is a case that affects companies and nations around the world.

At a time when developed nations should be leading the world towards trade liberalisation and openness, the US and EU are sending the wrong message while diverting energy and resources from more pressing needs. The Boeing/Airbus case not only reflects a battle for market share in a duopoly market structure, but also highlights a clash of ideologies over the appropriateness of state intervention in high value exports. Elevating this dispute to the WTO has reflected each nation's differing trade philosophies and may have made reconciliation more difficult, but both would do well to work together to liberalise trade worldwide rather than continue to squabble or appeal. The importance of this case is unmatched; the Boeing/Airbus dispute could potentially degenerate into a surrogate for wider differences between the US and the EU over international economic policy (Hayward, 2005). The future for the industry, however, remains just as murky.

The latest WTO rulings have found both violated agreements on subsidies, with neither gaining an overwhelming victory. The question now falls to compliance. If one side does not fulfil its obligations under the WTO's ruling, the other make just take unilateral action and continue using their own form of subsidies. To have a solution that would be sustained over the long-term, Airbus and Boeing need to negotiate more workable rules for the future, and only bilateral talks permit the kind of reciprocation-bargaining that a WTO panel cannot provide (Mathis, 2006). However, it is important to note that negotiations can no longer involve just the US and EU. The entry of China and the resurgence of Canada, Brazil and Russia's aviation industries requires an international solution involving all the major players. Naturally, a larger number of negotiating parties would make it more difficult to find an acceptable solution. Thus, this dispute will likely continue into the foreseeable future.

Above all, the dangers to the WTO itself are real and significant due to potential issues of compliance, the fragilities and the wider implications of its rulings. Observers have commented that there is a very real possibility of the EU and US walking away from the WTO if their economic security is threatened. Questions remain over whether the WTO is even the right arena for this dispute to be resolved, or whether the two parties are better off directly negotiating a resolution. The difference in political ideology when it comes to state intervention, coupled with the complexity of this particular case, poses a significant long-term threat to the WTO's relevance and

credibility. If a solution is not found, and quickly, then the WTO itself may end up as the biggest loser of the Airbus/Boeing saga.

References

Ahearn, R. (2005). U.S.-European Union trade relations: Issues and policy challenges. *Congressional Research Service*.

Boeing. (2010, September). *Boeing Facts*. Retrieved October 22nd, 2010, from Boeing Home: www.boeing.com.

Breuss, F. (2005). Economic integration, EU-US trade conflicts and WTO dispute settlement. *European Integration Online Papers*.

Carbaugh, R., & Olienyk, J. (2004). Boeing-Airbus subsidy dispute: A sequel. *Global Economy Journal*, *4*(2), article 6.

Clark, N. (2010, September 4th). *W.T.O. says aid to Airbus for A380 was illegal* . Retrieved October 20th, 2010, from The New York Times: http://www.nytimes.com/2009/09/05/business/global/05wto.html.

Cohen, A. (2010, June 30th). *Boeing, Airbus declare wins in WTO ruling*. Retrieved October 20th, 2010, from Seattle PI: http://blog.seattlepi.com/aerospace/archives/213023.asp.

Delaney, P. (2008). *WTO dispute resolution: Short-term solutions providing the foundation for long-term trade agreements.* Miami: St Thomas University.

Deutsche Bank Research. (2007, February 1st). *Boeing v Airbus: The WTO dispute that neither can win.* Retrieved October 18th, 2010, from Deutsche Bank Research: http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000205714.pdf.

EU Business. (2010, September 15th). *France, Airbus say WTO rules against Boeing in subsidy row* . Retrieved October 24th, 2010, from EU Business: http://www.eubusiness.com/news-eu/wto-trade-dispute.65y/.

Golich, V. (1992). From competition to collaboration: The challenge of commercial-class aircraft manufacturing. *International Organization*, *46*(4), 899-934.

Hayward, K. (2005). Trade disputes in the commercial aircraft industry: A background note. *The Aeronautical Journal*, *109,* 157-166.

Irwin, D., & Pavcnik, N. (2004). Airbus versus Boeing revisited: International competition in the aircraft market. *Journal of International Economics*, *64*(2), 223-245 .

James, K. (2010, October 22nd). *Airbus chief says subsidy spat with Boeing helps emerging rivals*. Retrieved October 24th, 2010, from Deutsche Welle: http://www.dw-world.de/dw/article/0,,6140280,00.html.

Krugman, P. (1987). Is free trade passé? *Journal of Economic Perspectives*, *1*(2), 131-144.

Mathis, M. (2006). *Uncivil aviation: How the ongoing trade dispute between Boeing and Airbus has undermined GATT and may continue to usher in an era of international agreement obsolescene under the world trade organisation.* Oklahoma: University of Tulsa.

Meier-Kaienburg, N. (2005). The WTO's toughest case: An examination of the effectiveness of the WTO dispute resolition procedure. *Journal of Air Law and Commerce*.

Miller, J., & Michaels, D. (2010, September 16th). *Boeing received illegal aid, WTO says*. Retrieved October 20th, 2010, from The Wall Street Journal: http://online.wsj.com/article/SB10001424052748704652104575493594258438602.html.

Pavcnik, N. (2002). *Trade disputes in the commercial aircraft industry.* Oxford: Blackwell Publishers Ltd.

Pritchard, D., & MacPherson, A. (2003). The trade and employment implications of a new aircraft launch: The case of the Boeing 7E7. *Canada-United States Trade Center Occasional Paper*.

Spadafore, A. (2008). *Excess baggage: Weighing the contribution of political and corporate interests in the WTO cases over commercial aircraft subsidies.* Miami: Miami University.

Verghese, V. (2009, December 27). *Airbus vs Boeing*. Retrieved August 11, 2010, from The Airline Herald: http://www.airlinesherald.com/2009/12/27/airbus-vs-boeing/.

WTO. (2010, July 21). *WTO dispute settlement.* Retrieved October 16th, 2010, from World Trade Organisation: http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds316_e.htm

Systems Thinking, Complexity Theory and Transnational Management

Nick Donald

Introduction

Systems thinking and complexity theory are two of the most important concepts in contemporary management thinking. These theories signal a fundamental shift in how we think about business and decision making. Both reject the notion of linear decision making, and replace current reductionist concepts with ideas based on a view of the business environment as a holistic system. In this essay, I will outline the basic theoretical assumptions of systems thinking and complex adaptive systems, before highlighting how complexity theory and traditional thinking deal with complexity. Transnational management strategies will be discussed in reference for more traditional models of international strategy, to highlight the utility of understanding the world from a systems perspective.

Systems Thinking

At the macro level, traditional management thinking can be characterised as rooted within enlightenment thinking. This form of thinking is centred on a view of the world as mechanistic, and consequently, can be understood completely via a process of breaking things down into small parts (Stacey, 1995). The relationships between these parts are characterised as simple, and follow a linear cause and effect process. While this worldview has been effective in fields of science, such as chemistry, engineering and physics, this view has been ineffective in terms of predicting human behaviour (Maani & Cavana, 2008). In terms of management and organisations, these characteristics transform into current management values. These values are centred on the view of management as in complete control of the organisation, through a hierarchical structure (Maani & Cavana, 2008). In these organisations, functions are separated and divided into separate parts, such as finance, marketing and operations. Relationships within the organisation and between organisations are centred on self interest, and as a consequence are based on confrontation (Stacey, 1995). Due to the importance of analysis, specialist expertise is heralded as important, as knowledge is gained through a process of reductionism. As a consequence of this worldview, organisations are expected to consist of a unified set of ideas and a single (correct) point of view (Maani & Cavana, 2008). This world view allows for long term planning, based on historical precedent, analysis, and quantitative analysis.

Systems thinking represents a different view of the world, one not based on reductionism and enlightenment ideas. It can be defined as a "scientific field of knowledge for understanding change and complexity through the study of dynamic cause and effect over time" (Maani & Cavana, 2008, p. 7). While there are many different conceptions by numerous

This assignment was for MANT 436 Advanced International Management 2
Supervised by Assoc. Prof. André Everett

theorists, Maani and Cavana suggest seven universal principles of systems thinking.

The Big Picture
This principle is based on viewing not only the forest or only the trees, but the whole picture. This is because all issues faced are related to larger forces and interactions. This holistic view allows a systemic problem domain, rather than a reductionist functional problem domain, which has benefits for complex problem solving (Maani & Cavana, 2008).

Short and Long Term
Systems thinking incorporates both short term 'survival' thinking, as well as considering the long term implications of actions. While short term actions are important, particularly in times of crisis, the cumulative effect these short term measures have an impact on the long term survivability of a company (Maani & Cavana, 2008).

Soft Indicators
This principle is centred on performance measurement of systems. There is much more to systems than measurable 'key performance indicators' and 'critical success factors'- there are many small factors that, over time, can have a huge impact(Maani & Cavana, 2008).

System as a Cause
This principle concerns the nature of problems and solutions. It stipulates that we contribute to our own issues through unintended consequences of our actions, but also due to our beliefs and assumptions as to the nature of problems. Many organisations see themselves as victims, rather than causes to their own problems. To solve these issues, beliefs and assumptions need to be made explicit in order to fully understand people's perceptions of problems (Maani & Cavana, 2008).

Time and Space
Our current way of problem solving has a cause and an effect, however in systems, this is non linear; actions we make now may have unpredictable consequences in the future. Thinking about cause and effect in a linear way often fails to address the problem, and consequently, yesterdays solutions become today's problems. People have become accustomed to instantaneous effects to action, due to increases in technology and production. However in organic systems, change is slow and un-dramatic, often taking long periods of time and can be unnoticeable (Maani & Cavana, 2008).

Cause versus Symptom
The current way we think about problem solving often ends up with people mistakenly identifying a symptom as the problem, rather than the problem itself. An example of this could be treatment for a headache (the symptom), where the problem causing the symptom remains undiagnosed (Maani & Cavana, 2008).

Either-or Thinking
Western philosophy identifies everything in what is called a binary opposition, you are male or female, black or white, Christian or Muslim. This polarises

decisions into either right or wrong answers, however the reality is there are multiple solutions to any one problem (Maani & Cavana, 2008).

A systems perspective views the organisation as a system of interrelated complex parts in which value is added through interactions and relationships between parts, rather than the parts themselves. This represents a completely different way of understanding the process of adding value in businesses, as the emphasis shifts from the valuing of individual parts within the system (such as technical skills) to the valuing of the interaction of parts (the ability of an employee to interact, discuss and collaborate with co-workers).

Complex Adaptive Systems and Complexity Theory

Systems thinking can be seen as providing the foundation for thinking about systems and interaction in different ways. One such way is through viewing particular systems as complex and adaptive. Complex adaptive systems were originally conceived in the sciences, as a way of understanding biological systems that were unexplainable via reductionism. A complex adaptive system consists of many individual agents acting in parallel, similar to a school of fish (Dettmer, 2003). These agents continually reshuffle and restructure, according to their interpretation of the context they operate in. These agents can identify patterns, and adapt themselves to the changing conditions, similar to a bird migration (Pascale, 1999). While there are many different conceptions as to what constitutes a complex adaptive system, Pascale identifies four key bedrock principles: requisite variety, self organisation and emergent complexity, movement towards the edge of chaos, and the fragility of the system.

Requisite Variety and Equilibrium

The most important concept of complex adaptive systems is also the concept which is most challenging: equilibrium is bad, and is a precursor to death (Pascale, 1999). For a system to survive, it must have the capacity to adapt, and in order to have that capacity, a system must have a variety of internal controls. These controls will ensure that the system can change accordingly to any changing conditions (Pascale, 1999). An example of a business approaching equilibrium could be a local supermarket, which has existed in the community for a number of years. This supermarket will have adjusted to its context and customers so well that it may be completely unable to adjust the way it does business if competition enters the area or if consumer preferences change towards fresh local produce or home delivery. In this example, the grocers complacency could potentially erode their strategic positioning, resulting in a loss of profit. A similar example is found at Yellowstone Park, where the natural system was forcefully put into equilibrium, by fire fighters quickly extinguishing all bushfires. The result was a build up of dead leaves and branches, which when ignited resulted in massive destruction of the forest and topsoil, which would have survived a smaller fire (Pascale, 1999). This complacency brought about by reaching equilibrium is particularly hard to swallow for larger companies, who have become successful through a particular product or industry. If we look at the case of software publishers, such as Microsoft, it can be seen that relying on

one or two breakthrough products (such as Microsoft windows) can lead to equilibrium, which can erode a company's ability to respond to changes in the market, (such as the advent of tablet computers, notebooks, smartphones and numerous others), and lead to more adaptive competitors taking over (an excellent example being Google and Apple, both of which have trumped Microsoft in Smartphone software, and have eroded Microsoft's dominance in web browsing software).

The promise of equilibrium is appealing to both business (who perceive equilibrium as a happy place with steady repeating business and continuing profitability) and species (who see equilibrium as an easy way to live), which suggests that everything should move towards equilibrium and eventually die off. While there are many cases where this happens, there are factors that draw businesses and species alike to instability and chaos. In nature, there are two forces that do this: the threat of death, and the promise of sex (Pascale, 1999). Translated to business, immanent failure acts as an excellent change agent, as does the promise of new lucrative markets. In terms of sex, it can be acknowledged that a species becomes more susceptible to failure if it is genetically homogenous, as there is a lack of requisite variety, a requirement of complexity. An organisation can also be viewed in this light, as diversity in terms of culture and ideas will provide the requisite variety required for long term survival (Pascale, 1999).

Self Organisation and Emergent Complexity

Emergent complexity is centred on the development of systems from simple origins (for example, the four base acids in DNA) to the emergence of infinite complexity (the combination of those acids to form a human being) (Pascale, 1999). Another example of this is a crow's foot pattern combining to create a fern pattern, or fractal images being created out of an equilateral triangle. One of the challenging aspects of emergent complexity is applying it successfully to business. One method, utilised by shell is a 'design for emergence' strategy, which is focused on establishing a wide ranging network of connections within the company, in order to allow for information from all levels of the company to be disseminated, while avoiding hierarchical structures that process and block information moving from the floor attendants to the regional managers (Pascale, 1999). The results of Shells informal network were an increase in important front line information as to what customers wanted, and how they wanted it. Having this information allowed Shells strategy team to capitalise on opportunities that would not have been identified otherwise. For Shell, embracing self organisation and emergent complexity required a reconceptualising of their information processes, from a 'well oiled machine', with each part functioning, to more of a neural network structure, with hundreds of informal connections.

Edge of Chaos

Innovation is challenging when systems are in equilibrium, as there is not motivation for change. However, systems in a state of chaos, such as riots or stampedes have no structure to apply changes to. The complexity required to spur innovation occurs between these two extremes; at the edge of chaos, where enough structure exists to shape and form ideas and concepts, and

enough chaos is around to generate novel adaptations(Pascale, 1999). The edge of chaos represents a central tenet in complexity thinking that separates it from contemporary enlightenment thinking. Traditionally, things travelled from one equilibrium state to another, for example water freezing to ice. Science focused on these equilibrium states, because measuring transition states was far too difficult to measure and analyse. This was the case for all sciences, including economics; however the advent of computer analysis allowed scientists to run simulations, and to do large calculations, paving the way for complexity science (Pascale, 1999).

Transitions occur within the relative calm of the edge of chaos, which allow very small changes to have large effects. The primary determinants of how effective these changes are dependent on feedback loops: a positive feedback will enforce the change; negative feedback will dampen change (Pascale, 1999). Complex adaptive systems thrive when there is tension between positive and negative feedback, as it balances the system between stability and chaos, the challenge is getting the mix right. This has real implications for business and strategy, as it suggests that creativity and order lie at opposite ends of the spectrum. If this is the case, then the role of the manager can be seen as a provider of tension between these two dichotomous forces: providing a space for creative expression, while at the same time structuring the conditions around that expression so that it produces something useful.

Disturbing a Living System

One of the primary differences between complex adaptive systems and traditional science is the link between cause and effect. Traditionally, this linkage is short and direct, a good example being chemical reactions. However, in complex adaptive systems, these connections are non linear- an action now may have numerous unpredictable effects. An example of this could be the coyote control measures used by the US federal government, which were aimed at reducing coyote numbers throughout the US (Pascale, 1999). Over the short term, coyote numbers decreased, based on trapping, shooting and coyote migration, however the measures merely accelerated natural selection, with only the wiliest coyotes surviving. These coyotes bred with Canadian wolves, and consequently, the coyote is not significantly larger, smarter, and spread throughout the continental U.S. (Pascale, 1999). The focus of complex adaptive systems is for the entity to adapt itself to the system, rather than trying to influence the direction of the system. In terms of strategy, Shells ‘design for emergence’ can be seen as demonstrating an understanding of the importance of adaptation within the industry it operates in (Pascale, 1999).

In summary, complex adaptive systems must display four characteristics: They must exhibit the ability to self organise through the process of emerging complexity; the systems do not operate in a state of chaos or equilibrium, but on the edge of chaos, with feedback loops providing direction as to where to move; and that attempting to influence a complex adaptive system may result in unexpected outcomes.

Complexity theory offers a completely different method in which to understand business, which has many consequences for the current theories used. One of the most important changes is the value of business analysis,

which is predicated on the understanding that through studying the past, predictions of future performance can be made. However, complex adaptive systems operate on the edge of chaos, where small changes can have large impacts, and are largely unpredictable. Examples of this happening throughout history are plentiful, and highlight the shortcomings of enlightenment thinking (Stacey, 1995). Another important factor associated with this is the value of long term planning, which becomes useless once one accepts the unpredictability of a complex adaptive system (Stacey, 1995). While planning may prove beneficial in the short term, it is important to acknowledge gradual shifts within the context that businesses operate in, and the impact that has on strategy. Associated with this, entrepreneurial 'visions' become illusions, as the acknowledgement on the importance of emergence in strategy materialises with key decision makers (French, 2009). The concept of a long term position for business is replaced with a strategy based on the best fit between business capability (resources) and market requirements, rather than an idealised future position. Businesses with strong homogenous organisational cultures become dangerous, as they move towards equilibrium, and do not have the wide variety of perspectives with which to adapt to changes in the business environment (French, 2009). Finally, if complexity theory is to become adopted as a method of understanding business issues, the importance and applicability of statistical techniques become dubious. Statistical relationships, probabilities, and values are all centred on an understanding of the world via reductionist means, which is not applicable in a complex adaptive systems approach (Stacey, 1995).

While it is acknowledged that both complexity theory and systems thinking share similarities in terms of understanding how the world works, they are two distinctly different theories. Systems thinking is the original philosophy, upon which complexity theory is grounded (Maani & Cavana, 2007). Systems thinking entails the understanding of organisms in three states: stability, instability and chaos. Complexity theory focuses specifically on unstable systems, which are stuck between stability and chaos. The study of complex adaptive systems is different yet again, and focuses on systems that have the ability to react to changes in their environment, such as a school of fish.

Complexity Absorption vs. Complexity Reduction

Dealing with complexity in the context of business can be a challenging task. The success of a business is entirely dependent on how it operates within its particular context, and involves not only customers, but stakeholders such as suppliers, community groups, the government and its employees. While western methods of business (such as enlightenment thinking and reductionism) lend themselves well to their particular context, international business brings more challenges. In terms of the management of complexity, Boisot and Child (1999) propose two methods: complexity reduction, and complexity absorption. While their study was focusing on China, it highlights important differences in how viewing the business context as a complex adaptive system impacts on decision making (Boisot & Child, 1999).

The first and most common method of dealing with complexity is through complexity reduction. This is where the business imposes familiar

methods and routines into its new context, in an attempt to reduce the complexity of contextual change (Boisot & Child, 1999). This method is centred on creating equilibrium in the new context, to make operations more familiar and comfortable. Complexity reduction can be seen as a method by which a business changes a context to suit them, rather than vice versa. A major factor in complexity reduction is the standardisation of processes such as HR, marketing and operations as a ploy to increase predictability and measurability across contexts (Boisot & Child, 1999).

The second method is that of complexity absorption, which in Boisot and Child's case, is engaging in a joint venture, in order to aide in the contextual adjustment of operating in a foreign country. This is done through the cultivation of long term relationships, in which defection carries real consequences. The challenge is for outside companies (in this case, western companies) to gain the trust and respect of local firms, to aide in their contextual awareness (Boisot & Child, 1999). This is achieved though synergies, and capitalising on each other's skills in a partnership. It is important to stress the long term importance of these relationships as the key to successful acclimatisation.

These two perspectives on managing complexity illustrate the huge differences between traditional reductionist approaches to understanding business, and a complex adaptive systems approach to business. This is exemplified through the application of Pascale's four concepts of complexity, which highlights these differences.

For complexity reduction, it can be seen that firms are actively seeking to replicate their original context in a foreign country. This is an attempt to reduce complexity, and replicate their comfortable operating environment which the firm is used to. This however, can be seen as an attempt at maintaining equilibrium within the system, something which can be viewed as a precursor to death. Second, the transposing of a business from one context to another fails to acknowledge the importance of emerging complexity (Boisot & Child, 1999). This top-down approach fails to include the voice of the ground level staff, which can be a particularly useful source of information when operating in a new context. Third, it can be seen that the potential for innovation and change is not an important factor when it comes to complexity reduction, in fact the more similar the foreign business is to the home company, the better. This indicates that the company is doing everything it can to avoid the edge of chaos, in favour of stability. Finally, the most important aim of complexity reduction is to mould the new system into the same shape as the home company, through the promotion of standardised practises, and requiring similar institutions, customs and contracts. The focus on reducing complexity by influencing the system provides ample evidence that complexity reduction is informed by reductionist thinking.

Complexity absorption as a method of managing complexity displays attributes that are more in line with complex adaptive systems thinking. First, it acknowledges the importance of different perspectives and diversity within a business, by suggesting that both parties bring something unique to the agreement that will have a beneficial outcome for both. This leveraging of specific competencies indicates an understanding of the importance of variety in order to adapt to changes within a complex adaptive system. Allowing for a more bottom up, or context informed business acknowledges the importance of emergent complexity, and the importance of flexibility and adaptability

within a complex adaptive system. In terms of operating on the edge of Chaos, Boisot and Childs iteration of the importance of a partnership indicates that the tension between the Chinese company and the Multinational Company represents the tension between stability and chaos. Through engaging in this relationship, both companies acknowledge the importance of regionalisation, or contextualisation, while also acknowledging the importance of firm structure, allowing the companies to reap the benefits of both. Finally, through the initiation of a joint venture with a Chinese company, the business is signifying its willingness to adapt to the new system, rather than attempting to influence it. (Bartlett et al., 1998)

International Management Strategies and Complexity Theory

Changing the way in which we conceptualise knowledge surrounding business had a tremendous effect on the way business operates. This has been identified in the discussion of the ways in which complexity is dealt with by businesses, with complexity reduction being informed by reductionist thinking, and complexity absorption being informed by complex adaptive systems thinking. Similarly, the same can be said for the way companies handle international operations, which can be handled using a variety of strategies. Bartlett et al. (1998) suggest four international management strategies: multinational, international, global and transnational. These strategies differ in the importance placed on the importance of innovation, local responsiveness, efficiency, and knowledge controls.

