

Chair
Cabinet Economic Growth and Infrastructure Committee

Research findings on the effects of 90-day trial periods in employment

- 1 This paper provides information about research into the effects of 90-day trial periods, which is planned for release on 17 June 2016, and the implications of this research.

Executive Summary

- 2 The research, carried out by Motu Economic and Public Policy Research (Motu), investigates whether trial periods have increased the quantity of hiring by firms; altered the types of individuals that are hired; or changed the duration of employment relationships. The study did not find any significant economy-wide effects in these areas, either positively or negatively, although there was weak statistical evidence of increased hiring in the construction and wholesale trade industries. It also did not find evidence at an economy-wide level for the concern that trial periods would increase job churn for employees.
- 3 The research will be released as a Treasury working paper once Cabinet has considered the findings.
- 4 Monitoring of the policy by the Ministry of Business, Innovation and Employment (MBIE) suggests that employers value trial periods to provide flexibility through reducing costs and risks in hiring and simplifying processes.
- 5 The lack of economy-wide impacts may be because employers were already finding ways to achieve flexibility within the labour market, or that the cost savings were relatively small and temporary. However, neither MBIE's nor Motu's research provides insights into these dynamics, except that it appears some employers are uncertain how to correctly apply trial periods.
- 6 Treasury and MBIE advise that, on balance, the policy appears to make a positive, if small, contribution to the range of regulatory options for achieving labour market flexibility and increasing the ease of doing business; without significantly increasing the number of short-term employment relationships or worker turnover.
- 7 As part of the existing Sector Workforce Engagement Programme (SWEP), employers co-lead conversations to identify and analyse their workforce requirements and co-develop possible solutions. MBIE and the Ministry of Social Development will, where appropriate, use these engagements to talk to employers about their views on the role of trial periods in assisting them to meet their requirements. These insights may help identify whether further opportunities exist to improve the value of trial periods, such as reshaping the information that is provided to employers.

Background

- 8 In March 2009, an amendment to the *Employment Relations Act 2000* came into effect that introduced the option of 90-day trial periods in employment for firms with fewer than 20 employees. In April 2011, the option of using 90-day trial periods was extended to firms of all sizes.
- 9 The trial period provision removes a dismissed employee's rights to raise a personal grievance based on unjustified dismissal. The policy objectives when trial periods were introduced in 2009 were to provide employers with greater confidence when hiring new employees and enable extra opportunities for employees, particularly those who are disadvantaged in the labour market. When the option of using trial periods was extended to all employers in 2011, the policy was part of a suite of amendments to the *Employment Relations Act 2000* that were collectively intended to: increase choice and flexibility for employers and employees, ensure an appropriate balance of fairness, reduce compliance costs, improve the operation and efficiency of the legislation, increase employers' confidence in the consistency of the system, and support improvements in workplace productivity [CAB Min (10) 24/6A refers]. MBIE has been monitoring the implementation of this policy.
- 10 Treasury, in consultation with MBIE, commissioned Motu Economic and Public Policy Research to examine the effects of the 90-day trial policy. The work was commissioned under the Government's Analysis for Outcomes programme, which seeks to identify new opportunities to achieve better outcomes for New Zealanders and improve value for money from initiatives. This research was also an opportunity to promote the use of the Integrated Data Infrastructure (IDI) by non-government researchers to increase the pool of IDI-competent researchers.
- 11 The research investigates whether the option of using trial periods when employing new staff has increased the quantity of hiring by firms; altered the types of individuals that are hired; or changed the duration of employment relationships.
- 12 The study compared the hiring rates and employee retention patterns of firms with 15-19 workers to those of firms with 20-24 workers. Because firms with 15-19 workers were able to use the trial period from March 2009 to April 2011, while firms with 20-24 employees were not, any macro effect of the trial period provision should be apparent during this period through the comparison. This relatively narrow sample of firms was used for the key results because firms within this size range were less likely to be differently affected by other changes occurring in the economy at the same time, such as the Global Financial Crisis.
- 13 The Treasury has advised me that three people, chosen for their econometric expertise, reviewed the paper. The reviewers all supported the approach taken, including the study design, choice of methods, and the application of those methods.