Firms operating a multinational strategy are focused on exploiting national differences to achieve its strategic objectives. This is done via a process of regionalisation, where businesses enter a market, and tailor their products/services to suit (Bartlett et al., 1998). This is an excellent strategy for meeting local customer requirements, that are often very different from home country preferences. Multinational strategies also take into account different impacts that stakeholders may have on business operations in different countries, such as the level of government involvement, taxes, regulation, and cultural expectations of the role of business in society (Bartlett et al., 1998). The multinational approach requires independence for the local subsidary firm to adapt to its specific context, relying on local innovation and customised business processes. Along with this independence is the requirement for the subsidiary to be self sufficient in terms of costs and revenue management, with the acknowledgement that operating in different contexts will alter expectations in terms of revenues, profits and costs of doing business(Bartlett et al., 1998). Multinational strategies were commonly adopted by european companies who operate in different states with different requirements. The main advantage of this strategy is the resposiveness gained through business autonomy. However, there are downsides to adopting a multinational strategy, such as higher operating and production costs, and less control over local operations (Bartlett et al., 1998). Companies operating in a cost sensitive market may find adopting a multinational strategy detremental, as would companies who posess a strong brand image and consumer expectations (Bartlett et al., 1998).

The opposite to a multinational strategy is a global strategy, with focuses on creating low cost, homogenised products to sell worldwide, with

little or no accounting for local tastes(Bartlett et al., 1998). The main purpose of this strategy is to leverage massive scale to achieve global efficiency. This approach is common to japanese companies, who aim to minimise total cost per unit through mass production (Bartlett et al., 1998). Under a global strategy, innovation is centralised at headquarters, as it is assumed that the target market in the home country will have similar tastes to the rest of the world. This limits flexibility and innovation, and adds risks in terms of exposure to supply chain vulnerability, due to manufacturing in a single location (Bartlett et al., 1998). This also exposes companies to fluctuations in exchange rates which can potentially have a detremental effect on profitability.

International strategy focuses on leveraging innovations throughout the world. This is commonly adopted by MNC's in technologiclly advanced countries, and it traditionally focused on developing technologiclly advanced products for the home market, and then exporting them throughout the world (Bartlett et al., 1998). By adopting an international strategy, MNC's international subsidiaries are utilised as places for research and development, to send back to headquarters. This strategy attempts to take the advantages of both the global and multinational strategy by utilising innovation as the key driver, however the reality is that the lack of focus on either localisation or globalisation leaves companies in a sort of no-mans land(Bartlett et al., 1998).

These three strategies of international business each have a differing assumption of the core factors of success; the global company assumes that cost leadership is the cornerstone of competitive advantage, the multinational company sees cultural adaptation and localisation as essential to success, and the international company utilises innovation to increase revenues and to reduce cost. These strategies, while effective in some cases, are limited by their exclusive focus on particular aspects of international business. In order to achieve sustainable competitive adantage, companies must focus on innovation, localisation and production costs simultaneously. A transnational strategy attempts to do this, by exploiting learning, flexibility and efficiency, however this brings many challenges to the business (Bartlett et al., 1998).

One of the biggest challenges facing the transnaitonal company is that of structure: a global strategy requires a concentration of resources in one location, a multinational approach requires a wid edispersion of resources worldwide, and an international approach requires large centralised resources in the home country, with resources also dispersed througout the world for desemination (Bartlett et al., 1998). However, none of these are applicable to a transnational strategy, which requires a reconceptualisation of the rational binary of decision making; transnational management does not require a decision of one or the other, but of where, how, when and how much.

The organisational configuration is highly dependent on which international strategy is chosen, as it effects the allocation of resources, and more importantly, the flow of information between headquarters and subsidiaries (Bartlett et al., 1998). Businesses adopting a multinational strategy require the free flow of information and capital between headquarters and its local offices (Bartlett et al., 1998). The configuration for a multinational organisation will be of a decentralised federation, with headquarters supplying capital to its independent local subsidiaries, with the subsidiaries providing dividends in return (Bartlett et al., 1998). For companies adopting a global strategy, tightere controls of subsidaries is

required, in order to minimuse costs (Bartlett et al., 1998). Decision making is centralised, and information flows outwards from headquarters to subsidiaries. Subsidiaries are utilised as points of access for the local market, and are under the direct control of headquarters. Companies following an international strategy will have a combination of both structures, with decentralised resources but rigid controls on capital, information and expertise (Bartlett et al., 1998). This coordinated federation is centred on acknowleging the importance of some autonomy, while identifying the need for tight controls on information and knoweldge, which is central to competititive advantage.

While these organisational structures are useful, none are applicable to a transnational management strategy. The transnational organisation differs from the other strategies in three ways. First, transnational management requires multidimensional perspectives, in order to get an understanding for local and international issues affecting the company (Bartlett et al., 1998). Other management strategies focus on particular management teams for decision making: global companies focus on headquarters, multinationals on local management (Bartlett et al., 1998). Transnational managers focus on breaking down barriers between powerful and weaker management groups in the company to ensure that decisions are made in an informed manner (Bartlett et al., 1998). Transnational organisations differ from both global and multinaitonal strategies by having cababilities distributed between subsidiaries, but having these subsidaries interdependant on each other, ensuring effort is not wasted through duplicating cababilities elsewhere(Bartlett et al., 1998). This means that traditional organisational configurations are not applicable to the transnaitonal organisation, instead, an integrated model is used, in order to allow interdependance and distribution of cabablities between business units. This requires extensive communication and collaboration, and results in large flows of knowledge, components, capital and people between headquarters and subsidiaries. It is important for transnationals to be able to deal with a diverse range of interests, perspectives and solutions, which is achieved through a flexible integrative process.

From this discussion, it can be seen that global, international and multinational approaches to strategy are different, yet share a similar theoretical foundation. All require specialisation, focusing, a reduction in a companies strategic aspirations to either focus on economies of scale, regionalisation, or innovation. By applying one of these strategies to a business, flexibility is grreatly reduced, and consequently, the ability to change the business to the changing nature of business on the local and global scale. The prescriptive and controlling nature of global and international strategies also fail to account for emergent complexity within the organisation.

Transnational Management and Complexity

If we are to analyse transnational management with complexity theory, several similarities emerge. First, Transnational management understands the concept of requisite variety being the secret to survival, with important capabilites being spread throughout its network of business units, rather than centralised in the centre, or individualised to each local level. This move

promotes diveristy of opinion, and places value on the interaction between business units. Transnational managements approach to management of its business network is centred on interdependance and constant collaboration, which is in-line with the concept of emergent complexity. Under a transnational strategy, there is a focus on perspectives on decision making,allowing for strategic emergence form a consensus among managers, rather than a top down prescription on what is appropriate. Transnational management exists between the two extremes of global and multinational managemeent strategies, which can be also be viewed as between a stable system (global management, with its standardised processes), and chaos (multinational management, with its decentralised and independent subsidiaries. This creates an advantagous situation for transnational organisations, with the benefits of both regionalisaiton and global manufacturing capabilities ensuring low costs while satisfying cutomer requirements. The understanding of contexts allows transnational organisations to adapt to the system, rather than attempting to change the system itself.

Conclusion

From this discussion, it can be seen that systems thinking represents a paradigm shift within contemporary management thinking. Complexity theory is the study of business as a complex adaptive system, with sucessful businesses acknowledgeing the importance of change, adaptation, emergence, and the contextual nature of business operations. When businesses are faced with complexity in their operations, there are two methods in which to cope: complexity reduction, which is in line with the current methods of thinking about business; or through complexity absorption, the process of understanding the inherent complexity in business, and adapting to the various values held within the business context. Various international management strategies were discussed, with the conclusion that global, international and multinational strategies are informed by reductionist views of knowledge and understanding, which informs decision making. Transnational management is more aligned with the concept of systems thinking and complexity theory, based on its focus on integration and interdependance, focusing on the value of relationships between headquarters and other business units spread throughout the globe. This will allow for a more emergent and adaptive organisation, with decisions being made with information from the grassroots and corporate level. The similarites between trtansnaitonal management and complexity theory highlight the utility of viewing organisations and the context they operate in as non linear complex systems, which will lead to more better strategic decision making, and sustainable competitive advantage.

References

Bartlett, C., Ghoshal, S., and Beamish, P. (2008). *Transnational management: Text, cases and readings in cross-border management* (5th ed.). McGraw Hill International.

Bennet, A., and Bennet, D. (2004). *Organizational survival in the New World: The intelligent complex adaptive system*. Chapters 1, 3&4. KMCI Press.

Boisot, M., and Child, J. (1999). Organisations as adaptive systems in complex environments: The case of China. *Organisation Science*, *10(*3), 237-252.

Dettmer, W.H. (2003). *Strategic navigation: A systems approach to business strategy.* ASQ Press.

French, S. (2009). Cogito ergo sum: Exploring epistemological options for strategic management. *Journal of Management Development.*

Maani, K., and Cavana, R. (2007). *Systems thinking, system dynamics: Managing change and complexity* (2nd ed.). Pearson Prentice Hall.

Pascale, R. (1999). Surfing the edge of chaos. *Sloan Management Review, 40*(3), 83-94. Retrieved from Business Source Complete database.

Rosenhead, J. (1998). *Complexity theory and management practice*. Retrieved from http://www.human-nature.com/science-as-culture/rosenhead.html on 27/10/10.

Rugman, A. M., and Brewer, T. l. (2001). *The Oxford handbook of international business* (pp. 88-122). Oxford University Press.

Stacey, R. (1995).The science of complexity: An alternative perspective for strategic change processes. *Strategic Management Journal, 16*(6), 477-495. Retrieved from Business Source Complete database.

Stacey, R., Griffin, D., and Shaw, P. (2000). Series preface: Complexity and emergence in organizations. *Complexity & Management*, *1*. Retrieved from Business Source Complete database.

Valente, M. (2010). Demystifying the struggles of private sector paradigmatic change: Business as an agent in a complex adaptive system. *Business and Society, 49*, 439-476.

Tax Havens and the Decision Faced by a NZ Company

Sean Harrison

Introduction

Throughout history there have always been people who have resented paying tax and sought measures to avoid or evade it. Sometimes the measures taken are extreme and illegal such as bribery, fraud or smuggling funds, other times legal measures may be used such as structuring income and profits through trusts, companies or similar legal vehicles.

The purpose of this paper is to assess the opportunities a New Zealand organisation has in regards to the use of tax havens or offshore financial hubs to mitigate their tax liability. My focus is on the possible decisions faced by the organisation such as the associated benefits, costs, risks, ethics involved, and strategic implications; and not the specific methods or issues surrounding the law. I have deliberately left out the issue of money laundering and terrorists' ability to fund their actions using the secrecy of tax havens, as I am only interested in the economic concerns related to the subject.

First, I introduce tax havens with some background, definitions and examples and then I look at tax avoidance and planning, emphasising the blurred boundary between the two. The methods used, starting at basic objectives, and then methods specific to tax havens are outlined at a basic level, which I am not proposing are legal, or ethical, but rather identifying how companies can use them. The last section is examining the specific factors companies face when deciding whether to utilize tax havens or not, keeping in mind how a New Zealand company will view them. The end result is never going to be a universal answer, but rather "depends". The situation changes for all companies, regardless where they are located, some factors are more relevant than others but there is no definite yes or no.

Tax Havens

Tax havens are not new phenomena, rather some would say inevitable, starting with hoards of Romans going over to the barbarians to avoid Rome's harsh tax regime, and later the establishment of America as the first postmedieval tax haven. More people fled to the New World from Europe to avoid the hated taxes than for religious or political freedom (Adams, 1999).

Modern tax havens did not get to where they are by conscience strategy, but more of a haphazard approach, stumbling upon the various attributes such as secrecy laws, low taxes, and 'liberal' corporation laws (Palan, 2002). The possible incentives they gain for being a tax haven vary as their economic situations vary. But because most are small they don't require the high tax revenue larger countries do, and they usually recoup the revenue by other forms of tax e.g. sales tax, GST or just tax locals. By encouraging large corporations to locate some form of office there, they usually gain highly skilled workers as well, either by negotiation with the

This assignment was for MANT435 Advanced International Management 2
Supervised by Assoc. Prof. André Everett

government to have workers come, or indirectly, with supporting workers needed to keep operations running (Dharmapala & Hines, 2007). Some tax havens have armies of bankers, tax lawyers, accountants, and fund administrators to make it all work. They claim it is their right as sovereignty to write laws, tax competition is part of an efficient market, and it is necessary for them to compete against the larger, more resourced countries (Palan, 2002). On the other hand, the argument against tax havens is the harmful tax competition. They are parasitic on the tax revenues of non-havens, leading to the unfair erosion of the domestic countries tax base (Weiss, 2001).

Depending on who you ask, the definition of a tax haven will vary, even if only slightly, but the result of differences in definition can be quite significant. Have you ever considered New Zealand a tax haven? It does not tax foreign income on a foreign trust, (a trust which has a non-resident settlor) meaning a non-resident can settle a trust in New Zealand, even with a New Zealand resident trustee, and pay no tax on its foreign sourced income (Taylor, 2003). But doesn't the trustee control the trust? Yes, but the settlor can appoint whoever it wants as trustee and that trustee could even be a company, and the shareholder of that company ... the settlor. If the definition was just setting tax rates to encourage overseas investment then it could be argued this law could meet that definition.

One definition of a tax haven suggests the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance (Doggart, 2002). Another definition is a country that attracts international trade oriented activities by minimization of taxes and the reduction or elimination of other restrictions on business operations (Palan, 2002). Some advocate a tax haven is merely a country that explicitly promotes itself as such (Ginsburg, 1991). The OECD, when cracking down on tax havens, considered four key factors to identify a country or territory as a tax haven:

- No or nominal tax rates
- Lack of effective information exchange – practices under which individuals or businesses can benefit from strict secrecy rules and other protections from tax authorities ie domestic
- Lack of transparency – referring to rules that depart from accepted laws and practices, secrete rulings, and ability to elect or negotiate a rate of tax.
- No substantial activities – if the untaxed activity is not substantial the jurisdiction may be trying to attract investments that are purely tax driven.(Samuels & Kolb, 2001)

Each definition used can result in slightly different countries being labelled as a tax haven, but the popular ones mostly recognised as havens include:

Andorra	Bahamas	Barbados
British Virgin Islands	Cayman Islands	Jersey
Guernsey	Gibraltar	Isle of Man
Liechtenstein	Luxemburg	Mauritius
Monaco	Norfolk Island	Panama
Samoa	Switzerland	Vanuatu
US Virgin Islands		

Other countries that are not always attributed the tax haven status but certainly have financial advantages include:

Ireland Singapore Hong Kong
(Source: Wikipedia)

Today it is believed over half of all world trade flows through tax havens, with an estimated $250 billion lost annual tax revenues (Tax Justice Network, 2010) (although these figures are not widely accepted). The issue has not gone without the OECD's concern as it effectively eliminated what it calls 'Harmful Tax Practices' first by published a book *Harmful Tax Competition: An Emerging Global Issue* in 1998, and then following up with a blacklist of 'Non-Cooperative Countries or Jurisdictions', along with threats of 'counter measures' if there was no cooperation of tax information exchange. The list originally identified 15 countries, with 8 later being added (Financial Action Task Force, 2010), and has had significant effect, as of May 2009 there were no official Non-Cooperative Countries or Jurisdictions left on the list (OECD, 2010).

Tax Planning and Tax Avoidance

The first broad adjective in tax planning is legally arranging financial affairs to reduce tax payable, the second, less known, (and second-rate compared to permanently reducing taxes) objective involves deferring the payment of tax, merely creating a timing advantage. Tax avoidance, often mistaken for tax evasion – the evasion of tax liability by illegal means, is also the use of legal mechanisms, directly or indirectly, to alter the incidence of any tax liability (Alley et al., 2009). While the definition sounds legitimate and very similar to planning, the actions taken in tax avoidance are generally designed to be in conflict with or to defeat the intention of the tax regime. The latter will also be void and the possibility of the taxpayer facing civil penalties. With this in mind there is only a very thin line between legitimate tax planning techniques and avoidance as there is no natural law such as the law of contract or tort, just the interpretation of various statues and court rulings. There is still much confusion in the courts over the distinction between planning and avoidance with arguments over impropriety, intention and the commercial reality of transactions and whether they constitute avoidance or not (Alley et al., 2009).

Methods

Legitimate tax planning is what companies should be aiming for and as outlined above there are two broad objectives – reduce tax liability permanently or defer payment of tax creating a timing advantage. These two broad objectives can further be broken down into more specific strategies, which include:

- Decreasing income
- Increasing expenses
- Delaying the recognition of income
- Accelerating the claiming of expenses

- Deferring the payment of tax
- 'Shifting' income to a 'related' taxpayer on a lower tax rate (Alley et al., 2009)

Adding tax havens to the mix substantially increases the complexity of the situation, but at the risk of oversimplification there are four general principals of gaining benefits using tax havens (Clarke, 2009).

- **Personal residency** – As residency is the primary basis of taxation (source of income being the other), individuals may choose to relocate themselves in a low tax country. New Zealand's highest tax rate for individuals earning over $70,000 is 38%, yet this will decrease as at 1st October, 2010 to 33% (Daniels, 2010). High earning New Zealand individuals moving to a tax haven will earn 33% more than if they stayed in the country. That is a huge stake in their income. Some prominent tax exiles are the Rolling Stones or the more recently publicized Formula 1 driver Lewis Hamilton (Pollock, 2009).
- **Asset holding** – Using a trust or company, or a trust owning a company, formed in a tax haven but usually administered in the high-tax jurisdiction, to hold assets. The assets, because they are not recognised in the domestic region, are not taxed there. This may be used to avoid a specific type of tax such as inheritance tax. A wealthy testator could transfer all their investments – stocks, bonds etc, to a company in a haven and settle the shares of the company on trust to himself for life, and then to his kids. Upon his death the shares automatically vest in the kids, bypassing probate and any inheritance tax liable to pay in the domestic country (Clarke, 2009).
- **Trading and other business activity** – Within this principal are three common devices to shift taxable earnings to a tax haven – debt contracts, conversion of domestic income to tax haven income and adjustments of transfer prices (Hines & Rice, 1994). The use of debt contracts is when a domestic company finances most of its business by debt from their subsidiary offshore (themselves), thus their deductable interest payments turn into untaxable profits in the haven.

  Converting domestic income to tax haven income can also be achieved by relocating a company's headquarters to the haven. One example of this is Nabors Industries, the largest oil and gas drilling company in the US, whose headquarters were located in Texas, but now is situated at 8 Par-La-Ville Road Hamilton, Bermuda (Nabors Industries, 2010). Other examples include another oil and gas drilling company, Weatherford, Stanley Works (Johnston, 2002a), Accenture, Tyco International and Seagate Technology (Johnston, 2002b). These companies gain their tax advantages by an accounting sleight of hand, which transforms taxable profits into deductable expenses like interest payments, royalties or management fees paid to a paper company in a tax haven. The money then gets sent off to another haven, where their headquarters is located, the money untaxed and able to use worldwide (Johnston, 2002a).

  Very similar to the above example is the use of transfer pricing. A subsidiary, special purpose entity, or paper company (whatever you wish to call it), is set up in the tax haven to 'transfer' costs and manoeuvre profits where tax laws are more favourable. The

transaction may involve raw materials sold at low prices to reduce the profit domestically and transfer the tax liability to the haven. GlaxoSmithKline, a pharmaceutical giant settled allegations of transfer pricing relating to its blockbuster ulcer drug, Zantac, for which it basically sold, underpriced to itself. The dispute was settled with GlaxoSmithKline agreeing to pay US $3.1 billion to the IRS out of a potential $11.5 billion the IRS claimed it was owed (Mortished, 2006).

- **Financial intermediaries** – A lot of the economic activity today in tax havens consists of financial services located in the tax haven, lending or investing money, often back to the high tax jurisdiction. While this does not always avoid customers' domestic tax liability, it enables the financial intermediary to provide products from around the globe without adding an additional layer of taxation. The Cayman Island, with a population of 56,000 and area of 264 km^2 is estimated to house around 75% of the worlds, $1.5 trillion, global hedge fund business (Browning, 2007). Other financial services using tax havens can include banking, insurance and retirement funds.

Keep in mind the above principals are very basic, with most developed jurisdictions having strict laws dealing with these methods used. New Zealand's General Anti-Avoidance Rule and Thin-Capitalisation Rule are a couple examples (Alley et al., 2009). However where there is a will there is a way, and it seems people will find holes in legislation, or ways to bend the rules, and benefit themselves. Nevertheless, the purpose of this paper is not to examine how the methods are used, nor question the legality of these methods, but to examine the possibilities for a New Zealand company, looking to gain a financial advantage, and factors that could influence their decision.

Factors Influencing the Decision

Many factors will cross the mind of managers deciding whether to utilize tax havens or not. Basic economic theory suggests if the benefits outweigh the costs then the answer would be yes, use them, but it seems there is much more to it than that. Obviously financial rewards would be the dominating factor encouraging managers towards the haven, but there are many non-financial reasons that could pull them away from that thought, such as how it affects the shareholders, will there be a consumer backlash, is it ethical, legal, and if so what are the risks, of being caught and charged by the IRD?

Types of Organisations Using Tax Havens

In a study investigating whether economies of scale exist in the use of tax havens, Rego (2003) discovered that higher levels of pre-tax income were associated with lower domestic and foreign effective tax rates (ETR) – a ratio of the current tax liability to pre-tax income. A similar study looking more specifically at the types of firms using tax havens found large multinationals, and those that are most active abroad, are the most likely to operate in tax havens, suggesting again that there are economies of scale in using havens to avoid taxes. Additionally, firms in industries that typically face low foreign tax rates, such as technology intensive industries, or those characterized by

extensive intra-firm trade are more likely than others to operate in tax havens (Desai, Foley & Hines, 2006).

The evidence that multinational corporations effectively use tax havens as opposed to domestic organisations is consistent with the source of income rule as a basis for tax. Income will be taxed at the source (Alley et al., 2009), so theoretically a company using a tax haven will only gain a tax advantages on its foreign source of income. Even though they could possibly use the methods identified above (or others), there is no way they could lower their domestic tax rate to 0% without a serious investigation into tax avoidance or evasion. The fact that they are located all around the world means they never have to bring that money back into the country, and this is exactly what some of America's largest companies are doing.

The question then for a New Zealand company is, are they big enough? Do they have the incentives, or the resources or an extensive foreign presence? The examples I've found and used have been very large companies, possibly only Fonterra could compare to (but that's a co-operative, so even more complicated). However, there are possibly distortions in the information, as larger, publicly listed, and/or of public interest companies will have a higher duty to report certain information making the chance of finding this information very difficult. Obviously larger companies will benefit more overall, and as suggested even marginally because of economies of scale, but that doesn't mean smaller ones don't use, and also benefit, from tax havens.

Financial Benefits

Because of economies of scale, financial benefits will depend on the incentives and resources available as to how much organisations actually save. This area is also difficult to find hard evidence because organisations will not admit a certain transactions' purpose is solely for a tax advantage, as this is one measure of avoidance. Along with the GlaxoSmithKline case and graph above, some examples are Tyco International, who believes it saved $400 million in 2001 after incorporating in Bermuda, Cooper Industries with an estimated $54 million in tax savings (Browning, 2007), and in 2002, Nabors paying 7 cents in the dollar for taxes (Johnston, 2003). In 2004, the most recent year for which data is available, US multinationals paid $16 billion in taxes on $700 billion in foreign income, an effective rate of 2.3 percent (Calmes & Andrews, 2009).

Financial Costs

Financial costs have to be weighed against financial benefits otherwise there would be no advantages to using a haven, more so an administration burden. Costs will depend on many variables such as which jurisdiction, structure and methods used, and will most likely differ for all companies. Ingersoll-Rand, a global diversified industrial company, is charged US $27,653 a year for its Bermuda mail drop 'headquarters' while avoiding $40 million in American corporate taxes (Johnstone, 2002c). The Cayman Islands charge about $35,000 in fees to set up (Browning, 2007).

Strategy

The financial benefits gained on tax dollars need to be thought of more than just a larger after-tax profit. There are strategic implications, so that extra cash should be used wisely, to potentially gain a competitive advantage. The case of Nabors Industries illustrates this well; paying 7 cents in the dollar for their taxes in 2002. The oil and gas drilling company has all its competitors crying foul as it tenders for drilling contracts at prices its competitors cannot match (Johnston, 2003a). Nabors has a massive advantage over its competitors and by using the extra cash strategically, as opposed to say increasing dividends, they have significantly lowered the attractiveness of the industry for their competitors, leaving them worried they will be broke within a decade. Insurance companies such as the Bermuda incorporated White Mountains and PXRE Group, also use their tax benefits to price their products at lower rates while their rivals continue to be fully taxed on their earnings and struggle to match the low prices (Johnston, 2002d). Both examples are industries where a first mover advantage could be very beneficial for the long-term prospects of the business. The successful bid for drilling and insurance contracts could see Nabors and the insurance companies respectively, gain a larger market share, putting pressure on the competitors and leaving them in a strong position.

On the flipside, if your competitors are the ones using tax havens this will greatly affect the decision on whether you should or not. Just as Nabors competitors complain of unethically being run out of the industry they too might follow suit and see themselves moving offshore. Whether the decision to move is based on a first mover advantage or a necessity to stay alive, it could have huge impacts on the strategic directions and the long-term successfulness of the organisation.

Foreign Direct Investment

When deciding where to direct foreign investment, *ceteris paribus,* the jurisdiction with the lower tax rate would win every time. But of course, seldom are all other considerations equal. Even within tax there is an array of aspects effecting the choice, which only complicates the situation to more than just the nominal tax rate – calculation of depreciation allowed, tax incentives on new capital assets, tax incentives on specific industries, or economic zones within the country that have tax advantages (Larkins, 2000). Non-tax factors include government & economic stability, investment treaties and guarantees, currency exchange restrictions, business & environmental regulations, privacy disclosure rules, trade barriers, adequate labour & consumer markets, infrastructure, sufficient professional & banking services, labour cost and non-tax government incentives.

Early research has found income tax incentives to be a very weak stimulant for those investing offshore. It was even described like a dessert, its good to have, but does not help if the meal is not there. The largest influencers to FDI seem to be political stability, costs and availability of labour & basic infrastructure, guarantee against expropriation and currency convertibility (Barlow & Wender, 1955), (Robinson, 1961), (Aharoni, 1966).

But to say tax policy has no or a very little role in FDI would be misleading, and what these earlier studies failed to do was distinguish between industries and characteristics of the companies. Certainly one of

Ireland's contributing factors is its low tax rate. After looking more specifically the vast differences between companies will determine wether, and to how much, tax influences FDI. Start-up companies prefer incentives that reduce their initial expenses e.g. equipment and materials, while expanding ones prefer incentives that target profit, and manufacturing firms prefer incentives related to depreciable assets because they utilize a lot (Rolfe et al., 1993). Small investors may be influenced more by tax than larger investors because they have less resources to develop sophisticated tax planning/avoidance strategies (Coyne, 1994), and as already alluded to, organisations competing in multiple markets are more likely to establish a subsidiary in a low tax country, giving them the opportunity to develop tax planning/avoidance strategies (Desai, Foley & Hines, 2006).

It seems foreign tax policy has some weight in it, but it really depends on the characteristics of the company and the industry it competes in. The examples I've used throughout this paper have been influenced solely by tax purposes, but more often than not, is not near the top of determining factors for FDI with the intention to grow.

Consumer Backlash

One of the drawbacks for moving offshore is the potential consumer backlash. This is a major factor for managers as it could be seen as 'unpatriotic' and it must be noted that the companies most willing to do this are not household names (Johnston, 2002c). For a little country like New Zealand, you only have to look at the storm kicked up when Fisher & Paykel left, and that was for more legitimate reason than a tax advantage.

Some see it as robbing the domestic country of tax revenue, which has a flow on affect to the governments spending on education, infrastructure healthcare and so on, therefore harming the whole country. It may be seen as a way for managers to benefit personally, as bonuses are usually tied in some way to financial performances, or the fact it makes it more difficult for shareholders to hold directors liable for reckless trading or other failed obligations, if the matter rose (Johnston, 2002e). Other ethical dilemmas are the potential for greater poverty in developing countries that further increase reliance on foreign aid, the potential for money laundering, secrecy over terrorist funding, and the general issue of the rich not paying taxes while the working class have to (Tax Justice Network, 2010).

It is estimated New Zealand already loses millions through foreign tax havens (Gibb, 2003), and with an economy so little and large attention on the biggest companies, there could be huge social and political costs for a company choosing to go offshore just to save on taxes.

Risks

The Risks associated with tax havens can be minimised by the utilization of a 'good' haven. While no or low tax is a necessary ingredient to a 'good' tax haven, non-tax characteristics are also of most importance. These are a stable government, equitable treatment of foreigners, freedom from government controls, free trade zones, a high degree of financial secrecy, local consumer labour markets, developed infrastructure, local banking & professional services, and investment incentives (Larkins, 1991).

The problem is however, finding a 'good' tax haven may have become a great deal harder, with the OECD clamping down on tax havens, focusing mainly on secrecy laws. They encourage fair tax competition, promoting principles enabling each country to apply its own tax laws without interference of practices that undermine the fairness and integrity of each country's tax system (OECD, 2010a). They identified countries and jurisdictions that did met their criteria (detailed in Tax Haven section), pressuring them to commit to an exchange of information agreement, which is a fundamental aspect of the tax haven system. Their goal is not purely an economic one, but also one concerned with money laundering, and terrorist financing, especially in the wake of 9/11. As of May 2009, there have been no countries or jurisdictions on their 'blacklist' meaning all have made some form of commitment to the information exchange agreement.

President Obama has also put pressure on tax havens and has had some positive response with giant Swiss bank UBS handing over the names of 52,000 American account holders (Mathlason, 2009). Obama's proposals include closing of many loopholes that legally allow profits to be deferred offshore which especially hit pharmaceutical, technology, financial and consumer goods companies. An epic battle with some major powers in American commerce is expected as many view the proposals as putting their corporations at a competitive disadvantage and the possibility of job losses as companies lose profits (Calmes & Andrews, 2009). If the proposals make it through the White House into effect, there is always the possibility others including New Zealand could follow.

Some suggest this could spell the end of tax havens, as it's been the secrecy laws that keep domestic countries taxing on top of the havens existing taxes. Yet it has also been warned that if you dry up the oasis, the camel will just move on to the next one. The number of high net worth individuals that have settled on East Asia – Macao, Labuan & Hong Kong, proposes not that it will go east, it already has (Mathiason, 2008).

The effective use of tax havens has become a lot more difficult and risky since the OECD began its initiatives, but this doesn't mean they can't make a financial benefit at all. There are still the loopholes in regulations that Obama refers to and legal methods of lowering your tax liability. All this may however, have a negative impact on a New Zealand companies decision, even if it is just to scare and put fear into the manager.

Costs of Avoidance and Evasion

The financial costs of being charged and found liable for avoidance or evasion could be considerable. The penalties all depend on the severity of the situation and for New Zealand are outlined in Section 149 of the Tax Administration Act. Penalties can either be civil such as short fall, which is applicable to avoidance and evasion and range from 20% of the shortfall to 150%, 100% being the norm of avoidance; and/or criminal penalties which is one imposed by the court upon convictions. The maximum sentence for an evasion sentence is a fine of $50,000 and/or imprisonment for up to 5 years. Use of money interest (UOMI) can also be charged, which is not a penalty but interest accrued on by the taxpayer on underpaid tax (Alley et al., 2009).

There is no better example for this paper than the recent case of Westpac. They are a New Zealand company (or subsidiary of an Australian

parent) that undertook transactions across boarders that were in the grey area between planning and avoidance. Even though they had clearance from the Commissioner of Inland Revenue for a single transaction of similar type that it satisfied all tax laws, nine others apparently did not. They still argue all transactions were commercially justified, and to their extreme disappointment they owe $900 million to the IRD, more specifically $586m for the tax liability and $332m in interest (Kloeten, 2009). This also illustrates the risks involved, the uncertainty surrounding the issue of avoidance, potentially strategy as all other major banks are in similar cases now, but bizarrely no consumer backlash. For a bank that promotes itself as a community friendly bank you would think a tax avoidance of this magnitude would hurt their image?

Conclusion

Weighing up the factors from a New Zealand business perspective, firstly the pure size of our companies is questionable. This is not to rule it out, but hampers the effectiveness they could achieve compared to the larger companies illustrated in this paper. Fisher & Paykel have offices all over the world, including Ireland, Hong Kong, Vanuatu & Mauritius (Fisher & Paykel, 2010) so it would be very interesting to examine their accounting transactions and see to what affect they use the havens. Obviously the financial benefits would have to be larger than the costs, which seeing as the direct costs can be rather cheap, would be likely. The company could be further persuaded by the strategic advantage it could achieve with the extra cash, possibly strengthening its position for the long term. If a New Zealand company of reasonable size did try to move offshore for tax purposes, I would expect a huge consumer backlash, and this could be a important factor in their decision, especially if their a household name, or known for their community support etc. It happened in the US with the examples I've used throughout, but New Zealand's small size puts even more media coverage on the select large few. The risks seem to have increased somewhat greatly since the OECD's initiative started in 2000, and now with commitments made towards information sharing agreements some say it's the end for tax havens. Lastly if the actions they were undertaking through the tax haven were in that quiet large grey are of avoidance/planning, the costs of being caught and charged with avoidance is significant. Westpac ended up paying back $300 million in interest, and this will put a chill down the spines of New Zealand managers, looking for the same offshore financial advantage.

All in all, it just depends. A New Zealand company will be influenced by many different factors and there is no universal answer. The financial rewards could be easily offset with social and political costs, so the decision is not an easy one. A manager would have to look long and hard, question if it could add to or become a competitive advantage, question if they would be performing tax avoidance, and question the purpose of their company. Is it purely to benefit the shareholders or for more social reasons? Maybe it's a cultural thing? But that's a whole different paper.

References

Adams, C. (1999). *For good and evil: The impact of taxes on the course of civilization.* New York: Madison Books.

Aharoni, Y. (1966). *The foreign investment decision process.* Boston: Harvard Business School.

Alley, C., Chan, C., Dunbar, D., Gupta, R., Hodson, A., Holmes, K., … Ritchie, K. (2009). *New Zealand taxation 2009: Principles, cases and questions*. Wellington, NZ: Thompson Reuters.

Barlow E., & Wender, I. (1995). *Foreign investment and taxation.* Englewood Cliffs, N.J: Hall.

Browning, L. (2007). Offshore tax breaks lure money managers. *The New York Times.* July 1, 2007. Retrieved http://www.nytimes.com/2007/07/01/business/yourmoney/01cay.html

Calmes, J., & Andrews, E. (2009). Obama calls for new curbs on offshore tax havens. *The New York Times.* May 5, 2009.

Clarke, G. (2009). *Offshore tax planning* (16th ed.). UK: LexisNexis Butterworths.

Coyne E. J. (1994). *An articulated analysis model for FDI attraction into developing countries.* Florida: Nova Southeastern University.

Daniels, C. (2010). Budget 2010: Income tax slashed, GST to 15 pc. *New Zealand Herald.* May 20, 2010. Retrieved from http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10646041

Desai, M., Foley, C., & Hines, J. (2006). The demand for tax haven operations. *Journal of Public Economics 90*, 513-531.

Dharmapala, D., & Hines, J. (2007). Which countries become tax havens? *American Law & Economics Association Annual Meetings.* Retrieved from http://law.bepress.com.ezproxy.otago.ac.nz/cgi/viewcontent.cgi?article=1970&context=alea.

Doggart, C. (2002). *Tax havens and their uses.* London: Economist Intelligence Unit.

Financial Action Task Force. (2010). *High-risk and non-cooperative jurisdictions.* Retrieved from http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236992_1_1_1_1_1,00.html

Fisher & Paykel. (2010). *Contact us*. Retrieved from http://www.fisherpaykel.com/customercare/contactus/.

Gibb, J. (2003). Tax havens cost NZ millions, expert says. *The Otago Daily Times.* 17 September 2003.

Ginsburg, A. (1991). *Tax havens*. New York: New York Institute of Finance

Hines, J., & Rice, E. (1994). Fiscal paradise: Foreign tax havens and American business. *The Quarterly Journal of Economics, 109*(1).

Johnston, D. (2002a). Tax Treaties with small nations turn into a new shield for profits*. New York Times.* April 16, 2002.

Johnston, D. (2002b). Senators assail corporate use of Bermuda as tax shelter. *New York Times.* March 22, 2002.

Johnston, D. (2002c). U.S. companies file in Bermuda to slash tax bills. *New York Times*. February 18, 2002.

Johnston, D. (2002d). Musical chairs on tax havens: Now it's Ireland. *The New York Times*. August 3, 2002.

Johnston, D. (2002e). Officers may gain more than investor in move to Bermuda. *The New York Times.* May 20, 2002.

Johnston, D. (2003). Company is foreign at tax time, but seeks Americans-only work. *The New York Times.* October 18, 2003.

Kloeten, N. (2009). Westpac loses $900 million tax avoidance case. *National Business Review.* October 8, 2009. Retrieved from http://www.nbr.co.nz/article/updated-westpac-loses-900-million-tax-avoidance-case-112725.

Larkins, E. (1991). Multinationals and their quest for the good tax haven: Taxes are but one albeit an important, consideration. *International Lawyer, 25,* 475-487.

Larkins, E. (2000). Comprehensive tax planning for multinationals. *Corporate Business Taxation Monthly,* March.

Mathiason, N. (2008). Prob spells end for tax haven. *Otago Daily Times*. March 16.

Mathiason, N. (2009). Obama bid to stamp out tax havens. *Guardian.co.uk.* Retrieved from http://www.guardian.co.uk/business/2009/mar/04/obama-tax-haven-crackdown.

Mortished, C. (2006). GSK settles largest tax dispute in history for $3.1bn. *The Times UK.* Retrieved from http://www.timesonline.co.uk/tol/life_and_style/health/article635994.ece

Nabors Industries (2010). Nabors.com.

OECD. (2010). *List of unco-operative tax havens*. Retrieved from http://www.oecd.org/document/57/0,3343,en_2649_33745_30578809_1_1_1_1,00.html.

OECD. (2010a). *Policy and administration*. Retrieved from http://www.oecd.org/about/0,3347,en_2649_33745_1_1_1_1_1,00.html.

Palan, R. (2002). Tax havens and the commercialization of state sovereignty. *International Organization*, 56(1), 151-176.

Pollock, I. (2009). Q&A: How to become a tax exile. *BBC News*. Retrieved from http://news.bbc.co.uk/2/hi/business/8290286.stm.

Rego, S. (2003). Tax-avoidance activities of U.S. multinational corporations. *Contemporary Accounting Research, 20*, p. 4.

Robinson H. (1961). *The motivation and flow of private foreign investment.* California: Stanford Research Institute.

Rolfe R., Ricks, D., Pointer, M., & McCarthy, M. (1993). Determinants of FDI incentive preferences of MNEs. *Journal of International Business Studies, 24*(2).

Samuels, L. & Kolb, D. (2001). The OECD initiative: Harmful tax practices & tax havens. *Taxes,* 79(3), 231–260.

Tax Justice Network. (2010). *Tax havens cause poverty.* Retrieved from http://www.taxjustice.net/cms/front_content.php?idcat=2.

Taylor, G. (2003). *New Zealand: When is a tax haven not a tax haven?* Retrieved from http://www.mondaq.com/article.asp?articleid=22391

Twain, M. (1902).

Weiss, M. (2001). International tax competition an efficient or inefficient phenomenon? *Akron Tax Journal, 16*.

Should there be a Youth Minimum Wage in New Zealand?

Janneke Hoek

Abstract

In 2006 the Green Party passed a bill that abolished youth minimum wages on the grounds of discrimination against 16-19 year olds. With the looming recession and the implementation of the new minimum wage legalisation, youth have seen an increase in unemployment with the rate rising to 23.4% in 2009 from 16.2% in 2008 (Department of Labour Website, 2010). In February 2010 ACT MP Roger Douglas proposed a Minimum Wage Amendment Bill, requesting a lower minimum wage for youths (16-19 years of age) while still performing the same level of work as that of adults. After an analysis of the two arguments set forth by the Green Party and ACT Party, and examination of the literature on the purposes of wages and the effect wages have on employment, it is reasonable to conclude that New Zealand should not reintroduce youth minimum wages. Youth minimum wages fail to serve social justice and there is little hard evidence to suggest that the minimum wages are to blame for the increase in youth unemployment.

Introduction

New Zealand's employment system has seen numerous changes over its lifetime and implementations of new policies and 'minimum conditions'. Such conditions include holidays, leave and grievance procedures to name a few (Department of Labour Website, 2010). More recently the Minimum Wage Act 1983 has seen the development of minimum wages to those under the age of 18; also known as the youth minimum wage. As of 31 March 1994, a youth rate for persons aged between 16 to19 years of age was implemented in New Zealand with youth paid a total of $3.68 per hour. Up until 2008, the youth minimum wage has been employed in New Zealand's award system with the wage rate increasing accordingly over the years (80% of that of the adult wage since 2001) (Green Party Website, 2006; Hyslop & Stillman, 2007). In 2008 the Labour Party passed a bill to abolish youth minimum wages in favour of minimum wages for all those over the age of 16 years. In February 2010 a Minimum Wage Amendment Bill was drawn proposing mitigation of youth unemployment through the reintroduction of youth minimum wages as ACT MP Sir Roger Douglas believes that the high minimum wage is causing the youth and the unskilled to loose jobs, creating high unemployment rates within the sectors (ACT Party Website, 2010).

Minimum wages are a widely researched area largely focused on the implications and effects there of across different sectors of workers and across a range of different countries and economies (Brown, Gilroy, & Kohen, 1982; Neumark & Wascher, 1999, 2008). There is a wide debate between the impacts of minimum wages and it's follow on affects on employment and is still a pivotal issue in today's society, particularly with the continuing rise in minimum wages and the changing state of the economic climate. The most

This assignment was for MANT406 Topic in Industrial Relations
Supervised by Prof. Alan Geare 45-55

frequently studied group in the empirical literature are teenagers/youth as it is highly acknowledged that youth are in a sector immediately affected by changes in minimum wage due to their lack of skills and experience, and the large numbers of youth being paid minimum wages (Brown, Gilroy, & Kohen, 1982; Card & Krueger 1995; Maloney, 1995; Neumark & Wascher, 1999).

This essay discusses the implications of minimum wages and youth minimum wages. It will review the rationale behind the current and prospective legislation. The essay will also discuss the theory of minimum wages and its impact on employment. The conclusion will argue whether youth minimum wages should or should not be reintroduced in New Zealand.

Review of Current Legalisation

Current legislation states three rates of minimum wage; the adult minimum wage, a new entrant's minimum wage and a training minimum wage. Adults are classed as any person 16 years of age and above and are not trainees or new entrants. New entrants are classed as employees aged 16 and 17 who have not completed the shorter of either 200 hours or 3 months of employment. Finally a trainee is classed as an employee aged 16 years and over who is in recognised industry training involving 60 credits a year (Department of Labour Website, 2010). As of 1 April 2010, adult minimum wage sits at 12.75 an hour, totalling $510 per week for a 40 hour week. New entrants and training minimum wage are set at $10.20 an hour, totalling $408 per week for a 40 hour week (Department of Labour Website, 2010). Employers are required by law to pay at least the minimum wage even when the employee is paid by commission or piece rate. There is no statutory minimum wage for those under 16 years of age (Department of Labour Website, 2010).

The Abolition of the Youth Minimum Wages

In 2006 the Green Party proposed the Minimum Wage Amendment Bill and in 2008 the amendment was made with the youth minimum wage abolished from legislation. The Greens Party proposed the bill arguing that the current youth minimum wage laws were discriminatory. The Human Rights Act 1993 prohibits discrimination on the grounds of age. The Greens Party argues that such discrimination is "arbitrary, inequitable and unjustifiable under the principle of equal pay for work of equal value" and that the proposed bill aim was to make "the Minimum Wage Act 1983 consistent with the anti-discrimination provisions of New Zealand's Human Rights legislation" (Greens Party Website, 2010). The basic principal behind the argument is to stop adults being paid a significant amount more for doing exactly the same job as their youth counterpart. With evidence from Hyslop and Stillman (2004) the Greens party were able to argue that youth employment would not be affected by the implementation of the new minimum wage laws. Hyslop and Stillman (2004) found that after the increase in minimum wages for youth (from 60% to 80% of the adult wage) there was no evidence of significant adverse employment outcomes for youth and that 16-17 year olds had actually increased their working hours by 10-15%. According to the Greens Party argument there is therefore no evidence to suggest that the abolition of the youth minimum wage would further effect employment, and that it is

"scaremongering" (Greens Party Website, 2006). Further research has also qualified and challenged this argument and this will be discussed later in this essay.

The Proposed Reintroduction of Youth Minimum Wages

February 2010 saw the proposal from the ACT Party, looking to reintroduce youth minimum wages. In a press release, Roger Douglas blamed the Labour Party for the high rate of unemployed among young New Zealanders and believed that since the abolition of youth minimum wages the unemployment rate had almost doubled and had ongoing implications. "An excessive minimum wage denies young people the opportunity to get a job, as employers cannot afford to hire them…when unemployed, they can't gain work experience, don't receive on-the-job training, and never develop a work ethic" (ACT Party Website, 2010). Douglas acknowledges that these declines are partly a result of the recession with youth being the first targeted due to their lack of skills and experience, and youth are more likely to be unemployed than the rest of the working population (ACT Party Website, 2010).

Recent Employment Statistics in New Zealand

Using statistics from the Department of Labor it is evident that youth employment has fallen over the past two years and therefore supports Douglas's argument. Over the last year annual average youth employment fell by 13.5%, while employment for all persons decreased by 1.1% (Department of Labour Website, 2010). The unemployment rate for youth increased to 23.4% for the year to December 2009, this is significantly higher than the year to December 2008 where youth unemployment sat at 16.2% (Department of Labour Website, 2010).

The recession is acknowledged as a factor behind the high levels of unemployment. This is supported in the recent statistics released from Statistics New Zealand. When comparing the household labour force statistics 2007 December quarter with the 2009 December quarter it is evident that the ratio of adults employed to teenagers employed has changed. Although employment for the entire labour force has increased as whole from 2,153,600 in 2007 to 2,187,700 in 2009, the ratio of adults employed for 15-19 year olds has shifted. In 2007 the adult to youth employment ratio was 2,005,000:148,600 and this has shifted to 2,050,000:137,000 in 2009 (Household Labour Force survey December 2007, Household Labour Force survey December 2009). These statistics therefore show that over the period of the recession and the introduction of the new wage laws youth employment has decreased. However it is important to note that the level of significance of these figures has not been calculated therefore further assumptions and conclusions cannot be made.

Theory of Minimum Wages

This essay endeavours to find out whether or not youth minimum wages should be employed in New Zealand's award system. It is important to look at the principals behind minimum wages and to discuss the main purposes that the minimum wage serves in order to assess possible arguments as to why, or why not, the proposed minimum wage laws should be implemented.

Wages are most commonly paid to employees at a set rate for every hour in which they work, also known as 'pay for time' (Abernethy, 1996). The minimum wage is a payment scheme in which entitle workers to a minimum hourly rate as stated by legislation. Acknowledged by many, the minimum wage was originally developed as a tool to reduce poverty and serve social justice by ensuring fair distribution of earnings and that those on low wages are paid enough to meet their individual or family needs (Cunningham, 2007; Coutts, 2004; Neumark and Wascher, 2008). Overall literature outlines four central purposes of the minimum wage:

1. Addressing poverty
2. Distribution of wealth
3. Serving social justice
4. Rewarding work effort

The purposes of minimum wage are in general said to be 'right and good' however the actual extent to which minimum wages achieve these means are largely challenged and will be discussed further in this essay. As described by Piore (1973) in most economies families wish to increase their income levels however managers have the pressure to minimise costs, it is this economic motivation that is the cause of conventional models of wage determination. Minimum wages have the potential to cause harm to employment, particularly if the wages are set too high. Therefore any benefits from minimum wages will only be seen if it does not affect employment.

1. Addressing poverty

Minimum wages are said to address poverty to people who are in work. This is achieved through minimising adverse effects on employment (Dolado et al., 1996). Dolado et al. (1996) found that the minimum wage was effective as an anti-poverty tool as it could be used to prevent damaging the employment prospects of people in poorer regions and young people through adequate differentiation in wage rates by region and age. It reduces poverty by ensuring that families who are dependent on minimum wage earners are able to pay for their needs through their earnings (Coutts, 2007).

The concept of minimum wages alleviating poverty relates to ACTs argument as it is suggested that the abolition of the Youth Minimum Wage will cause teenagers to miss out on employment altogether therefore diminishing earnings and effectively creating poverty amongst youth. Douglas's key goal is to increase the earnings of teenagers through greater employment rather than in higher rates of pay and therefore reduce such poverty. Douglas's argument is also supported by Dolado et al. (1996) as they suggest that the differentiation of wage rates between age groups prevents damage to employment for those groups and as a result reduce poverty. Therefore, according to this theory youth minimum wages would be in the favour of youth. An important note here is that the minimum wage is

only effective if it is higher than the market wage, if not it would have no impact on wages. Thus while ACT is looking to introduce a youth wage, it would only be effective if the wage remains higher than the market rate, and this could be challenged by the present rates that have been set.

2. Distribution of wealth

The minimum wage is said to alleviate poverty through better distribution of wealth (Dolado et al., 1996). Coutts (2004) argues that low wage workers benefit from minimum wages through rewards in the form of wage rises that result from economic success across the country. However Card and Krueger (1995) calculated that between 1989 and 1991 a 90% increase in wages only transferred $5.5 billion dollars to low-wage workers. This is an insignificant amount and therefore shows limited effects on wealth distribution and poverty alleviation. Specific to the New Zealand context it has been found that the majority of minimum wage workers are not from poor households and a 10% increase in minimum wages lowered the poverty rate by less than one-tenth of a percentage point (Maloney & Pacheco, 1999). ACT argues that the increase in the minimum wage has contributed to the increased poverty amongst youth. However this evidence suggests that the negative impacts of minimum wage increases on wealth distribution and poverty is an issue of the 'minimum wages' model itself, and the reintroduction of the youth minimum is not necessarily the answer to problem at stake.

3. Serving social justice

Economic theory related to poverty and wealth distribution does not solely justify the use of youth minimum wages. Social justice and protection of employees is a major component of wages and this therefore has major influence. Minimum wages is used as a tool to combat the payment of substandard wages to workers who are recognised as having unfair and unbalanced bargaining power to that of employers (Abernethy, 1996). The Green Party argued that the youth minimum wages were discriminating and did not provide youth workers with adequate and fair rewards. Wilkinson (cited in Barry & Brosnan, 2006) argued that within society people who had equal skills and abilities were being paid at a range of different levels due to "preference" of certain workers. Wilkinson (cited in Barry & Brosnan, 2006) found that categories of "less preferred" workers tended to be women, racial or religious minorities, and people with less education. In the Employment Relations Act 2000 and Human Rights Act 1993 there are minimum conditions outlined that restrict discrimination against such categories of workers (Department of Labor Website, 2010).

In 1977 the Human Rights Act made it unlawful to discriminate on the grounds of sex, marital status and family status (Coutts, 2004; Department of Labor Website, 2010). As a result there were vast improvements in the employment and income levels of such minority groups (Barry & Brosnan, 2006). People have been campaigning for equal pay for work of equal value in New Zealand employment for many years. New Zealand has yet to the see the true impact that the new minimum wage legislation will make. Katz and Murphy (1992) found that although the difference in earnings between men and women narrowed throughout the 1980's, it was not an instantaneous outcome and even now there are still some discrepancies between the sexes. Time is needed in order to not only see how youth employment is affected on a long term basis, but to see how youth employment is affected when the

New Zealand economy stabilises. This therefore constitutes an argument against the reintroduction of youth minimum wages.

4. Rewarding work effort

Wages are paid in an exchange of work effort and ethic (Coutts, 2007). Employers often feel as though they should be paying for productivity and merit, and employees feel they should be being paid for productivity and merit (Katz & Murphy, 1992). Merit does not only include the level of output of an individual but also includes skills, and education levels. Some jobs are socially constructed as to deserving low pay and therefore attract low skilled workers (Barry & Brosnan, 2006). The problem lies between the types of reward being awarded, as employers and employees often share different concepts on the level/rate in which the productivity and merit should be paid. However, if it is agreed between employees and employers that it is the work effort that should be rewarded, then the concept of paying youth less than that of adults for the same amount of work effort does not support this principal of minimum wages and supports equal pay for work of equal value.

The Affect of Wages on Employment - Evidence from Literature

The effect that minimum wages have on employment is a widely researched area and has seen many controversial and conflicting outcomes. To get an idea on whether youth minimum wages should be implemented in New Zealand it is important to analyse the proposed effects minimum wages have on employment and whether they are a contributory factor to youth unemployment levels in New Zealand.

Literature that Supports ACT's Proposed Bill

Neumark and Wascher (1999) found evidence that minimum wages cause employment losses amongst youth. Neumark and Wascher (1992) also found that subminimum wages for youths created lesser unemployment effects, and governments that employed active labour market policies to bring non-employed people into the work force showed smaller negative impacts on employment. Neumark and Wascher (1992) found that a 10% increase in the minimum wage resulted in a 1 to 2 % decrease in employment of teenagers. This supports findings of Brown, Gilroy and Kohen (1984) who also found evidence that a 10% increase in the minimum wage reduces teenage employment by one to three percent.

Pereira (2002) conducted a study in Portugal. Portugal is relative to that of New Zealand as population wise they are closer than that of the large scale studies conducted. In 1987 the minimum wage for workers aged between 18 and 19 raised by 49.3%. An experiment was conducted to evaluate the impact of the wage change on youth employment. Results showed that an increase in the minimum wage significantly reduced youth employment. In France econometric studies were performed by Bazen and Skourias (1997) and also found that there was a statistically significant negative effect on youth employment following a 10% increase in the minimum wage in 1981. These results confirm that of Neumark and Wascher (1999) and Brown et al. (1984).

Although Hyslop and Stillman (2007) found little evidence that supported the theory that minimum wages reduced employment in teenagers, they did discover that while increases in minimum wages did increase the labour supply of teenagers this was not matched by an increase in employment. This therefore suggests that employment is reduced for teenagers when more teenagers enter the competitive market.

These studies performed have all produced arguments that support ACT MP Roger Douglass' claims and provides economic reasoning for the implementation of Youth Minimum wages. It also shows evidence that supports the common theory by economists that minimum wages increase unemployment in youth and unskilled (Chapple, 1997). Practices such as youth minimum wages could therefore be of benefit to youth in New Zealand.

Evidence that Suggests Otherwise

There are many studies which contradict these findings and some which challenge the studies all together (Chapple, 1997; Dolado et al., 1996; Katz and Krueger, 1992). Studies performed by Katz and Krueger (1992) on fast food industries in Texas found that although the industry attracted large numbers of teenagers only 5% of the fast-food restaurants used the new youth minimum wage laws. The overall findings from Katz and Krueger (1992) were that employment actually increased in firms who were thought to be affected by the minimum wage increase. These findings are also supported by Card and Krueger (1995) who, after a cross-state analysis, found that federal minimum wage increases did not adversely affect teenage employment and showed no statistical significance towards unemployment. Card, Katz and Kruger (1994) do not agree with Neumark and Wascher (1992, 2008) and believe that their studies were flawed. However Neumark and Wascher (1994) refute these claims. Reasons offered by both the parties for the differences in opinion are highly controversial and are put down to the use of poor data and complex methodologies (Kennan, 1995). This demonstrates the complexities and vagaries of using such literature to support arguments for or against youth minimum wages.

Dolado et al. (1996) present views that neither support nor challenge the findings of above and conclude that there is very little strong evidence that supports the theory of minimum wages harming youth employment. It outlines the fact that different studies have shown harmful effects while others have shown either positive or no effect at all. They conclude that the "importance of minimum wages has probably been exaggerated" (Dolado et al., 1996, p. 357).

In relation to the New Zealand context evidence has been found to support Dolado et al. (1996). Using time series and panel data sets Chapple (1997, p. 47) concludes that although it was possible to use the data to calculate negative impacts of minimum wages on youth employment overall the study concluded that such research done on minimum wages provided "non-robust" results due to the large amount of variables involved in the equation of minimum wages and youth employment. They add that there is "no apparent tendency for lower-wage industries to throw more workers out of work when minimum wages rise" (Chapple, 1997, p. 47). Maloney (1995) also supports this view finding contrasting sets of evidence that suggest that while a 10% increase in the minimum wage caused a 3.5% reduction in the employment of young adults in New Zealand, studies from overseas data

showed the opposite. This shows the extent to which minimum wage data varies over the context.

It is acceptable to conclude that evidence for and against minimum wages is largely variant. The significance of these findings reveal that more robust studies are needed. However with some studies supporting the proposal of youth minimum wages, others debate that minimum wages are not the cause of youth unemployment. There is very little research done in New Zealand on the topic, and with the recent abolition of Youth Minimum wages, there is now the opportunity for some more full-bodied and robust research to be implemented.

Conclusion

The last 3 years has seen the recession and the implementation of the new minimum wage laws simultaneously. Employment in New Zealand has been affected and this is evident through the comparison of statistics from 2007 to 2009. Employment amongst teenagers has declined and evidence suggests that this could be a result of the recession, the new wage laws, or the two combined. Despite this there is evidence to suggest that minimum wages do not cause such harmful effects on youth employment. Nonetheless it is apparent that if the situation of youth unemployment does not improve then the New Zealand government will have to step in and make some changes.

First, it is evident that the literature on minimum wages provides conflicting results. While some scholars have found that increases in minimum wages have had negative impacts on youth employment, others have found that they have in fact had no affect and in some cases have improved youth employment. The methods used to obtain such results have also been greatly disputed. Due to such conflicting arguments it is difficult to argue that the higher rate of minimum wage set across the entire work force is the reason behind the current levels of unemployment in New Zealand therefore there may be no valid reason for the act to be reversed.

Second, the concept of 'youth minimum wages' fails to serve the principals of wages, and justice to employees. The Greens Party held strong and valid arguments in regards to the discriminating factors of Youth Minimum Wages. It can be considered to be a more ethical outlook on the matter and takes into consideration the elements of fairness and justice for teenagers. However this comes at a cost. Social justice can be viewed in two different lights. The first aspect being the elements of equal pay for the work of equal value, and the second being an economical perspective on improving employment opportunities for youth. Two years after the abolition of youth minimum wages it is clear that during this time youth have suffered and are finding it increasingly difficult to gain employment and this has been suggested to be a result of their little experience and skills in comparison to older people in the labour force (Department of Labour Website, 2010).

ACT propose that teenagers would benefit with the youth minimum wage as this would allow them to earn a weekly salary of around 400 dollars per week, than sit on the benefit or have no employment at all (Act Party Website, 2010). However, as New Zealand is moving out of the recession and with the global economic climate starting to improve, the employment of youth could also improve alongside. Equal pay for the work of equal value is an extremely important issue. The Equal Pay Act 1970 introduced equity of

pay between genders and the factor of age is a similar discriminatory issue. It is discriminatory to pay youth a lesser wage than that of adults if both parties are doing the same job. Youth minimum wages does not serve social justice, and social justice in the form of anti-discriminatory behaviour is something that has long been fought for in New Zealand and is a credit to New Zealand.

Third, the current wage laws have not been in the system for long enough to determine a causal link, and it is obvious that studies carried out on the topic fail to provide robust answers. New Zealand has not had the chance to see the changes in the award system moving into a period of economic recovery and growth. Minimum wages for all above age 16 have only been implemented in New Zealand for two years and with the recession occurring during this time statistics cannot provide a solid basis on what specific factors were to blame for the loss of jobs, at this stage only assumptions can be made. With the climate improving the New Zealand government should keep a close eye on the employment of youth and employment levels, and get a more valid understanding of the effects the abolition of youth minimum wages has had. Without trialling the new legalisation for a substantial amount of time New Zealand will not know which system is more beneficial to the economy and to its youth. Studies done in New Zealand so far have not had a chance to examine the effects of the new minimum wage laws.

Finally, equal pay for work of equal value provides many benefits to New Zealand and the employment system. There are suggested benefits that come from youth unemployment. Coutts (2004) suggests that minimum wages cause the unskilled to become more competitive and get more training and Neumark and Wascher (1999, 2009) argue that high minimum wages could make individuals increase their education and training received in order to improve their human capital worth. This outlook can be seen as a beneficial for the New Zealand economy. In addition to this Wilkinson (1984) argues that minimum wages, in fact, produces increased productivity in firms by forcing them to invest in their labour, and become more efficient therefore increasing competitiveness and overall success. These sorts of advantages cannot be seen in New Zealand due to the current economic circumstances and short space of time in which the minimum wage has been employed. Therefore the youth minimum wage should not be implemented in New Zealand just yet. The government should allow the current legislation more time in order to give the economy a chance to rebuild itself and youth a chance to prove themselves in the workforce.

References

Abernethy, W. B. (1996). *The sin of wages: Where the conventional pay system has led us and how to find a way out.* USA: PerfSys Press.

ACT Party Website. (2010). Retrieved 9th April, 2010 from, http://www.act.org.nz/news/minimum-wage-is-hurting-young-nzers.

Barry, M., & Brosnan, P. (2006). Minimum wages in the Asia Pacific region. *New Zealand Journal of Employment Relations, 31*(2), 46-61.

Bazen, S. (2000). The impact of the regulation of low wages on inequality and labor-market adjustment: A comparative analysis. *Oxford Review of Economic Policy, 16*(1), 57-69.

Brown, C., Gilroy, C., & Kohen, A. (1982). The effect of the minimum wage on employment and unemployment. *Journal of Economic Literature, 20*(2), 487-528.

Card, D., & Krueger, A. B. (1995). *Myth and measurement: The new economics of the minimum wage.* Princeton, NJ: Princeton University Press.

Card, D., Katz, L. F., & Krueger, A. B. (1994). Comment on David Neumark and William Wascher, employment effects of minimum and subminimum wages: Panel data on State minimum wage laws. *Industrial and Labor Relations Review, 47*(3), 487.

Chapple, S. (1997). Do minimum wages have an adverse impact on employment? Evidence from New Zealand. *Labour Market Bulletin, 2*, 25-50.

Coutts, J. (2004). How do we solve the conundrum of minimum wages? *New Zealand Business Roundtable Policy Backgrounder.* No.3. Retrieved from http://www.nzbr.org.nz/documents/policy/policy-2004/PB_No3.pdf.

Cunningham, W. (2007). *Minimum wages and social policy: Lessons from developing countries.* Washington: The World Bank.

Department of Labour. (2010). Retrieved 9th April, 2010 from, http://www.dol.govt.nz/publications/lmr/lmr-quick-facts-youth.asp.

Dolado, J., Kramarz, F., Machin, S., Manning, A., Margolis, D., Teulings, C., … Keen, M. (1996). The economic impact of minimum wages in Europe. *Economic Policy, 11*(23), 319-372.

Employment Relations Service. (2010). Retrieved 9th April, 2010 from, http://www.ers.dol.govt.nz/pay/minimum.html.

Greens Party Website. (2005). Retrieved 9th April, 2010 from, http://www.greens.org.nz/actionalerts/action-alert-submission-guide-minimum-wage-abolition-age-discrimination-amendment-bill.

Greens Party Website. (2005). Retrieved 9th April, 2010 from, http://www.greens.org.nz/bills/minimum-wage-abolition-age-discrimination-amendment-bill).

Household Labour Force survey, December 2007. (2007). Retrieved 9th April, 2010 from, http://www.stats.govt.nz/.

Household Labour Force survey December 2009. (2009). Retrieved 9th April, 2010 from, http://www.stats.govt.nz/.

Hyslop, D., & Stillman, S. (2004). Youth minimum wage reform and the labor market in New Zealand. *Labor Economics, 14*(2), 201-230.

Katz, L., & Krueger, A. (1992). The effect of the minimum wage on the fast-food industry. *Industrial and Labor Relations Review, 46*(1), 6-21.

Katz, L., & Murphy, K. (1992). Changes in relative wages, 1963-1987: Supply and demand factors. *The Quarterly Journal of Economics*, *107*(1), 35-78.

Maloney, T. (1995). Does the adult minimum wage affect employment and unemployment in New Zealand? *New Zealand Economic Papers, 29*(1), 1-19.

Neumark, D., & Wascher, W. (1992). Employment effects on minimum and subminimum wages: Panel data on State minimum wage laws. *Industrial and Labor Relations Review, 46*(1), 55-81.

Neumark, D., & Wascher, W. (1994). Employment effects of minimum and subminimum wages: Reply to Card, Katz and Kreuger. *Industrial and Labor Relations Review, 47*(3), 497-512.

Neumark, D., & Wascher, W. (2004). Minimum wages, labor market institutions, and youth employment: A cross-national analysis. *Industrial and Labor Relations Review, 57*(2), 223-248.

Neumark, D., & Wascher, W. (2008). *Minimum wages.* London: The MIT Press.

Pereira, S. C. (2003). The impact of minimum wages on youth employment in Portugal. *European Economic Review, 47*, 229-244.

Organizational Culture: An Investigation into the Link between Organizational Culture, Human Resource Management, High Commitment Management and Firm Performance

Katherine McKenzie

Introduction

Recent research suggests that the management of human resources has become increasingly important for business success. Employees are said to be one of the most valuable assets to an organization; as a result the effective management of these employees is essential. Management literature has had a tendency to associate human resource management (HRM) with firm performance. It is this link which has been the underlying cause for the abundance of research regarding HRM practices and their effects on a firm. However, there is a substantial debate within the literature that argues that HRM practices do not directly impact organizational performance (Boxall & Purcell, 2000), with claims that there is a missing link between the two. In regards to this 'black box' the concept of organizational culture has emerged. It is said that organizational culture is manifested in the behaviour of its employees (Ngo & Loi, 2008), and is entrenched in the everyday working lives of cultural members (Martin, 2004). Culture is claimed to affect employee's job attitudes, efficiency and productivity (Mahal, 2009), and can impact the ability to carry out an organizations plans and meet strategic goals (Chan, Shaffer & Snape, 2004). With these assertions, organizational culture could in fact influence a firm's productivity and their overall performance.

This paper examines the relationship between HRM, organizational culture and firm performance. The next section of this paper defines and explains the organizational culture concept. I then investigate the relationship between HRM and organizational culture by exploring the overarching themes which emerge from the literature regarding this link. Finally, I explore the relationship between HRM, organizational culture and firm performance.

What is Organizational Culture?

Organizational, or corporate culture, is a widely researched topic, with a literature base that stems from organizational and social psychology as well as social anthropology (Scott, Mannion, Davis, & Marshall, 2003). Nowadays organizational culture research is prominent among management scholars. The expression 'organizational culture' emerged out of Pettigrew's (1979) research on a private British boarding school, however it's fundamental themes originate from earlier literature on organizational analysis (Scott et al., 2003). Scholars in the 1980s took a large interest in the organizational culture concept, with claims that a strong organizational culture could lead to

This assignment was for MANT431 Advanced Human Resource Management 1
Supervised by Dr. Fiona Edgar 57-68

a competitive advantage for the firm (Barney, 1986); an abundance of literature surfaced during this era.

Management scholars have proposed a number of definitions for the organizational culture concept (Ravasi & Schultz, 2006). Unsurprisingly there is little agreement over a precise definition of organizational culture. Schein (2004) states that the concept refers to "the climate and practices the organizations develop around their handling of people, or to the espoused values and credo of an organization" (p. 7). Hofstede (1998) refers to organizational culture as, "the collective programming of the mind which distinguishes the members of one organization from another" (p. 478). While there is no single widely accepted definition, there appears to be some agreement that definitions should emphasis a range of social phenomena, including a common pattern of values, beliefs, symbols, meanings, behaviours, and assumptions held by organizational members that help to shape the ways in which they respond to each other and to their external environment (Aycan et al., 2000; Barney, 1986; Chow & Liu, 2009; Ngo & Loi, 2008; Ogbonna & Harris, 2002; Scott et al., 2003). Despite the lack of consensus about a definition of organizational culture, Hofstede (1998) asserts that many authors would agree that the concept is, difficult to change; historically determined, and holistic, so that the entire range of social phenomena is more important than the sum of its parts.

Having established that organizational culture comprises a range of complex social phenomena, it is not surprising that scholars have identified corporate culture as a multi-layered construct which can be divided into layers according to these phenomena's observability and accessibility (Cabrera & Bonache, 1999; Chew & Sharma, 2005; Schein, 2004; Ulrich, 1984). Schein (2004) accentuates that three levels of culture exist within an organization. At the outermost, most accessible level are those overt patterns of behaviour, which have become appropriate and acceptable within the organization. These behaviours are often shaped by a set of central norms (Cabrera & Bonache, 1999), or values – the second layer in the organizational culture continuum. Values, according to Gordon, (1991) are what ought to be. They are broad tendencies to prefer certain states over others (Hofstede, 1998). Values are manifested by certain symbolic tools (Smircich, 1983), such as symbols, which involve the arrangement of offices and use of department titles (Ulrich, 1984); rituals, including evaluation and reward procedures and farewell parties (Ulrich, 1984); as well as stories and myths which have been passed down through the firm's history (Smircich, 1983). Fundamental assumptions are situated at the deepest, least accessible level of culture, and are the hardest to change (Schein, 2004). They are those things which are commonly taken for granted as 'correct' within the organization (Gordon, 1991). Schein (2004) states that it is these assumptions which are the essence of organizational culture, as they underpin both the values and beliefs which organizational members hold. The combination of these three layers of culture provides stability to employees, as both meaning and predictability surface from these highly embedded social phenomena. This allows for culture to survive within the organization even when some members depart (Schein, 2004).

Overall, organizational culture is an intangible component of a firm (Carmeli & Tishler, 2004). It encompasses a range of social phenomena including beliefs, values, behaviours and assumptions, which become entrenched within organizational members (Aycan et al., 2000; Barney,

1986; Chow & Liu, 2009; Martin, 2004; Ngo & Loi, 2008; Ogbonna & Harris, 2002; Scott et al., 2003; Smircich, 1983). It is therefore a characteristic of the organization, not of individuals (Hofstede, 1998). These social phenomena comprising organizational culture help shape the way a firm conducts its business, how the organization interacts with the external environment, and how things are done within the organization (Barney, 1986; Cabrera & Bonache, 1999; Mahal, 2009; Ngo & Loi, 2008; Ulrich, 1984). It is commonly viewed as less flexible, and hard to change due to its multi-layered and intangible nature (Carmeli & Tishler, 2004).

The Link between HRM and Organizational Culture

Previous literature has identified and focused around two common sources of organizational culture: (1) founders of the organization, and (2) national culture. Barney (1986) claimed that firms are historically bound. In line with Schein (2004) he argued that a firm's culture reflects the unique personality of its founders. Along with these unique personalities a number of scholars have alleged that culture originates in the values and assumptions articulated by top management, which in turn, play an important role in shaping cultural views and employee's behaviours (Chew & Sharma, 2005; Mahal, 2009). These values are then reinforced in a number of ways. Smircich (1983) articulated that top managers mould organizational cultures, and thus the values and beliefs held by employees, to suit their strategic ends; in turn the corporate culture should reflect the vision of the firm (Ngo & Loi, 2008). Values are also reiterated in hiring employees with similar priorities to top management as well as thoroughly socializing new employees to elicit those desired behaviours (Martin, 2004). Furthermore, national culture plays a prevailing role in shaping organizational culture. National culture refers to the culture specific to a national group (Chew & Sharma, 2005), and is entrenched deeply within individual's everyday lives. These ingrained values will subconsciously affect how management practices are both carried out and received in an organization, and therefore how employee's will behave within the firm (Chew & Sharma, 2005). Consequently, a company's culture is said to be linked to the founder's of the organization and the values which they demonstrate, as well as the national culture in which the organization was first founded.

A third relationship has begun to emerge out of management literature. There have been claims by a number of scholars (Bowen & Ostroff, 2004; Cabrera & Bonache, 1999; Lau & Ngo, 2004; Wilkins, 1984) that organizational culture is related to HRM and the human resource practices which are implemented by the organization. HRM has become an increasingly important activity within an organization. Its function is to attract, develop, motivate and retain employee's who ensure the effective functioning of the organization (Jackson & Schuler, 1995). Relatively little is known about the link between organizational culture and HRM, as few empirical studies testing this relationship have been conducted (Platonova, 2005). However, a few overarching themes emerge from the literature regarding this HRM-culture relationship.

HRM Practices Influence Organizational Culture

Within the HRM-organizational culture link lays a belief that firm's HRM practices will motivate employees to adopt certain attitudes and behaviours, and will therefore elicit a certain corporate culture (Bowen & Ostroff, 2004; Cabrera & Bonache, 1999; Chow & Liu, 2009; Lau & Ngo, 2004; Ngo & Loi, 2008; Wilkins, 1984). One of the earliest views on this HRM-organizational culture link was from Peters (1978), who suggested that management systems (e.g. HRM systems) could be thought of as mechanisms to transmit values and beliefs of the organization which, as a result, help to shape its character. With organizational culture comprising a range of social phenomena there are certain situations in which organizational norms are not the result of shared values among employees; rather, they are determined by the rules and practices an organization implements (Cabrera & Bonache, 1999). Tichy (1983) thought that the way in which HRM systems are designed can communicate important and useful information about the organizations culture to employees. Schwartz & Davis (1981) also argued that HR practices provide information to employees. They convey standardized information to employees about expected patterns of activity and acceptable behaviours which allow the firm to achieve its objective. Lewicki (1981) argues that HRM practices answer three questions for employees, providing information to staff about the acceptable behaviours: (1) what does the organization expect from its employees? (2) What kind of behaviour does the organization reward? And (3) what are the dos and don'ts of proper social conduct within the system? (p. 8). Ulrich (1984) iterates this view using an example of socialization programs. Her belief is that socialization and induction programs play a significant role in transmitting corporate culture to individuals entering into the organization. They ensure that acceptable behaviours and cultural norms are passed down to new employees, thus keeping organizational culture consistent. It is through this shared information as well as the experiences of employees that behavioural norms are established, thus becoming the means through which culture is created and sustained within the firm.

Building on the HRM-organizational culture link, Ulrich (1984) advocates that procedures and practices implemented by HR executives become rituals within the company. Ulrich deems rituals to be customary and repeated actions within a firm. They take on a meaning within the organization. As we identified earlier, rituals are a symbolic tool in which values are manifested. These rituals, which include evaluation and reward procedures, help guide the behaviour of employee's as they establish boundaries and behavioural norms within the firm.

Wilkins (1984) asserts a different view; that HR systems can create career paths for employees as well as groupings of people who remain in the firm for a long enough time for a company culture to form. This outlook suggests that firms can implement HR practices that foster job security and internal career development in order to keep turnover low, and maintain those social phenomena that comprise organizational culture (values, beliefs, norms, assumptions) within the organization, and therefore forming a strong organizational culture.

While a number of scholars claim that HRM practices lead to organizational culture, few studies have been conducted on the relationship. Lau and Ngo (2004) studied 332 firms HR and organizational development

practices in Hong Kong. The board purpose of this study was to explore the link between culture, HR systems and outcomes. The research found that HR practices which emphasize training, performance based reward as well as team development help to create an organizational culture that promotes innovation. Organizational culture was said to play a mediation role between the HR system and the firm's outcomes. That is, the HR practices implemented by the firm had an effect on the organizational culture, which in turn had a direct impact on employee's behaviours and outcomes. This study demonstrated that a company's culture was significant in affecting employee's outcomes; regardless, the culture needs to be supported by an HR system that elicits those behaviours needed to achieve the desired outcomes.

High Commitment Management Practices Influence Organizational Cultures

Following on from the view that human resource practices can influence employee's behaviour is an argument that only certain practices will be beneficial to an organization's culture. Corporate culture will only be an advantage when it is seen as appropriate in order to achieve a certain objective or organizational goal (Chow & Liu, 2009); not all practices will elicit an appropriate culture. High Commitment Management (HCM), or best practice, is a theory that has outlined a number of HRM practices which are believed to help a firm achieve competitive success from its workforce (Pfeffer, 1995).

It is a common held belief within the literature that "systems of high commitment HR practices increase organizational effectiveness by creating conditions where employees become highly involved in the organization and work hard to accomplish the organization's goals (Whitener, 2001, p. 516). Pfeffer (1998), the founder of best practice, believed that there were seven core practices which characterized the most successful organizations: employment security; selective hiring of new personnel; self managed teams; high compensation contingent on organizational performance; extensive training; reduced status distinction and barriers; and extensive sharing of information throughout the organization. When implemented these practices would lead to high levels of job satisfaction, retention and motivation of employee's, which in turn influence a firm's effectiveness and performance.

It is thought that these HCM practices shape work force attitudes and values by framing employee's perceptions of what the organization is like and help to influence their relationship with the organization. Employee behaviours and attitudes are said to reflect their perceptions and expectations about the organization; their behaviours respond to the treatment they receive from the firm (Whitener, 2001). Accordingly, HCM practices are said to act as a culture embedding mechanism (Hartog & Verburg, 2004), playing an important role in reinforcing certain behaviours within employees and therefore shaping corporate culture. Kerr & Slocum (1987) demonstrate this relationship. They state that some organizations have cultures emphasizing the value of teamwork and security. These values foster loyalty to the organization and give employees a long term commitment. They iterate that other organizations consist of cultures which emphasize personal initiative and individual rewards. These values reinforce norms where organizational members do not promise loyalty and where the

company does not provide job security. These authors point out that the practices, specifically HCM practices implemented by an organization, bring out certain behaviours from employees. For that reason, a firm can manipulate its culture by implementing practices which foster the behaviours they want to achieve from employees, and those behaviours that will help the company achieve their strategic goals.

A small number of studies have been conducted exploring the relationship between certain best practices and organizational culture. In her study of 170 individuals views on compensation systems, Kuhn (2009) found that a bonus being rewarded on the basis of individual outcomes, compared to team or organizational performance led to the organizational culture being regarded as relatively more individualistic. Sheridan's (1992) longitudinal study of 904 college graduates hired in six public accounting firms found that the firm's organizational culture had a significant effect of the retention rates of these employees. Those firms that had a culture fostering the interpersonal relationship values of teams and respect for people stayed 14 months longer than those hired in firms whose culture emphasized the work task values of detail and stability. These two examples, in which both show the implementation of HCM or best practice, illustrate that organizational culture is contingent upon the HRM practices implemented. Practices will elicit different behaviours from employees. In addition claims are made that these behaviours will facilitate or hinder performance and efficiency within a company.

Strategy Shapes HRM Practices which in turn Shape Organizational Culture

In accordance with the view that HRM/HCM practices influence organizational culture, employee's behaviours are said to be indirectly affected through a company's strategy (Bowen & Ostroff, 2004; Chow & Liu, 2009). The term Strategic Human Resource Management (SHRM) has emerged within recent management literature to cover the relationship between a firm's strategy and their HRM system. This perspective of HRM is commonly seen as comprising integrated functions which are linked to organizational strategy (Macky, 2008). The guiding logic behind this view is that a firm's human resource practices must, "develop employees' skills, knowledge and motivation such that employees behave in ways that are instrumental to the implementation of a particular strategy" (Bowen & Ostroff, 2004, p. 205). Given a certain strategic goal, a set of HRM practices should be implemented to help the organization attain these goals. Different business strategies will therefore require the implementation of a varied set of HRM practices in order to elicit certain behaviours from employees'. Attention should be paid to designing an HR system that is best able to link the desired culture and business strategy. For innovation-oriented firms, HR must implement innovation-enhancing practices to obtain the desired behaviours associated with innovation (Lau & Ngo, 2004). With strategy affecting HRM practices, culture is indirectly affected. This culture will be an asset for an organization if it encourages the behaviours that support the organizations intended strategy (Cabrera & Bonache, 1999).

Organizational Cultures Influence HRM Practices

There is a belief, held by a small number of scholars, which challenges the previous, more widely accepted view that HRM practices (and HCM practices) influence organizational culture. While this view appears within some industrial psychology literature, it is a less common perspective among management scholars. These scholars find that prominent core values within an organizational culture have a strong influence on management practices and in shaping HRM systems (Ferris et al., 1998; Aycan, Kanungo, & Sinha, 1999). This view asserts that firstly values and other social phenomena form within the organization, while HRM practices occur because of the organizational culture already entrenched within the firm.

The social context model, developed by Ferris et al. (1998) claims that the attitudes, beliefs, and values which make up the corporate culture drive the development of HRM policies, practices, and systems. These scholars profess that a well-defined culture within a firm should drive the development of consistent HRM policies, as employees values are reflected in the formation of these policies. Furthermore, these policies should drive the design of a set of mutually supporting and integrated HRM practices which form a cooperative system. Bowen and Ostroff (2004) expand on this view. They allege that organizational assumptions and values shape HRM practices, which, in turn reinforce cultural norms and routines which shape individuals performance. Aycan et al. (1999) as well as Aycan et al. (2000) advocate the model of culture fit. This model contends that managers implement HRM practices based of their assumption about the nature and behaviour of employees. There needs to be a rationale behind the practices which HR implements; they do not evolve within a vacuum. For this reason HR practices are there to reinforce the values, behaviours and assumptions which already exist within the organization, and to further develop these social phenomena.

The Link between HRM, Organizational Culture and Performance

Scholars have long asserted that the way in which an organization manages its employees can influence its performance (Delaney & Huselid, 1996). HRM is therefore an organizational issue which firms cannot afford to ignore. Much of previous HRM and organizational culture literature is based on this assertion that human resource practices and corporate culture are linked to organizational performance (Platonova, 2005). The underlying assumption of the link between HRM, organizational culture and performance is that HRM practices lead to employee knowledge, skills, and abilities, which in turn are said to influence firm performance at the collective level (Bowen & Ostroff, 2004).

While a small number of empirical studies have tested the relationship between HRM and organizational culture a copious amount of research exists on the HRM-firm performance link. In addition, a number of empirical studies have also focused on the organizational culture-performance relationship. The relationship between comprehensive sets of HR practices and firm performance has been frequently demonstrated within the literature. Becker and Gerhart (1996) explain that HR decisions can influence organizational performance through increased efficiency or revenue growth. Barney (1986)

notes that increased firm performance is often attributed to higher profitability, while Bowen and Ostroff (2004) argue that increased motivation from employees leads to higher firm performance.

A large number of empirical studies have been conducted on the relationship between HRM practices and firm profitability. Pfeffer (1995) identified a certain set of best practices which companies can implement to manage their employees. He argues that these practices are universal in nature, and will have a positive effect on organizational performance. The implementation of HRM practices can contribute to firm performance by motivating employees to adopt desired attitudes and behaviours. They tend to unify people around shared goals which will shape and guide employee behaviour. In addition HCM practices are said to create an internal atmosphere where employees become highly involved in the organization and work hard to accomplish goals the firm sets. In his study of steel minimills, Arthur (1994) found that reward systems provided considerable motivation for employees, which in turn contributed to an increase in productivity. His study also found that higher rewards contribute to a decrease in turnover among staff. Merit or incentive pay systems provide rewards for meeting specific goals; in turn employees will be motivated to achieve these goals (Delaney & Huselid, 1996). Koch and McGrath (1996) found that investment in recruitment and selection procedures was positively related to labour productivity. Their findings suggest that labour productivity is related to those proactive firms, those firms who plan for their future labour needs, and those that make investments in getting the 'right' people for the job.

In addition a number of claims have been made alleging that HRM practices can influence performance by impacting employees' knowledge, skills and abilities. Practices fostering extensive training can be considered a source of competitive advantage, as they involve keeping employee's skills and knowledge up to date. Training is said to have a positive impact on performance (Delaney & Huselid, 1996) by impacting dimensions such as product quality. In their study of 590 firms, Delaney and Huselid (1996) found positive associations between practices such as training and firm performance measures. Pfeffer (1998) also conveys a link between training of employee's and profits.

Some scholars assert that HRM practices will lead to increased performance when there is a high level of fit between the practices and the organization's strategy. This is commonly known as the configurational perspective of SHRM. This perspective maintains that an organization should implement HRM practices that are congruent with the firm's strategy, and are consistent with one another. Two practices can work together to enhance each other's effectiveness; consequently a powerful connection is formed (Delery, 1998). The implementation of firm specific training programs combined with highly selective staffing practices can work together to generate a talented pool of employees with high productivity. It is therefore thought that HR practices which complement each other and the firm's strategy will have a positive effect on organizational performance (Lengnick-Hall, Lengnick-Hall, Andrade, & Drake, 2009).

Overall, there is a strong view in the literature that certain HRM practices lead to increased organizational performance. However, studies on this relationship often differ as to the extent a practice is likely to be positively or negatively related to performance (Becker & Gerhart, 1996). Some scholars also express concern regarding the causality between this

relationship; do empirical studies actually prove that HRM practices cause increased performance? It has been said that HRM practices are not the only factor which could affect a firm's performance; many other organizational and environment factors could in fact be attributed to performance (Boxall & Purcell, 2000).

Barney (1986) developed the Resource Based View of the firm (RBV). He argued that certain organizational resources and capabilities can lead to a sustainable competitive advantage for the firm, and therefore can increase organizational performance through superior financial performance. Barney (1986) affirmed that a firm's organizational culture can in fact be one of these resources. However, he asserts that not just any culture will lead to a competitive advantage; corporate culture must be valuable, rare, imperfectly imitable, and be of value to the entire organization. If a company's organizational culture meets these four criteria it has a better opportunity to be a source of sustained competitive advantage. In addition an appropriate HRM system can create and develop organizational capabilities which themselves become sources of competitive advantage (Lau & Ngo, 2004). For example, one of America's most successful retailers, Nordstrom, attributes their success to its culture of customer service. This culture is seen as a unique, valuable and hard to imitate resource and has become a source of competitive advantage for the company (Carmeli & Tishler, 2004). Since organizational cultures and HRM systems can be a valuable resource for companies they have a key role to play in the firm performance link.

Conclusion

This paper has focused around the concept of organizational culture. It has primarily explored the relationship and different views between HRM and culture. While a number of challenging views exist in regards to the HRM-culture link, it is commonly found that HRM practices influence organizational culture, by providing information to employee's that impacts their assumptions, values and attitudes. In addition, certain HCM practices are said to shape work force attitudes by framing employee's perceptions about the organization; in turn leading to higher levels of job satisfaction, retention and motivation; all of which influence a firm's performance. Furthermore, an organization's strategy has been alleged to influence corporate culture indirectly through the implementation of HRM practices that help the organization attain their goals. Organizational culture has been considered a valuable resource for companies and could in fact lead to a competitive advantage for the firm.

While HRM has been argued to affect organizational culture, and in turn lead to firm performance we need to be wary of arguing that current evidence proves this relationship. There could, and probably are, a number of other organizational elements that provide a link between HRM and firm performance. More studies regarding the organizational culture and performance link need to be conducted before we can deduce this causality relationship. In saying this, organizational culture has been shown to be an important aspect of a firm, as it can, and does affect employee's behaviours, motivation and values.

References

Arthur, J. (1994). Effects of human resource systems on manufacturing Performance and turnover. *Academy of Management Journal*, *37*(3): 670-687.

Aycan, Z., Kanungo, R., & Sinha, J. (1999). Organizational culture and human resource management practices: The model of culture fit. *Journal of Cross-Cultural Psychology, 30*, 501-526.

Aycan, Z., Kanungo, R., Mendonca, M., Yu, K., Deller, J., Stahl, G., & Kurshid, A. (2000). Impact of culture on human resource management practices: A 10-country comparison. *Applied Psychology: An International Review, 49*(1), 192-221.

Barney, J. (1986). Organizational culture: Can it be a source of sustained competitive advantage? *The Academy of Management Review*, *11*(3), 656-665.

Becker, B., & Gerhart, B. (1996). The impact of human resource management on organizational performance: Progress and prospects. *Academy of Management Journal, 39*(4), 779-801.

Bowen, D., & Ostroff, C. (2004). Understanding HRM-firm performance linkages: The role of the "strength" of the HRM system. *The Academy of Management Review*, *29*(2), 203-221.

Boxall, P., & Purcell, J. (2000). Strategic human resource management: Where have we come from and where should we be going? *International Journal of Management Reviews, 2*(2), 183-203.

Cabrera, E., & Bonache, J. (1999). An expert HR system for aligning organizational culture and strategy. *Human Resource Planning, 22*(1), 51-60.

Carmeli, A., & Tishler, A. (2004). The relationship between intangible organizational elements and organizational performance. *Strategic Management Journal, 25*, 1257-1278.

Chan, L., Shaffer, M., & Snape, E. (2004). In search of sustained competitive advantage: The impact of organizational culture, competitive strategy and human resource management practices on firm performance. *Journal of Human Resource Management, 15*(1), 17-35.

Chew, I., & Sharma, B. (2005). The effects of culture and HRM practices on firm performance: Empirical evidence from Singapore. *International Journal of Manpower, 26*(6), 560-581.

Chow, I., & Liu, S. (2009). The effect of aligning organizational culture and business strategy with HR systems on firm performance in Chinese enterprises. *The International Journal of Human Resource Management, 20*(11), 2292-2310.

Delaney, J., & Huselid, M. (1996). The impact of human resource management practices on perceptions of organizational performance. *Academy of Management Journal*, 39(4), 949-969.

Delery, J. (1998). Issues of fit in strategic human resource management: Implications for research. *Human Resource Management Review, 8*(3), 289-309.

Ferris, G., Arthur, M., Berkson, H., Kaplan, D., Harrell-Cook, G., & Frink, D. (1998). Toward a social context Theory of the human resource management-organization effectiveness relationship. *Human Resource Management Review, 8*(3), 235-264.

Gordon, G. (1991). Industry determinants of organizational culture. *Academy of Management Review, 16*(2), 396-415.

Hartog, D., & Verburg, R. (2004). High performance work systems, organizational culture and firm effectiveness. *Human Resource Management Journal, 14*(1), 55-78.

Hofstede, G. (1998). Attitudes, values and organizational culture: Disentangling the concepts. *Organization Studies, 19*(3), 477-492.

Jackson, S., & Schuler, R. (1995). Understanding human resource management in the context of organizations and their environment. *Annual Review of Psychology*, *46,* 237-264.

Kerr, J., & Slocum, J. (1987). Managing corporate culture through reward systems. *The Academy of Management Executive, 1*(2), 99-107.

Koch, M., & McGrath, R. (1996). Improving labor productivity: Human resource management policies do matter. *Strategic Management Journal, 17*, 335-354.

Kuhn, K. (2009). Compensation as a signal of organizational culture: The effects of advertising individual or collective incentives. *The International Journal of Human Resource Management*, 20(7), 1634-1648.

Lau., C.-M., & Ngo, H-Y. (2004). The HR system, organizational culture, and product innovation. *International Business Review, 13,* 685-703.

Lengnick-Hall, M., Lengnick-Hall, C., Andrade, L., & Drake, B. (2009). Strategic human resource management: The evolution of the field. *Human Resource Management Review, 19*, 64-85.

Lewicki, R. (1981). Organizational seduction: Building commitment to organizations. *Organizational Dynamics, 9*, 5-21.

Macky, K. (2008). *Managing human resources. Contemporary perspectives in New Zealand.* McGraw-Hill.

Mahal, P. (2009). Organizational culture and organizational climate as a determinant of motivation. *Journal of Management Research, 8*(10), 38-51.

Ngo, H., & Loi, R. (2008). Human resource flexibility, organizational culture and firm performance: An investigation of multinational firms in Hong Kong. *The International Journal of Human Resource Management*, *19*(9), 1654-1666.

Ogbonna, E., & Harris, L. (2002). Managing organizational culture: Insights from the hospitality industry. *Human Resource Management Journal, 12*(1), 33-53.

Peters, T. (1978). Symbols, patterns, and settings: An optimistic case for getting things done. *Organizational Dynamics, 7*(2), 3-23.

Pettigrew, A. (1979). On studying organizational culture. *Administrative Science Quarterly, 24*, 570-581.

Pfeffer, J. (1995). Producing sustainable competitive advantage through the effective management of people. *Academy of Management Executive, 9*(1), 55-73.

Platonova, E. (2005). *The relationship among human resource management, organizational culture, and organizational performance* (Unpublished doctoral dissertation). University of Alabama at Birmingham, Birmingham, AL.

Ravasi, D., & Schultz, M. (2006). Responding to organizational identity threats: Exploring the role of organizational culture. *Academy of Management Journal, 49*(3), 433-458.

Schein, E. (2004). *Organizational culture and leadership*. San Francisco: Jossey-Bass.

Schwartz, H., & Davis, S. (1981). Matching corporate culture and business strategy. *Organizational Dynamics,* Summer, 30-48.

Scott, T., Mannion, R., Davies, H., & Marshall, M. (2003). The quantitative measurement of organizational culture in health care: A review of the available instruments. *Health Services Research, 38*(3), 923-945.

Sheridan, J. (1992). Organizational culture and employee retention. *Academy of Management Journal*, *35*(5), 1036-1056.

Smircich, L. (1983). Concepts of culture and organizational analysis. *Administrative Science Quarterly*, *28*, 339-358.

Tichy, N. (1983). Managing change strategically: Technical, political, and cultural dynamics. New York, NY: Wiley.

Ulrich, W. (1984). HRM and culture: History, ritual, and myth. *Human Resource Management Journal*, 23(2), 117-128.

Whitener, E. (2001). Do "high commitment" human resource practices affect employee commitment? A cross-level analysis using hierarchical linear modelling. *Journal of Management*, *27*, 515-535.

Wilkins, A. (1984). The creation of company cultures: The role of stories and human resource systems. *Human Resource Management*, *23*(1).

Good Faith in Redundancy: The Provisions of a Good Faith Relationship in Times of Redundancy

Sam Robertson

Businesses are required to adapt within their economic environments in order to remain competitive (Volderba, 1998). While this may encourage some organisations to promote innovative, entrepreneurial solutions, many will opt to change their organisational structure in a bid to stay viable. Within the last 20 years alone, New Zealand experienced a series of unique challenges which confronted New Zealand businesses, including the economic deregulation in 1987 and the 1990 and 2009 economic downturns (Ewart & Harcourt, 2000; Rasmussen, Hunt, & Lamm, 2006; Rassmussen & Lamm, 2005). Many businesses elected to downsize their organisations, either to increase productivity in the increasingly competitive global market, or due to business failure (Kelsey, 1997; Ross & Bamber, 1998). This made redundancies a contentious issue within New Zealand homes (Harbridge & Kiely, 1998). Over this period, New Zealand operated under a laissez-faire paradigm, meaning private organisations were less restricted by state intervention (Walsh, 1993). Later changes to the employment legislation acted to balance the employer's right prerogative to structure their businesses and the employee's right to fair and honest treatment within their employment (Nelson, 2000; Rassmussen & Lamm, 2005). While the Employment Contracts Act (1991) (ECA) had a strong focus on the employer, and the Employment Relations Act (2000) (ERA) was centred on employee rights, both found common ground on the understanding that a redundancy was another form of dissolving the employment relationship (Rasmussen, Hunt, & Lamm, 2006). The ERA and its following 2004 amendment require employers to act in a manner of good faith. It is said that this must prevail throughout the employment relationship, including during redundancy procedures, under section 4(4)(e) (Anderson, 2010).

Good faith has been a controversial topic in employment law cases. The obligation for employers to act in good faith during redundancy procedures was solidified by the Court of Appeal in *Coutts Cars Ltd v Baguley 2001*. However, the Court did acknowledge that the obligation of good faith did not significantly alter the responsibilities of the employee during the redundancy process and that the principles of substantive justification and procedural fairness set out in *Aoraki Corporation v McGavin 1998* still stood. These principles were auctioned under the ECA, and still stand in many cases despite the ERA having a substantially different philosophical grounding. Since the *Coutts* case, employment law and the concept of good faith has been strengthened by the 2004 Employment Relations Amendment Act (ERAA) (Anderson, 2006). However, the amendment has not done enough to rectify the incongruence between common law, the ERA and the concept of good faith (Anderson, 2010).

This essay will explore the process of redundancy by identifying the commonly used and accepted definitions, and identifying the types of

This assignment was for MANT406 Topic in Industrial Relations
Supervised by Prof. Alan Geare 69-84

redundancy that are recognised under the ERA. The obligations of good faith will then be discussed, as considered in the ERA and the ERAA, as well as the legal redundancy requirements under both Acts, including consultation, substantive justification and procedural fairness. It will then discuss the common redundancy factors that are not legislated for. These include notification procedures and periods, selection criteria and methods and compensation. Examples of appropriate levels of remuneration etc will be gained from the failed 2009 Employment Relations (Statutory Minimum Redundancy Entitlements) Amendment Bill. Conclusions will then be made about the congruency of good faith within the current provisions for employees made redundant.

Redundancy Defined

Redundancy is, at times, used interchangeably with myriad other terms, such as restructuring, organisational downsizing, de-layering and rightsizing (Macky, 2004). Current New Zealand statutes do not define redundancy. The common starting point in forming a definition for redundancy is the dissolution of an employment agreement due to a number of reasons, including job superfluity or a change in business ownership (Cascio, 1993; Nelson, 2000; Palmer, Kabanoff, & Dunford, 1997). The repealed Labour Relations Act (1987) defined redundancy as:

> A situation where… [a] worker's employment is terminated by the employer, the termination being attributable, wholly or mainly, to the fact that the position filled by that worker is, or will become, superfluous to the needs of the employer.

This definition has a strong emphasis on the position becoming superfluous, rather than the individual within the role (White, 1983). This emphasis is well supported in New Zealand law, as demonstrated in *Brighouse Ltd v Bilderbeck 1994:*

> Employees affected by redundancy have done no wrong. Neither their conduct nor their capacity is in issue. It is simply that in the circumstances the employer faces the employees are considered to be surplus to the needs of the business.

If this definition is accepted, then redundancy is considered a non-fault dismissal, where the employee is not to blame for their job loss. Geare and Edgar (2007) provide a definition from the UK Employment Consolidation Protection Act (1978), which states:

> Redundancy is dismissal on two grounds: a) the employer has ceased, or intends to cease to carry on their business for which the employee is employed, or has ceased to carry on business in the area that the employee is employed or; b) the expectations or requirements for an employee to carry out work of a particular kind in the place where they are employed has ceased or diminished.

While this definition is satisfactory, it does not address the level of change required for a role to be considered different. This level of change has not been acknowledged in New Zealand statues, and is open for judicial interpretation (Rudman, 2009). It is accepted that any employer must act in good faith when dealing with their employees in any part of the employment environment, including redundancy procedures. This means that there is the expectation the employer would act in the same manner as a fair and reasonable employer (Ralph, 2009). Also, it is understood that redundancy is another form of dismissal, and consequently is still subject to personal grievances under the ECA and the ERA (Mitchell, 1992; Nelson, 2000). Consequently, the employer must ensure they follow the procedures set in the ERA by providing consultation, having substantive justification and procedural fairness.

Types of Redundancies

Superfluity in Role and Location

As per *G N Hale and Son Ltd v Wellington Caretakers etc IUW 1991,* common law dictates that employers have the prerogative to determine the structures of their business and therefore make positions redundant (Malos, Haynes, & Bowal, 2003; Mitchell, 1992). When a business has a decrease in business activity, perceives advantages in mechanisation or new technology adoptions, or reorganises the business operations in order to enhance operations or prevent business closure, then a position may become superfluous (Harbridge & Crawford, 1998). This is supported by the right of the employer to act as they wish, provided they follow the terms and conditions put in place by legislation, common law and the employment agreement (Morin & Vincens, 2001).

According to the Department of Labour (2009) superfluous redundancies are lawful for three reasons, including:

- The reduction of employee numbers for efficiency or cost cutting reasons, including on or following the appointment of a receiver to the business, or because the work can be done by other means (for example, contracting out), or:
- Materially changing the job description applying to a position (and therefore changing the duties and responsibilities), or:
- Relocating a business or position in a business more than a reasonable distance from its original place.

As Ralph (2009) discusses, many of these reasons are open to the interpretation of what is reasonable. For example, are no statutes which outline how much job content must change for it to be considered new, although common law is paving the way (see *Westpac Banking Corporation v Smythe (Unreported))*. It is similar for the job location, especially when considering what a 'reasonable' distance entails (Geare & Edgar, 2007).

Technical Redundancies

Technical redundancies arise from the sale of a business. Again, the concept of superfluity occurs, as the sale effectively nullifies the employment agreements on the basis that the previous vendor no longer requires their

service (Geare & Edgar, 2007; Mitchell, 1992). It is conditional of a technical redundancy that the employee is offered the same position within the new organisation, including the same terms and conditions of employment that would have been enjoyed under the previous employer (Department of Labour, 2009). Employment agreements typically have a clause to avoid redundancy compensation for technical redundancies, even when the employee elects not to transfer their employment to the new owner (Rudman, 2009).

Implied Terms of Mutual Trust, Confidence and Fair Dealings

The ERA is built on the foundation of good faith employment relationships. However, this objective is only reinforcing the common law understanding that already existed under the ECA (Anderson, 2006; Nelson, 2000). For example, in *Auckland Shop Employees Union v Woolworths (New Zealand) Ltd 1985* the Court stated: "It may well be that in New Zealand a term recognising that there ought to be a relationship of confidence and trust is implied as a normal incident of the relationship of the employer and employee"

The ECA was heavily focused on the employers' ability to control their working environments, demonstrated by a low level of government intervention on the employment relationship and the promotion of "an efficient labour market" (Anderson, 2010, p. 4). Typified as a Unitarist, anti-collective piece of legislation, the underlying philosophy of the act was the consideration of the employment agreement embodying that of a private contract, leaving parties free to negotiate on their own terms and conditions (Anderson, 2006). This assumed that the employee had the same balance of power as the employer, which the ERA later appeals (Dannin, 1997; Harbridge & Crawford, 1998). Despite no claims being made that the Act was intended to promote 'fairness' or 'harmony' in the employment relationship (Dannin, 1995), the continued support from institutions such as the Employment Tribunal and the Employment Court indicated that the ECA acknowledged a power imbalance within the employment relationship.

The *Brighouse* case indicated that the implied duty of mutual trust, confidence and fair dealings had become a staple in New Zealand employment relations law through the requirements of procedural fairness and substantive justification (Nelson, 2000). Although these standards were adjusted in *Aoraki*, the requirement of the employer to treat the employee in a fair and reasonable manner through the implications of trust, confidence and fair dealings, has since evolved with the ascension of the ERA (Harbridge & Crawford, 1998).

The Employment Relations Act

The main objective of the ERA is to "build productive employment relationships through the promotion of good faith in all aspects of the employment environment and the employment relationship" (ERA (s. 3)). This contrasts the ECA's promotion of the "efficient labour market" and was introduced by the incoming Labour government to "reinforce to employees basic rights which had been denied for over a decade" (Geare & Edgar, 2007,

p. 336). Within the ERA, good faith extends to all aspects of the employment relationship and employment environment (Anderson, 2006). As stated in the ERAA 2004, the objective of the ERA is:

(a) to build productive employment relationships through the promotion of good faith in all aspects of the employment environment and of the employment relationship
  (i) by recognising that employment relationships must be built not only on the implied mutual obligations of trust and confidence, but also on a legislative requirement for good faith behaviour; and
  (ii) by acknowledging and addressing the inherent inequality of bargaining power in employment relationships; and
  (iii) by promoting collective bargaining; and
  (iv) by protecting the integrity of individual choice; and
  (v) by promoting mediation as the primary problem-solving mechanism; and
  (vi) by reducing the need for judicial intervention; and
(b) to promote observance in New Zealand of the principles underlying International Labour Organisation Convention 87 on Freedom of Association, and Convention 98 on the Right to Organise and Bargain Collectively.

The ERAA outlines behaviours that are deemed appropriate under the condition of good faith. As well as the requirement of good faith dealings, conditions are made that neither party should directly or indirectly a) mislead or deceive each other, or b) act in a manner that is likely to mislead or deceive each other. While this does not provide an accurate definition of what is good faith behaviour, the ERAA required that duty of good faith means 'to be active and constructive in establishing and maintaining a productive employment relationship in which the parties are, among other things, responsive and communicative' (Anderson, 2006). The Act does detail appropriate behaviour for good faith in collective bargaining, but no other detail is provided on good faith behaviours in other areas of the employment relationship. This is a critical flaw in the Act that must be rectified.

Despite the best efforts of the ERAA, good faith is still considered a vague and unclear statement (Bayley, 2009). As employment relationships are heavily context driven, it is difficult to ascertain exactly what is considered good faith behaviour. As Bayley (2009) discusses, it is not clear whether good faith requires honest conduct, reasonable conduct, or a combination thereof. Instead, the objective of good faith is at the mercy of the judicial system, which can alter the meaning and understanding of the ERA. This lack of understanding has been compounded by the lasting shadow that has been cast by the ECA and supporting cases (Anderson, 2010). Again, this is another critical flaw that must be addressed for ERA congruency (Tipples, 2002).

Legal Requirements for Redundancies

Under the ERA there are a number of provisions that must be accommodated when an employer is entering into a process of redundancy or restructuring. The primary requirements include consultation, procedural fairness and

substantive justification. It is assumed that the good faith obligations are entrenched within each of these requirements.

Consultation

Consultation is an essential part of the wider redundancy process under the ERA (Mitchell, 1992). Within New Zealand the legal obligation to consult prior to and during redundancy applies to organisations of all sizes. Although not outlined within the ERA, the Department of Labour (2009) provides a guide outlining appropriate 'good faith' consultation behaviours, which includes: employers being precise enough in their proposal to allow employees to provide useful comments, giving reasonable opportunity to consider the proposals of interested stakeholders and alternatives, and to take all feedback seriously before any decision is made. It is not a legal requirement that the employer and employee agree on the employer's final course of action (Mitchell, 1992). It is also accepted that consultation may vary depending on the organisational context. For example, it is easier to closely consult and procure feedback from a smaller organisation than one that employs thousands. However the employer must demonstrate that their consultation is adequate to be procedurally fair (Hall & Edwards, 1999; Nelson, 2000).

Substantive Justification

To be substantively justified, a redundancy must be genuine. As per *Hale*, employers have the prerogative to maintain viable business operations and are allowed to structure their businesses accordingly (Mitchell, 1992). Therefore it was not for the Court to substitute their judgement for that of the employer (Nelson, 2000). This condition stood until the ERAA, where 'could' was substituted for 'would' in the consideration of substantive justification. This acted to narrow the appropriate behaviours available to employers, and allowed the Court to apply their judgement to the proceedings. Traditionally, restructuring would take place when the business experienced a downturn or failure. Today, restructuring on the basis of improving productivity is more legitimate (Volderba, 1998). So long as the redundancy is for genuine reasons and the employer can demonstrate that their actions are what "a fair and reasonable employer would have done" (ERRA, 2004), then it can be considered justifiable. Genuine reasons, as depicted by the Department of Labour (2009), include:

- the introduction of new technology
- rationalisations of staff to increase business efficiency
- restructuring business operations, including a change in the organisation's roles or location
- closure of business
- outsourcing, and
- the sale of the employer's business.

As per the 1987 Labour Relations Act definition, redundancy is only considered justified if the position is becoming superfluous in some manner. It is therefore inappropriate to use redundancy as a performance management tool for underperforming employees. This also implies that the selection criteria and processes must also be what a fair and reasonable employer would do (Mitchell, 1992; White, 1983).

Procedural Fairness

Even when a decision is considered substantively justified, it may still be procedurally unfair. The ERA provides some behaviours that must be entered into for the process to be considered fair. These include: consultation, the consideration of alternatives, a fair selection process, notification, and following the obligations, if any, for redundancies under the employment agreement (Ewart & Harcourt, 2000; Nelson, 2000). For the redundancy process to be considered procedurally fair, then all actions taken must meet the principles of natural justice, including a decision free from bias and predetermination, and a fair hearing, or in this circumstance an opportunity to provide information to the employer around an employee's redundancy (Mitchell, 1992).

There has been an increased focus on the redundancy procedure after cases such as *Brighouse* and *Aoraki*, which both looked into redundancy compensation. It was unanimous in Brighouse that the requirements of procedural fairness be upheld, which included the payment of compensation where the contract may be silent for poor redundancy procedure. As Casey said "I can see no reason in law preventing the Tribunal and the Employment Court ... developing the concept of unjustifiable dismissal so as to take into account the moral obligation of a fair-minded employer, to pay compensation in appropriate circumstances" (Nelson, 2000, p. 605). This was supported by the earlier decision in *Hale*.

In *Aoraki*, the court said that there are no obligations to pay redundancy compensation, unless it is required to ensure procedural fairness. It was also acknowledged in *Aoraki* that the mutual obligations of trust, confidence and fair dealings (later called good faith) impose a duty upon the employer to act in a sensitive and fair manner, and that consultation is not required if there are large numbers of individuals being made redundant. While there is no prescribed procedure for redundancies within the ERA, it is assumed that all employers will act with good faith in order to be considered procedurally fair. Nelson (2000) outlines appropriate behaviours that are considered procedurally fair and within the good faith obligations. These include:

- being open with all parties involved in redundancy processes
- considering alternative proposals that are presented
- give employees plenty of notice on the proposal to restructure
- keeping people well informed with each step in the process
- advise employees on who is going to be selected and what the selection criteria are prior to any selection process
- explaining why some proposals will and won't work
- giving as much notice as possible to what is happening throughout the process
- consider redeployment programs where possible, effectively mitigating the blow of redundancy
- providing redundant employees with assistance (such as financial compensation, opportunities to look for alternative work and personal support such as Employee Assistance Programs) (Department of Labour, 2009).

While some of these behaviours are a legal requirement (for example, being open with all parties as a form of consultation), other behaviours such as the provision of employee assistance are not (Nelson, 2000). Mitchell (1992) also proposes that most of the controversy surrounding the procedural fairness of a redundancy claim is technical, and the process taken by some employers would not impact their final decision. However, this argument can be countered with the belief that procedural fairness supports the ERA foundation of good faith, and therefore must be protected within all dismissal cases.

Good Faith in Redundancy: Proposed Changes to the Employment Relations Act

Although there is no definition of redundancy in the ERA, its meaning in New Zealand industrial relations is of no debate. However, the obligations and requirements on the employer that are not explicitly stated in New Zealand statutes are up for discussion (Malos et al., 2003). The failure to provide clear legislative structure to the redundancy process gives the Courts grounds for misinterpretation and judicial activism. Further legislation can also decrease the vulnerability of employees by altering the power balance between employees and employers, especially during the dismissal process. A number of requirements have been outlined in New Zealand law, including: consultation, substantive justification and procedural fairness. However, common redundancy issues such as notification, selection and compensation are not detailed and require further statutory direction to ensure employees are being treated in good faith.

The Public Advisory Group on Restructuring and Redundancy was formed by Labour in 2005 and had the task of examining the adequacy of redundancy laws and provisions in New Zealand workplaces. In 2009, Labour proposed the Employment Relations (Statutory Minimum Redundancy Entitlements) Amendment Bill (herein the ERAB), which was the product of this advisory group. The amendment would have inserted a new section to Part 6E of the ERA in order to provide universal entitlements for qualifying employees who are made redundant. Recommendations included:

- notice of redundancy termination to the affected worker
- compensation based on length of service
- a maximum level of statutory compensation, and
- provision of redundancy support and other active labour market mechanisms to affected workers and organisations.

Qualifying employees were those who had worked for the organisation continuously for one calendar year or longer, whose wages were lower than $150,000 per annum, and were employed in organisations with employee numbers greater than five(ERAB, 2009). While this bill was negated in its first reading, many of the proposed mechanisms will be adopted as a framework for this essay.

Notification

Proper notification can enhance procedural fairness and the democratic participation that employees are entitled to in their employment (Budd, Gollan, & Wilkinson, 2010). After the removal of the Wage Adjustment Regulation Act (1974) and its redundancy provisions, it became routine that unions negotiated notification clauses into their collective agreements (Harbridge & Crawford, 1998). However, there is no statutory requirement in place for notification periods or procedures during redundancy process (Mitchell, 1992).

Notification Period

Within the notification period issue there are two main areas of concern: the actual period of notification and the notional period of payment in lieu (Geare & Edgar, 2007). Despite Cooke stating in *Hale* that notification is at the manager's prerogative, Mitchell (1992) argues that notification acts to increase procedural fairness by increasing consultation. While it would be more productive to have the employee work out their notice (Campbell & Rimmer, 1994), employees who are facing job loss become depressed and depressing, and can become toxic within their workplaces. Employers may therefore elect to make payments in lieu (Vickers, 2009). Currently the choice of notification type and its period are down to the good faith of the employer as there is no statutory obligation (Ball, 2005). This contrasts other western countries, for example under the United Kingdom's Trade Union and Labour Relations (Consolidation) Act (1992) there is a requirement for organisations with 100 employees or more to provide no less than 90 days notification to employees who are likely to be affected by redundancies.

The ERAB recommended a compulsory notification period of four weeks for all qualifying employees. The Public Advisory Group recognised the advantages to such a notification scheme as it would provide legitimate good faith behaviours. Previous common law rulings have already identified the benefits of notice periods, as they will give employees certainty over when their employment will end (*A-G in respect of DGSW v Richardson 1999*), will allow for the negotiation of redundancy agreements (*Hands v WEL Energy Group Ltd 1992*), will give the employee opportunity to adjust to the changed circumstances (*Kitchen Pak Distribution Ltd v Stoks 1992*) and will allow the employee to try and find employment whilst still employed (*Farmers Transport Ltd v Kitchen (Unreported)*). By legislating a 4 week notification period, a prerequisite for consultation will be formed, again strengthening the good faith principles and increasing the opportunity for procedural fairness.

Notification Procedure

Within common law, it has been demonstrated that the notification procedure for redundancies is different to other types of dismissals under the obligation of good faith (Mitchell, 1992). The Court of Appeal in *Charta Packaging Ltd v Howard 2001* concluded that redundancy is a special case where the normal principles of applying reasonable notice of dismissal do not apply (Beaumont & Hunter, 2007). They also noted that any notification procedure must balance the benefits of consultation to the employee along with the financial circumstances of the company (Harbridge & Crawford, 1998; Macky, 2004; Nelson, 2000).

Notification procedure, other than the implied four week notice, is not outlined in the ERAB. Importance is placed upon the procedure as it has

multiple benefits both for the employer and the employee, as by having a sensitive, formalised notification procedure there is a decreased chance that employees' will take a personal grievance against the company (Malos et al., 2003). Also, by providing a set structure for notification, communication and consultation will be enhanced during a time where communication may be more difficult (White, 1983). However, there may also be flow on benefits through recovered public appearances and again, through honouring the good faith in the employment relationship even in times of termination.

Selection

In many redundancies situations, the employer will need to select between employees. Some employment agreements will stipulate selection methods and criteria, which the employer must follow.

Selection Methods

There are a number of selection methods that can increase efficiency within the workplace, effectively limiting the need for redundancy. These include: natural attrition, outsourcing, retraining and redevelopment or altering the hours of operation (Macky, 2004; Oswald & Turnbull, 1985). Despite these methods, redundancies are increasingly common place (Volderba, 1998). Redundancies can be voluntary, voluntary early retirement or non-voluntary. Again, it is at the discretion of the employer to use these methods, and usually depends on the level of restructuring required. There is still a requirement that the employer acts in good faith throughout the selection method (Mitchell, 1992). Provided the employer can justify the redundancy and the selected process as procedurally fair then there is little issues with the method. Usually the selection criteria are of greater contention.

Selection Criteria

Once the employer has indicated a desired method, they will form a selection pool of superfluous positions. Considerations when compiling the selecting pool consist of the line of work the employees are carrying out, whether groups of employees are doing similar work, whether any of their jobs are interchangeable, and whether any agreed procedure should be followed (Hills, 2003). Criteria may then be applied to the selection pool. The criteria used need to be applied equally and fairly across the pool and should be objective. Where criteria are better established, there will be a greater uptake and support for its use. Examples of selection criteria include (Hills, 2003):

- disciplinary records
- experience
- capability
- relevant skills and competence.

Many of these section criteria, including relevant skills and competence and disciplinary records, should be well communicated within the organisation prior to redundancy procedures to ensure procedural fairness and an increased acceptance of the criteria's use. For example, people need to know they are underperforming before they are selected for poor performance. A common selection method is 'last in, first out' (Muir, 1996). Here, employees with the shortest tenure are the first selected. Although this can sometimes

indirectly discriminate against age, it usually retains employees who are seen as 'loyal' to the organisation and can protect those who are unlikely to regain employment (for example, older workers who are too close to retirement to be hired by another organisation) (Oswald & Turnbull, 1985). While no redundancy method or criteria is perfect, employers will typically opt to use the cheapest and easiest form of selection. Typically employers will use a combination of factors off the above list, weighted against tenure within the company to aid in eliminating bias and prevent long term age bias within the surviving employees (Furnham & Petrides, 2006; Hills, 2003; Muir, 1996).

It should be noted that no employer can select on the basis of the protected categories under the Human Rights Act (1993) (Hills, 2003). For example, redundancy selection criteria cannot include gender, marital status, sexual orientation etc. There are also limitations placed on the genuine reasons for redundancy. It cannot be used in place of performance management (Department of Labour, 2009). Despite conflicting rulings in common law cases (see *Brighouse and Bilderbeck 1994, Aoraki Corporation Ltd v McGavin 1998, Coutts Cars Limited v Baguley 2001,* and *Philpott v State Insurance Ltd 2002*) there is a requirement of the employer to share the selection criteria with the selection pool. This is not a requirement in the ERA but it is now a well accepted practice for procedural fairness (Mitchell, 1992). Selection on unfair criteria can mean the employee has the grounds for an unfair dismissal (Nelson, 2000).

There were no recommendations put forward by the Public Advisory Group and the ERAB about selection methods and criteria. This may be because the choice of selection criteria and method are highly context driven, with no right or wrong answer. However, moves should be made to outline the appropriate use of select methods and criteria to help protect employees and increase procedural fairness. Currently, the Department of Labour (2009) identifies a) giving appropriate notice about redundancy proposals, b) being open minded to alternatives to redundancy, and c) offering counselling and career advice services, as the suitable steps in a fair process. There are no guides on how to appropriately select employees from the redundancy selection pool. This needs to be rectified to ensure that selection criteria are free from bias and is enacted with good faith. Not only will this meet the objectives of the ERA, but it will prevent employers having personal grievances taken against their organisations.

Compensation

In 1992, the Rt Hon Bill Birch said "redundancy has always been a matter of negotiation between employers and employees under both previous industrial relations laws and the Employment Contracts Act" (Ferguson, 1992, p. 375). Despite redundancy compensation being in place in Australia and the United Kingdom, New Zealand was still experiencing changing views on its requirement (Anderson, 1998; Nelson, 2000). In *Brighouse*, the court took an interpretation of the ECA, determining that "contrary to the philosophy of the Employment Contracts Act… [redundancy compensation is]…a way of redressing the balance between employees and employers" (Nelson, 2000, p. 613). The Labour Courts had effectively found a loophole in providing redundancy compensation and actively sought to bridge the gap in the ECA power imbalance (Harbridge & Crawford, 1998). The extension of mutual trust and confidence was deemed appropriate, a move that has been reaffirmed under the ERA (Harbridge & Crawford, 1998). Chief Judge

Goddard, when expanding on the interpretation of substantive justification in *Hale*, noted that genuine redundancy justifies dismissal, given proper compensation and a notice of termination. He argues that, should a provision exist within the employment contract, then employers must provide compensation to their employees. If this does not happen then it is breaching the contractual provisions agreed to, consequently undermining the contracts purpose (Mitchell, 1992).

This ruling was then overturned four years later in *Aoraki*. Here, the Court of Appeal overturned *Brighouse*, determining that redundancy compensation would "erode the statutory emphasis on free negotiation of employment contracts" (Nelson, 2000, p. 613). They stated that a) where there was no provision for the payment of redundancy compensation in an employment contract, there is no duty on the employer to pay redundancy compensation, and b) if a genuine redundancy is carried out in a procedurally unfair manner there is no right to compensation for loss of earnings. Only loss caused by the procedurally unfair behaviour of the employer can be compensated, which will mainly include humiliation and distress. Humiliation cannot be offered because of the actual loss of the job (Harbridge & Crawford, 1998). This supported the intent of the ECA to limit redundancy payments where possible (Anderson, 1998; Nelson, 2000).

Nelson (2000) recognises the purpose of compensation. As the termination is involuntary and not due to individual performance, there is a loss of service related benefits, the lost opportunity cost for the employee of the period invested with that particular employer and the risk of not finding a comparable job and the impact generally on the earning power of the employee. For many organisations, the provision of compensation may be more out of self interest (Ewart & Harcourt, 2000; Wood, 1999). If employees receive a severance pay then they are more likely to move out of the organisation with little fuss. However, if they receive nothing or very little, they may feel aggrieved and create trouble (Vickers, 2009).

Under the ERA there is still no obligation for employers to provide redundancy compensation to their employees. The ERAA does however promote the negotiation of compensation clauses into collective agreements. Also, the ERAA provides for vulnerable employees such as cleaners, laundry servicers, orderlies and caretakers, are entitled to the same terms and conditions when experiencing a technical redundancy.

Due to the large range of benefits for providing compensation, the Public Advisory Group recommended a number of options for providing a minimum, universal level of compensation. The ERAB states that compensation in the amount of four weeks remuneration for qualifying employees, with further compensation amounting to two weeks remuneration for each subsequent full or partial year of the employees' continuous employment, up to a maximum entitlement of 26 weeks. While the continuous compensation claim seems exorbitant, the Public Advisory Group did make helpful suggestions that could easily be implemented by the Department of Labour. These included a 'code of compensation', whereby employers who wished to give redundancy compensation had an enforceable code of employment practice to apply as well as a set of guidelines illustrating best practice, but also a statutory formula for compensation calculations. While this would not provide statutory regulations on the level of compensation required, it would provide a helpful indicator for those negotiating redundancy packages.

Conclusion

While steps are being taken in the desired direction, it would appear the ECA has had a lasting impact on New Zealand employment relations (Anderson, 2010). The radical changes that became increasingly effective during the time of the ECA have shifted the employment relations landscape to a point that the ERA alone could not change. Through the lasting effects of cases like *Aoraki*, the ERA attempt to "build productive employment relationships through the promotion of good faith in all aspects of the employment environment and the employment relationship" (ERAA, 2004) has been undermined by a myriad of inconsistencies. This has been demonstrated in the case *Coutts Cars v Baguley 2001* where the conflicting principles between *Aoraki* and *Brighouse* were reviewed. While redundancy is commonly accepted and well understood within New Zealand, steps needs to be taken to outline the requirements of good faith within redundancy procedures. Although attempts have been made to correct such inconsistencies through the ERAA 2004, employers are still capable of entering into 'bad faith' behaviours as good faith behaviours are not explicitly legislated for, which is compounding the ECA's lasting shadow. This essay proposes rectifying these issues through strengthening notification, selection and compensation legislation. This will, in turn, support good faith within redundancy.

References

Cases

A-G in respect of DGSW v Richardson, 2 ERNZ 866 (1999).

Aoraki Corporation v McGavin, 2 NZLR 533 (CA 1998).

Auckland Shop Employees Union v Woolworths (New Zealand) Ltd, 2 NZLR 372 (1985).

Brighouse Ltd v Bilderbeck, 1 NZLR 158 (1994).

Charta Packaging Ltd v Howard, 2 ERNZ 10 (CA 2001).

Coutts Cars Limited v Baguley, 1 ERNZ 660, 673 (CA) (2001).

Farmers Transport Ltd v Kitchen, Shaw J (WC 26/06 14 December 2006 Unreported).

Hale and Son Ltd v Wellington Caretakers, etc IUW, etc, 1 NZLR 151 (1991).

Hands v WEL Energy Group Ltd, 1 ERNZ 815 (1992).

Kitchen Pak Distribution Ltd v Stoks, 2 ERNZ 815 (1992).

Philpott v State Insurance Ltd, 6 NZELC 636 (2002).

Westpac Banking Corporation V Smythe, AC 5/06 (30 June 2006 Unreported).

Legislation

Employment Contracts Act. (1991, 08 19). Retrieved 09 01, 2010, from http://legislation.knowledge-basket.co.nz/gpacts/public/text/1991/an/022.html

Employment Relations (Statutory Minimum Redundancy Entitlements) Amendment Bill. (2009, 08 09). Retrieved 09 02, 2010, from http://www.parliament.nz/en-NZ/PB/Legislation/Bills/d/5/f/00DBHOH_BILL9306_1-Employment-Relations-Statutory-Minimum-Redundancy.htm

Employment Relations Act. (2000, 08 19). Retrieved 08 25, 2010, from http://www.legislation.govt.nz/act/public/2000/0024/latest/DLM58317.html

Employment Relations Amendment Act. (2004, 10 28). Retrieved 09 01, 2010, from http://union.org.nz/policy/employment-relations-amendment-act-official-version

Human Rights Act. (1993, 08 10). Retrieved 08 25, 2010, from New Zealand Legislation: http://www.legislation.govt.nz/

Labour Relations Act. (1987, 01 01). Retrieved 09 02, 2010, from http://legislation.knowledge-basket.co.nz/gpacts/public/text/1987/an/077.html

Trade Union and Labour Relations (Consolidation) Act. (1992). Retrieved 09 01, 2010, from http://www.statutelaw.gov.uk/content.aspx?activeTextDocId=2357340

Electronic Resources

Department of Labour. (2009, 08 09). Restructuring and Redundancy. Retrieved 09 01, 2010, from Department of Labour: http://dol.govt.nz/publications/research/restructuring-and-redundancy/restructuring-and-redundancy-03.asp

Academic Journals, Books and Other

Anderson, G. (1998). Interpreting the Employment Contracts Act: Are the courts undermining the Act? *California Western International Law Journal*, *28*, 117-144.

Anderson, G. (2010). 'The sky didn't fall in': An emerging consensus on the shape of New Zealand labour law. *Australian Journal of Labour Law, 23.*

Anderson, G. (2006). Transplanting and growing good faith in New Zealand labour law. *Australian Journal of Labour Law, 19*(1), 1-29.

Ball, M. (2005). Consultation matters. *Strategic Direction, 21*(7), 40-42.

Bayley, E. (2009). *A doctrine of good faith in New Zealand contractual relationships* (Unpublished master's thesis). University of Canterbury, Christchurch, NZ.

Beaumont, P., & Hunter, L. (2007). The process of consultation: Responding to challenge. *International Journal of Human Resource Management, 18*(7), 1228-1245.

Budd, J., Gollan, O., & Wilkinson, A. (2010). New approaches to employee voice and participation in organisations. *Human Relations, 63*(3), 303-310.

Campbell, D., & Rimmer, M. (1994). Managing retrenchment: Award standards or enterprise agreements. *Australian Bulletin of Labour, 20*(1), 45-65.

Cascio, W. F. (1993). Downsizing: What do I know? What have I learned? *Academy of Management Executive, 7*(1), 95-104.

Dannin, E. (1995). Bargaining under New Zealand's Employment Contracts Act: The problem of coercion. *Comparative Labor Law & Policy Journal, 17*, 455-491.

Dannin, E. (1997). *Working free: The origins and impact of New Zealand's Employment Contracts Act.* Auckland: Auckland University Press.

Ewart, B., & Harcourt, M. (2000). The effects of redundancy at a New Zealand airline. *New Zealand Journal of Industrial Relations, 25*(2), 151-169.

Ferguson, J. (1992). Personal grievances arising from redundancy: Life after Hale and the Employment Contracts Act 1991. *New Zealand Journal of Industrial Relations, 17*(3), 371-386.

Furnham, A., & Petrides, K. (2006). Deciding on promotions and redundancies: promoting people by ability, experience, gender and motivation. *Journal of Management Psychology, 21*(1), 6-19.

Geare, A., & Edgar, F. (2007). *Employment relations: New Zealand and abroad*. Dunedin, NZ: Otago University Press.

Hall, M., & Edwards, P. (1999). Reforming the statutory redundancy consultation procedure. *The Industrial Law Journal, 28*(4), 299-319.

Harbridge, R., & Crawford, A. (1998). Redundancy: The rise and rise of judicial activism. *Current Research in Industrial Relations, 2*, 47-57.

Harbridge, R., & Kiely, P. (1998). The rise and fall of judicial activism. *Employment Law Bulletin, 8*, 160-164.

Hills, S. (2003). Redundancy pools and selection criteria. *Strategic Direction, 19*(8), 39-42.

Kelsey, J. (1997). Employment and union issues in New Zealand. *California Western International Law Journal, 28*, 253-274.

Macky, K. (2004). Organisational downsizing and redundancies: The New Zealand workers' experience. *New Zealand Journal of Employment Relations, 29*(1), 63-87.

Malos, S., Haynes, P., & Bowal, P. (2003). A contingency approach to the employment relationship: Form, function and effectiveness implications. *Employee Responsibilities and Rights Journal, 15*(3), 149-168.

Mitchell, D. (1992). The burgeoning of fairness in the law relating to redundancy. *Auckland University Law Review*, *7*, 897-930.

Morin, M., & Vincens, C. (2001). Redundancy, business flexibility and workers security: Findings of a comparative European survey. *International Labour Review, 140*(1), 45-68.

Muir, J. (1996). Last in - first out: now that is redundant. *Work Study, 45*(5), 18-29.

Nelson. (2000). The implied term of trust and confidence: The change in approach of the Court of Appeal to the requirement to pay redundancy compensation. *Victoria University Wellington Law Review, 31*, 599-529.

Oswald, A., & Turnbull, P. (1985). Pay and employment determination in Britain: What are labour 'contracts' really like? *Oxford Review of Economic Policy*, 80-98.

Palmer, I., Kabanoff, B., & Dunford, R. (1997). Managerial accounts of downsizing. *Journal of Organisational Behaviour, 18*, 623-639.

Peden, E. (2003). Contractual good faith: Can Australia benefit from the American experience? *Bond Law Review, 15*, 187-205.

Ralph, S. (2009). Employment law: 'Operational reasons' to justify retrenchments replaced by genuine redundancy requirements. *Keeping Good Companies, 61*(8), 492-494.

Rasmussen, E., Hunt, V., & Lamm, F. (2006). New Zealand employment relations: Between individualism and social democracy. *Labour and Industry, 17*(1), 19-42.

Rassmussen, E., & Lamm, F. (2005). From collectivism to individualism in New Zealand employment relations. In M. Baird, R. Cooper, & M. Westcott, *Reworking Work* (pp. 479-486). *Proceedings of the 19th Conference of the Association of Industrial Relations Academics of Australia and New Zealand.*

Ross, P., & Bamber, G. (1998). Changing Employment Relations in Former Public Monopolies: Comparisons, contrasts and strategic choices at New Zealand Telecom and Telstra. Current Research in Industrial Relations. *Proceedings of the 12th Association of Industrial Relations Academics of Australia and New Zealand (AIRAANZ) conference* Wellington, New Zealand.

Rudman, R. (2009). *New Zealand employment law guide 2009*. Wellington: CCH New Zealand Ltd.

Tipples, R. (2002). The Employment Relations Act 2000: Good faith behaviour. *Practitioner, 5*(2), 29-32.

Vickers, M. (2009). Journeys into grief: Exploring redundancy for a new understanding of workplace grief. *Journal of Loss and Trauma, 14*(5), 401-425.

Volderba, H. (1998). Building the flexible firm: How to remain competitive. *Corporate Reputation Review, 2*(1), 94-98.

Walsh, P. (1993). Preparing for privatization: Corporate strategy and industrial relations in New Zealand state-owned enterprises. *British Journal of Industrial Relations, 31*(1), 57-74.

White, P. (1983). The management of redundancy. *Industrial Relations Journal, 14*(1), 32-43.

Wood, S. (1999). Redundancies: The money and the box. *Review - Institute of Public Affairs, 51*(2), 10-12.

The Youth of the Union: Youth Awareness, Opinion and Recruitment into Unions

Sam Robertson

In the last three decades there has been a steep decline in union membership. If union representation is important for democracy and fair terms and conditions in the workplace, then why has there been such a great decline in membership? This essay will address the questions of 'what are unions', 'why they are important', as well as 'why and how unions are recruiting younger members?' To answer these questions, this essay will be divided into two sections, that discussing the modern union as we see it today and that of the recruitment of youth into unions. The first section will discuss unions, their history and importance, and why there has been such a decline in numbers both globally and within New Zealand. The second section will explain what is considered a youth, why and how they are being attracted into unions, as well as youth's opinion of union membership.

The Modern Union

Within the literature a 'union' has been called many things. The common British term is that of a 'trade union', while the Americans use the label 'labor union'. Ultimately both of these terms refer to an organised body of workers who, through their leadership, achieve common goal such as better work conditions and increased income through negotiations with employers. Values and beliefs differ across individuals and cultures, meaning the importance but in unions can change. How the employment relationship is viewed can be described by one of three ideologies, Unitarist, Pluralist or Radical. According to Geare and Edgar (2007), the Unitarist ideology is that of the organisation being a team or family, where management power is legitimate and HR functions bring both employees and employers objectives in line. Conflict within the workplace can be attributed to an external influence or due to trouble makers within the organisation. Pluralism takes the view of different groups in the employment relationship (employees, employers and the state) having both similar and dissimilar objectives that they are striving to meet. Problems will arise in the employment relationship because of the conflict between these objectives. Power becomes more important as the employer has a greater bargaining power over the employee. The radical ideology is based on the Marxist theory of inequalities of power being rooted in the exploitation of labour by capital. This creates a fundamental division of interest between the two parties (Geare & Edgar, 2007; Horwitz, 1990). While this ideology is thoroughly discussed in literature, it is very uncommon in practical application. For the rest of this discussion, the employment relationship will be viewed with a pluralist ideology, which Farnham and Pilmott (1986) agree is the most realistic view.

One theory in the literature is that unions represent a collective voice for workers in the organisation or industry, meaning they represent an important forum for change for employees. Befort and Budd (2009) discuss the framework of 'efficiency, equity and voice', which succinctly captures the employment

This assignment was for MANT406 Topic in Industrial Relations
Supervised by Prof. Alan Geare 85-96

relationship and its dynamics within the workplace. Efficiency, an objective usually associated with the employer, can be described as the effective, profit-maximising use of labour and other scare resources. Equity, typically the opposite of efficiency, is the fairness and distribution of economic rewards, the administration of employment policies and the provision of employee security. Voice, the last objective of the framework, is defined as the meaningful participation in workplace decision-making (Befort & Budd, 2009). A standard employment relationship in many western countries will see a conflict between employers and employees as they try to achieve efficiency and equity respectively. Voice is therefore important as it provides a mechanism for employees to try and equalise the power imbalance between the employer and employee. Befort and Budd (2009) continue to theorise that without unions employees would suffer detrimentally due to a lack of bargaining power. If applied under the pluralist model, then this lack of bargaining power would lead to the dominance of the employer and one would assume inferior working condition and poor pay (Budd, 2004). However, if Befort and Budd's argument that collective bargaining is important for employee rights, why is there such a decline in union membership? This prompts the argument of an individualistic approach to the employment relationship. This involved the employee representing themselves in an individual agreement, which has been argued as more effective for both parties and consequently has led to this decline (Waddington & Whitson, 1997).

Union Membership Decline

Union membership has declined globally over the past number of decades due to many regulatory and social factors, which can present problem to the efficiency, equity and voice model. While trends have differed slightly between countries due to differences in statutory law, the predominant trend on western countries is a decline in membership since the late 1970s. For example, New Zealand's union membership numbers have almost halved in a decade, from over 600,000 in 1990 to 318,000 in 2000 (Visser, 2006). Reasons for this decline are wide and varying. Ward and Lusoli (2003) state that unions are struggling to adapt as fast as workplaces are changing. For example, many unions have not changed their recruitment criteria or practices to be friendlier to employees on alternative contracts, such as part time, casual or fixed term. They also identify the issue of some Human Resource Management practices removing the conflict as well as improving managers' skills, which would usually present issues requiring union intervention. These ideas are supported in the literature, (Fiorito, 2001; Fiorito & Maranto, 1987; Lipset & Katchanoviski, 1986), while other explanations include structural changes to the economy, changes in worker values and attitudes, government provision of benefits that were once obtained from a union, a lack of awareness of unions over employees or union suppression and substitution. These are only some of the multiple reasons that explain the decrease of union membership numbers shown in Table 1, which will change depending on the country.

New Zealand is a prime example of this decline, with various reasons. As per Table 1, New Zealand has seen a drop off of union membership of 36% over three decades, which is higher than Australia but less than France which has seen a 47% decline (Visser, 2006). New Zealand has seen this decline for many reasons. Prior to 1991 Employment Contracts Act union membership was effectively compulsory (Haynes, Vowles, & Boxall, 2005). Despite having a focus

on collective bargaining and ways to re-collectivise the workplace the introduction of the Employment Relations Act 2000, still saw membership decrease. While this has been particular to New Zealand, many other countries have gone through similar deregulation periods. For example, in Britain when the 1980 Conservative government came into power and changed labour law regulations into an American style regulation, union membership decreased. This is because it depressed negotiating efficiency, curbed strikes and undermined trade union voluntarism (Ward & Lusoli, 2003).

Table 1: Union Membership in 9 Countries

	USA	Canada	Australia	NZ	Japan	Germany	France	UK	Ireland
	Membership increase/decrease (in thousands)								
1970-79	1,034	1,276	54	185	764	1,188	-176	1584	109
1980-89	-977	354	92	-110	-104	-139	-1314	-2700	-49
1990-03	-963	138	-792	-268	-1,734	-893	-138	-2428	74
Total	**-1,940**	**493**	**-646**	**-194**	**-1074**	**-1628**	**-1628**	**-3544**	**134**
	Percentage Increase/Decrease Growth in Union Membership								
1970-79	5.40	57.70	2.20	35	6.60	17.10	-5.10	15.70%	26.60
1980-89	-5.50	10	3.60	-15.50	-0.80	-1.70	-40	-23%	-10
1990-03	-5.80	3.60	-29.80	-44.50	-14.10	-11.20	-7	-27%	16.90
Total	**-11.30**	**22.30**	**-25.70**	**-36.70**	**-9.30**	**2.20**	**-47.10**	**-35**	**35.20**

(Visser, 2006)

So if such a decline is to be accepted as factual, what can unions do to stay viable in today's workplace? Unions have two challenges before them, to adapt their strategies and structures to the rapid expansion and diversity of new and growing industries, such as the service sector, and investigate effective ways in which to carry out recruitment of the next generation of workers instead of the aging population that will eventually leave the workplace (Lowe & Rastin, 2000). Unions will need to be flexible and more strategically aligned with the businesses that they represent. As a result, the effectiveness of amalgamated unions, such as the Engineering, Manufacturing and Printing Union (EMPU) or Public Service Association (PSA) can be questioned. For example, the PSA covers the health sector, Disability Support Services, local governments, the New Zealand Defence Forces, the Ministry of Justice and Housing New Zealand employees, totalling to 57,000 employees (New Zealand Public Service Association, 2008). While they have a strong bargaining power, it can be debated how effectively their 4000 union delegates can communicate the needs and concerns of members to the upper echelon of union leaders. While greater coverage of workers is good for 'strength in numbers' and increasing bargaining power, it may be difficult for these large unions to adapt to suit the needs of their respective industries. However, one area that unions can easily adapt in is that of recruitment. Fundamental changes to society have had a flow on effect to the workplace. As a result the cohort of workers settling into stable work has changed and is no longer seeking collective representation. This has seen union membership populations aging faster than the rate of the labour force, meaning new recruitment techniques of those entering the labour market essential (Lowe & Rastin, 2000). One recruitment strategy is that of youth enrolment into unions, which would engage young workers as they enter the labour market.

Youths in the Union

While some unions have been seeking to recruit youths into membership for many years, this strategy seems to be more crucial as workplaces and society change. Unionisation rates of youth are one third of adult workers in Canada and the US, and one half of that of adults in Britain (Bryson, Gomex, Gunderson, & Meltz, 2005; Visser, 2002). In Australia, the unionisation rate decline has been steeper in youth than in adults (Bailey, Price, Esders, & McDonald, 2010). This highlights the growing need for youth, as the future of the labour market, to be engaged in union movements if the union wishes to remain viable. Unions have an opportunity to increase the rate of youths in the union simply by increasing exposure, adjusting individuals attitudes towards unions and removing the idea that 'union membership goes with the job or organisation' (Payne, 1989). Instead, more focus needs to be placed on the idea that unions are able to stand up for those not being treated fairly, a common problem for youths in low paid, menial jobs (Gomez, Gunderson, & Meltz, 2002). If youths become engaged with a union on this level, then it is more likely they will join and become a member for life. Ultimately, unions have a recruitment window that will not stay open indefinitely (Budd, 2009), and they must act quickly to take advantage of new entrants into the labour market. Failure to mobilize young people raises the possibility of a bleak future for union movement (Haynes, Vowles, & Boxall, 2005).

What is a Youth?

A youth can be defined as an individual between the ages of 15-24 (Chin, DeLuca, Poth, Chadwick, & Hutchinson, 2010; Francesco, 2009; Greenberger & Steinberg, 1981; Tannock, 2001). As many of the individuals in this age bracket are in the workforce their workplace behaviour and trends can be studied. Studies of work patterns of the youth has found that youths in the 1990s were twice more likely to be working than their counterparts in the 1950s (Moskowitz, 2004). There has also been a shift in work habits, with most youth workers completing full time in the 1980s, while in 2005 full time work was only participated in by one third of the youth group. As a result, many youths are now facing the challenge of balancing their school or university work with their part time employment (In the USA it averages to 75% of youths having both employment and still attending school or college).

There are also many characteristics of youths that have not changed so rapidly. For example, youth are still being characterised as vulnerable in their roles due to their inexperience, low job attachment, lack of knowledge and bargaining capacity. By many organisations they are viewed as cheap, disposable and having a reputedly high tolerance for boring and unrewarding tasks (Bailey, Price, Esders, & McDonald, 2010; Tannock, 2001). Youths are also more transitory as a job can simply be a way of getting them through school or university. However, for many individuals employment has the benefits of removing teenage alienation, reducing age segregation, fostering the development for personal and social responsibility and aids in easing the transition from adolescence to adulthood (Kelloway, Barling, & Agar, 1996). Ultimately, the youth of today represent the workforce of the future (Loughlin & Barling, 2001) and if the union is to be viable it is essential that they are recruited into the folds of union membership, both for their own representation

and to maximise the benefits of working at an early age (Waddington & Kerr, 2002).

Youth's Opinion of Unions and Membership

Throughout the literature there were three main accounts of young people's perceptions of membership into unions, of which one was a negative perception or opinion. Tannock (2001) reported that youths were against unions because of age discrimination of youth who, according to some union delegates, were 'not needing or deserving a good job' when compared to older workers. This perception was supported by other researchers who identified Generation Y high school students thought they did not need unions and expressed negative views about them (Bulbeck, 2008; Loughlin & Barling, 2001). Another part to this line of thought is the change in attitudes attributed to 'Generation Y', namely a more individualist approach. This means that young people may see no need for unions and collectivisation as they are determined to complete tasks such as negotiation on their own (Huntley, 2006; O'Bannon, 2001).

Another point of view is that of there is no difference between the opinions of young and older workers towards unions, but instead the inclination to join a union spans all ages. For many, union membership is as simple as individuals signing up into a union when they start working in a particular industry, typically at the start of their working career (Ebbinghaus, 2002). Some research has found that there is no differential factor, either age, nationality or race, that can change the requirement for collective representation among workers, but rather their exposure to poor working conditions (Bryson, Gomex, Gunderson, & Meltz, 2005). This would have a major implication for unions trying to recruit new members as strategy would have to be adopted to focus on particular organisations with poorer working conditions rather than being able to target certain demographics or market segments. At present union delegates are targeting older workers, leaving younger workers neglected (Freeman & Diamond, 2003). This may account for the differences in union density between age groups as the young are less likely to join though self-initiated contact (Waddington & Whitson, 1997).

'The third perspective of youth opinions on union membership is that of positivity, which has substantially more support within the literature than the earlier two perspectives. Typically youths are more likely to join a union than older workers (Bailey, Price, Esders, & McDonald, 2010; Gomez, Gunderson, & Meltz, 2002). For example, there is a higher potential for a younger worker in a non-unionised workplace to sign up when compared to workers over 45, and lower numbers of youths agree that 'their country would be better off without unions' than older workers (Bailey, Price, Esders, & McDonald, 2010). While this may be debatable due to an older workers experience or different psyche, support for this argument can be mapped to the family socialisation process (Pesek, Raehsley, & Balough, 2006). Namely, future workers have been found to be more sympathetic if they were the children of union members. While this can be an effective way of generating support for unions, it also presents a problem as union membership decreases. As there are fewer parents in unions to educate their children, there are fewer youths to be inducted into the folds of membership (Gomez, Gunderson, & Meltz, 2002).

Youth Recruitment Techniques

Youth in the union presents a challenge to many union delegates. It has been discussed that youths are typically positive towards unions, and willing to join, however they feel they are ignored by delegates. As the decline in union membership continues, it is essential that unions adopt recruitment strategies that are attractive to youths (Bailey, Price, Esders, & McDonald, 2010). This does not need to be complicated. For example, one strategy is to maintain the current initiatives, but simply increase union presence. While this seems an intuitive strategy as membership will increase if you ask people, many unions seem to be not employing 'organisation-knocking' as a strategy. Current strategies are focused on creating loyalty and identity between the employees and the union (Zoll, 1996). As loyal members continue their membership, they can influence other 'passive' members to join by identifying the benefits of membership. Through maintaining this strategy but by increasing the reach, industries with lower presence, such as construction (30.9% of the industry is able to join a union), retail (19.9%), Hospitality (22.5%), agriculture (19.6%) and business services (14.9%) could see a strong increase in numbers (Haynes, Vowles, & Boxall, 2005). As youth workers are more common in some of these industries (for example retail and hospitality) due to the flexible nature of the work, targeting these industries harder with the current strategies would be an easy way to lift youth membership. Delegates could also ensure that managers within the industries, who usually rise through the ranks from young positions, are aware of the union's presence in the organisation or industry as well as the benefits. While there might be a company policy surrounding management's promotion of unions, it seems an easy way for delegates to access new markets of potential members.

Another strategy that is effective and easy to implement is the introduction of a dedicated union recruiter position. While some unions may already have the position, for other unions recruitment falls under the job description of the workplace delegate. However, one can argue the system will become more efficient if the delegate is focused on helping represent employees and solving their industrial relation issues, while a regional recruiters' sole purpose is to increase membership. While this may cost more to create the position, with the right person in the job and the correct training the position would eventually pay for itself through the increase of members and their incoming fees (McCracken & Sanderson, 2004). The role would need to be specifically shaped to drive recruitment. This would require a bonus or commission on the new members signed up. For smaller unions with less ability to hire new people, this initiative can be given to delegates to help increase their efforts in recruitment. Other initiatives for delegates include competitions and performance management, although behaviour modification in a negative context (as performance management regularly is) might decrease the number of delegates. While this would help to increase membership in many demographics, it would help lessen the perspective that youths feel 'neglected' (Freeman & Diamond, 2003).

While these are simple strategies that most unions can adopt, there are advanced strategies that can be adopted through the application of the 'four P' marketing theory. One of the 'P's, Place, represents a new source of techniques and technologies for the union. Place represents the location where the product can be purchased (McCarthy, 1960). It is well acknowledged that technology is changing the way organisations sell their products, yet it is reported that union adoption of these new resources is slow and patchy (Bailey, Price, Esders, &

McDonald, 2010; Lowe & Rastin, 2000). Traditionally unions would 'sell their product' in an occasional face to face environment or through posters and fliers in the workplace. However there are multiple new platforms available such as internet websites, social networking sites, chat rooms and information guides that allow the targeted advertisement of unions to young workers. One union delegate reported that young workers are going to turn to the internet before they turn to the phone, and that it was 'essential for the union to have an internet presence so they would be able to inform the youth that they could assist with their workplace problems' (Bailey, Price, Esders, & McDonald, 2010, p. 55). Despite this, unions have paid undue attention to the need to communicate with youths in a 'place' they are familiar. It therefore makes sense that unions interact with youths on platforms such as the internet which allow better forms of advertising that can be direct and 'face-to-face' in a virtual manner. As more 'Generation Y' members take positions of leadership this technology adoption rate may increase, however at the moment it is an underutilized resource that could vastly increase youth membership numbers (Fiorito & Royle, 2005).

Continuing with the application of the 'Four P' marketing theory, there is Product. This can be a tangible or intangible item that will bring the consumer some sort of value (McCarthy, 1960). For unions, their product is membership and the advantages that it can bring. There are two major ways that this product can be better improved to suit the needs of youth. One of these ways is through the enhancement of value of the product, or membership. For many 'Generation Y' workers, training and mentorship is very important (Glass, 2007). If the union was able to provide some services to help then they would increase value and benefits in the product for the youth market and potentially wider to adult employees. While it may not be cost effective for all unions, this initiative provides a unique opportunity for some. This would help boost loyalty to the union, aid in raising recruitment numbers and make youths feel less ignored by their union (Bailey, Robin, & Esders, 2009). There are also other strategies that unions can adopt to allow youths to have more value out of their union membership. For example unions can create a Youth Club, the youth focused subsection of the union. This will carry the benefits of having all the union strength and experience and also allows focus onto issues that youths can face in the workplace. Again, this would act to address youths directly, making them feel less neglected. They can also have informal meetings at times that suit youth workers. Where union meetings would be based around the traditional 9-5 worker, more adoption to the needs of younger workers and their schedules can increase the membership rate (Cockfield, 2005). While it may not be practical to implement all of these initiatives, in industries where there is a high percentage of youth workers, such as retail and hospitality, it is essential that the members feel represented.

There is also the concept of Price, essentially the monetary and non-monetary costs exchanged for membership (McCarthy, 1960). Union fees can stagger across income levels meaning most youths find themselves paying smaller dues as they earn less. One strategy that can be adopted is the creation of a 'youth fee', a flat rate for all youths. This will help make the process more transparent and, should this fee be cheaper, help recruit younger members. This strategy has been trialled in some Australian unions by offering free membership for students who are in their final year of study in a professional degree. This youth focused policy will enable the union to capture the student before they become full time workers (Bailey, Price, Esders, & McDonald, 2010). This idea

can be used further by adopting the strategy of sampling. For a small fee youths can access the union resources, such as online chat rooms, employment agreement builders or advice from union delegates, effectively allowing youths to trial the system and see the advantages of being a union member. For this to work effectively many unions would need to ensure they have a product that is suited to youth members. As mentioned earlier, youths are unlikely to approach unions and seek membership, so this can give them a taste without being too forward or directive.

The final 'P' of the Four P theory is Promotion. This is all the communication that the union may use within the marketplace (McCarthy, 1960). To attract youths, union have a lot of different initiatives available. One of these is to target universities, colleges or schools. This can have many applications, such as the establishment of union information desks or referral services on campuses, passing out fliers on how to join unions and what they can do, targeting big events such as orientation weeks or be affiliated with important Industrial Relations papers if they are available at the university (Badigannavar & Kelly, 2005). Not only would this promote the union, but it would enable youths to seek advice if needed and would let them experience the practical benefits of membership. Similar to the earlier P initiatives, these strategies will act to increase awareness which is essential for building membership. For the message to get through to youths it is essential that the messages are clear, bright and bold. Another simple strategy is to communicate in a manner that suits the younger generation, such as suitable language, visuals and messages on a platform that is commonly used, such as the internet. While is this currently taking place, many unions report the resources allocated to the strategies success are patchy (Bailey, Price, Esders, & McDonald, 2010). There is also the strategy of promoting youth focused activities and initiatives. For example, a union may choose to run an internship program. While this would allow a small number of students to experience the union organisation, they will be able to carry a message back to their peers about the role they undertook (McDonald, 2007).

One example of these P initiatives being used is the New Zealand Educational Institute (NZEI). Currently New Zealand's largest educational union with 48,000 members, NZEI includes primary, secondary and area schools as well as early childhood centres and support staff in their membership (NZEI Te Riu Roa, 2009). Starting May 2010 the NZEI has started a Student/Beginning Teacher focused newsletter used to advertise upcoming events (an example of increased Promotion). These initiatives include 'recruitment road-shows' which are run in conjunction with employers and YMN (Young and New Member network) events (an example of enhanced product) such as the YMN Hui, as well as inviting all new members to the annual meeting. They also promote the use of their Facebook site where members can ask and view frequently asked questions (an example of unions expanding their communication into new platforms, or Places). This Facebook page also has photos, videos and link to appropriate resources for all students and beginner teachers. The institute also asks that they attempt to recruit one-another, utilising the networks that are formed in educational institutions such as teachers colleges and universities. NZEI also offers a student fee, $5 a year, for all student teachers. This is a New Zealand example of the initiative seen in Australia. According to their website, student numbers are at a record high because of these initiatives (NZEI Te Riu Roa, 2009). This is a prime example of how the initiatives discussed above can help rise the numbers of youths within the union.

While there is no one way that works best for unions to increase their youth membership numbers. Strategies will vary between countries, industries and individual unions. However, all unions need to understand the importance of the youth in the union and prioritise their recruitment in order to ensure their viability. Any strategy that is adopted must target the youth group, make human and economic resources available and ensure key messages are reaching youths on a platform they appreciate. Unions may need to change in order to cater to these increasing union numbers by changing meeting times, building structures and policies to suit a different type of work force, creating initiatives that suit younger workers and help attract them into the union. Through strengthening youth networks, increasing presence in key industries and increasing existence on common communication platforms such as the internet, unions stand a change of recruiting the youth into the folds of membership.

Conclusion

Unions are facing a decline that must urgently be addressed. If the argument of Befort and Budd is to be accepted, then this decline is a serious problem as the collective voice of employees is represented in the union movement and without a mechanism to equalise bargaining power employees' rights can lost against employers control and power. Despite this argued importance, unions are declining for multiple reasons, including: not being able to adapt at the same pace as organisations, Human resource management practices working to remove the conflict between parties, economic, social and cultural changes such as aging populations and changing values, union suppression and/or submission as well as changing statutory regulations. As a result, unions must adopt new recruitment techniques to remain viable. One of these recruitment techniques is the deliberate targeting of youth. Youths are between the ages of 15 – 24 and face a unique set of challenges. As a result they require special attention from unions and consequently have been ignored or looked over by delegates when recruiting, despite their opinions of unions being more positive than that of older workers.

Strategies that can aid in recruiting youths into the folds of union membership are an interesting challenge for most unions. This requires a change to the traditional mindset of most union organisations and can see some innovative policies and strategies being adopted. For many unions, the application of McCarthy's 4P theory provides insight into adaptations that can be made. The first P, place, would see unions venturing further into the electronic realm to communicate with Generation Y. This technique has already been adopted by some unions however it does not 'jump off the page' and is not comparable to the multi-media internet pages that are common today. Changes can be made to the union product through the addition of extra benefits and value. This can be done through creating youth friendly subgroups of the union, youth clubs, youth seminars or having meetings at a time that suits. There is also the concept of price, where the union can drop fees for students and younger workers, or providing a 'sampling' system where individuals can test the benefits before they fully commit. The last P is promotion. This can be tackled in different ways, but would see more promotion and information in places like schools and universities. These techniques can help lift the youth union rate, acting to increase membership immediately but also reinforce the family socialisation process and help induce the next generation of workers to join.

Ultimately it is essential that unions continue to communicate and recruit younger workers to help keep their existence in the workplace viable.

References

Badigannavar, V., & Kelly, J. (2005). Why are some union organizing campaigns more successful than others? *British Journal of Industrial Relations, 43* (3), 515-535.

Bailey, J., Price, R., Esders, L., & McDonald, P. (2010). Daggy shirts, daggy slogans? Marketing unions to young people. *Journal of Industrial Relations, 52,* 43-60.

Bailey, J., Robin, A., & Esders, L. (2009). Marketing unions to young people: Recruiting and 'rusting on'. *Labour, Capital and Change - Proceedings of the 23rd Conference of the Association of Industrial Relations Academics of Australia and New Zealand,* (pp. 1-12). Newcastle, Australia.

Befort, S., & Budd, J. (2009). *Invisible hands, invisible objectives*. Stanford, CA: Stanford University Press.

Bryson, A., Gomex, R., Gunderson, M., & Meltz, N. (2005). Youth-adult differences in the demand for unionization: Are American, British, and Canadian workers all that different? *Journal of Labor Research, 26*(1), 155-168.

Budd, J. (2004). *Employment with a human face: Balancing efficiency, equity and voice.* Ithaca, NY: Cornell University Press.

Budd, J. (2009). When do workers first experience unionisation? Implications for voice and representation in a new world of work. Paper presented at the *15th World Congress of the International Industrial Relations Association*. 24th August. Sydney.

Bulbeck, C. (2008). Only 'victim' workers need unions? Perceptions of trade unions amongst young Australians. *Labour and Industry, 19*(1), 49-71.

Chin, P., DeLuca, D., Poth, C., Chadwick, I., & Hutchinson, N. (2010). Enabling youth to advocate for workplace safety. *Safety Science, 48*(5), 570-579.

Cockfield, S. (2005). Union renewal, union strategy and technology. *Critical Perspectives on International Business, 1*(2), 93-108.

Ebbinghaus, B. (2002). Trade unions' changing role: Membership erosion, organisational reform, and social partnership in Europe. *Industrial Relations Journal, 33*, 465-548.

Farnham, D., & Pilmott, J. (1986). *Understanding industrial relations.* London: Rinehart and Winston.

Fiorito, J. (2001). Human resource management practices and worker desires for union representation. *Journal of Labor Research, 22*(2), 335-355.

Fiorito, J., & Maranto, C. (1987). The contemporary decline of union strength. *Contemporary Policy Issues, 5*, 12-27.

Fiorito, J., & Royle, M. (2005). Information and communication technology use in British unions. *Critical Perspectives on International Business, 1*(2), 180-193.

Francesco, P. (2009). Young workers in the global economy. *Education Economics, 17*(2), 279-282.

Freeman, R., & Diamond, W. (2003). Young workers and trade unions. In H. Gospel, & S. Woods (Eds.), *Representing workers: Union recognition and membership in Britain.* London: Routledge.

Geare, A., & Edgar, F. (2007). *Employment relations: New Zealand and abroad.* Wellington: Astra Print Ltd.

Glass, A. (2007). Understanding generational differences for competitive success. *Industrial and Commercial Training, 39*(2), 98-114.

Gomez, R., Gunderson, M., & Meltz, N. (2002). Comparing youth and adult desire for unionization in Canada. *British Journal of Industrial Relations, 40*(3), 521-542.

Greenberger, E., & Steinberg, L. (1981). The workplace as a context for the socialization of youth. *Journal of Youth and Adolescence, 10*(3), 185-210.

Haynes, P., Vowles, J., & Boxall, P. (2005). Explaining the younger-older worker union density gap: Evidence from New Zealand. *British Journal of Industrial Relations, 43*(1), 93-116.

Horwitz, F. (1990). HRM: An ideological perspective. *Personnel Review, 19*(2), 10-32.

Huntley, R. (2006). *The world according to Y: Inside the new adult generation.* Sydney: Allen & Unwin.

Kelloway, K., Barling, J., & Agar, S. (1996). Preemployment predictors of children's union attitudes: The moderating role of identification with parents. *The Journal of Social Psychology, 163*(3), 413-415.

Lipset, S., & Katchanoviski, I. (1986). The effects of corporate strategy and workplace innovations on union representation. *Industrial and Labor Relations Review, 34*, 487-501.

Loughlin, C., & Barling, J. (2001). Young workers' work values, attitudes, and behaviours. *Journal of Occupational and Organizational Psychology*, 543-558.

Lowe, G., & Rastin, S. (2000). Organizing the next generation: Influences on young workers' willingness to join unions in Canada. *British Journal of Industrial Relations, 38*(2), 203-222.

McCarthy, E. (1960). *Basic marketing: A managerial approach* (Vol. 25). Homewood, IL: Richard D. Irwin.

McCracken, M., & Sanderson, M. (2004). Trade union recruitment: Strategic options? *Employee Relations, 26*(3), 274-291.

McDonald, P. (2007). Compounding vulnerability? Young workers' employment concerns and the anticipated impact of the Work Choices Act. *Australian Bulletin of Labour, 33*(1), 60-89.

Moskowitz, S. (2004). American youth in the workplace: Legal aberration, failed social policy. *Albany Law Review, 67*, 1071-1095.

New Zealand Public Service Association. (2008). About Us. Retrieved 05 01, 2010, from New Zealand Public Service Association Te Pukenga Here Tikanga Mahi: http://www.psa.org.nz.

NZEI Te Riu Roa. (2009). About Us. Retrieved 05 01, 2010, from New Zealand Educational Institute: http://www.nzei.org.nz/.

O'Bannon, P. (2001). Managing our future: The Generation X factor. *Public Personnel Management, 30*(1), 95-109.

Payne, J. (1989). Trade union membership and activism among young people in Great Britain. *British Journal of Industrial Relations, 27*, 111-132.

Pesek, J., Raehsley, R., & Balough, R. (2006). Future professionals and managers: Their attitudes towards unions, organizational beliefs, and work ethic. *Journal of Applied Social Psychology, 36*(6), 1569-1594.

Tannock, S. (2001). *Youth at work: The unionized fast-food and grocery workplace.* Philadelphia: Temple University Press.

Visser, J. (2006). Union membership statistics in 24 countries. *Monthly Labor Review*, 129, 38-50.

Visser, J. (2002). Why fewer workers join unions in Europe: A social custom explanation of membership trends. *British Journal of Industrial Relations, 40*, 403-433.

Waddington, J., & Kerr, A. (2002). Unions fit for young workers. *Industrial Relations Journal, 33*(4), 298-315.

Waddington, L., & Whitson, C. (1997). Why do people join unions in a period of membership decline? *Industrial Relations Journal, 35*, 515-551.

Ward, S., & Lusoli, W. (2003). Dinosaurs in cyberspace? British trade unions and the Internet. *European Journal of Communication, 18*(2), 147-179.

Zoll, R. (1996). Modernization, trade union and solidarity. In P. Leisink, J. Van Leemput, & J. Vilrokx (Eds.), *Challenges to trade unions in Europe: Innovation or adaptation? (*pp. 7-88). Cheltenham: Edward Elgar.