Comment

Findings of the Research

- 14 While the report noted that trial periods may have altered some firms' behaviour at a micro level, the study was not able to find any significant economy-wide effect of the policy change on:
- i. The quantity of hiring

- ii. The quantity of hiring into employment relationships that are short or that last beyond the 90 days
 - iii. The probability that a new hire is a disadvantaged job seeker, such as youth, young Māori or Pasifika, former beneficiaries, job seeker beneficiaries, recent migrants, people who were previously non-workers, and school or tertiary education leavers
 - iv. The survival rate of new employment relationships
 - v. Employees' willingness to change jobs.
- 15 However, when examining construction and wholesale trade (two industries that have made relatively high use of trial periods) the study found statistically weak evidence that the policy increased hiring. The researchers looked for, but did not find, evidence of significant changes in other aspects of hiring practices in construction and wholesale trade, and also did not find evidence of significant changes in any other industries.
- 16 The research concluded that while the policy has had little impact on employers' hiring and retention decisions in aggregate, it is likely to have reduced dismissal costs for firms that do decide to dismiss a new employee, and increased uncertainty for employees who are hired with a trial period. However, no evidence of adverse effects on employees, such as an increase in the number of short-term employment relationships or worker turnover, was found.

Other Evidence of Policy Effectiveness

- 17 MBIE's ongoing monitoring and research of the policy has found that there is significant uptake of trial periods. An employer survey in 2013/14 indicated that 63 percent of firms who had employed a new staff member in the past year (39 percent of all employers) had used a trial period, and 20 percent of employers who had used a trial period had dismissed at least one staff member during or at the end of the trial.
- 18 An evaluation by MBIE in 2014 found that firms use trial periods to reduce the risks around recruiting and the potential cost associated with dismissing an employee. This is reflected in employer association surveys where employers report that trial periods have increased their confidence when making hiring decisions. Employers reported some cost savings related to the reduced risk of potential problems with personal grievances, as well as administrative savings in dismissal processes.
- 19 Statistics New Zealand's Survey of Working Life data indicated that recent migrants were more likely to be on a trial period, but these findings were not strong. In MBIE's qualitative research, some SMEs reported using trial periods to give opportunities to a wider range of people, but MBIE does not have more detailed information on these employees' characteristics.
- 20 Treasury understands, anecdotally, that at least one NGO that provides employment support services to people with disabilities, addictions or mental health issues finds trial periods significantly useful in securing job opportunities for their clients.
- 21 MBIE has noted that there appears to be some uncertainty among a small group of employers on how to apply trial periods correctly. This is reflected in cases before the Employment Relations Authority on whether there is a valid trial period provision in the employment agreement. However, these make up a relatively small number of cases before the Authority.

Policy Implications

- 22 An overarching objective of the trial period policy was to provide greater flexibility for employers, while maintaining an appropriate level of fairness for employees. Labour market flexibility allows employers to react to changing economic conditions, to grow, and to be competitive internationally, by adjusting their choice of labour inputs. The OECD compiles indicators¹ of employment protection that are a proxy for this flexibility. Data from 2013 (the latest data available) places New Zealand within the top four countries with the least restrictions for all four indicators, including ranking first in two of these. This relative flexibility was likely an important contributor to New Zealand's swift recovery from the Global Financial Crisis.
- 23 The increase in flexibility provided by trial periods was expected to be significant enough to increase employment, especially of disadvantaged job seekers by providing increased certainty for employers. However, only limited regulatory impact analysis was done at the time, and the regulatory impact statements lacked detail on the size of any expected impacts, or explanation of the underlying policy logic.
- 24 In its report, Motu suggests the following policy logic:
- i. that trial periods would reduce the costs and uncertainty of the personal grievance system that was incentivising firms to restrict their hiring below the ordinary optimal level in order to mitigate the risk of being stuck with too much labour in the event of a negative demand shock; and
 - ii. that trial periods would reduce costs for firms in the event of hiring a worker who turned out to be unsuitable for that work;

However, Motu comments that only the second effect (better quality job matching) would be significant since trial periods are limited to the first 90 days of employment.

- 25 Treasury and MBIE believe that the lack of economy-wide impacts may be for a number of reasons:
- It may be that employers were already finding ways to achieve flexibility within the labour market. Employers may have substituted the use of non-standard employment arrangements to screen job candidates (for example, casual or fixed term contracts) with more secure job opportunities subject to a trial period.
 - It is possible that, while employers experience positive effects in making processes easier and reducing risk, which has made hiring easier, overall the costs saved are relatively short term in nature, and at a relatively low level. This may be compounded if employers don't adequately understand how to apply trial periods properly. In addition, factors other than dismissal costs may be more important in driving decisions on hiring in most cases.

However, neither MBIE's nor Motu's research provides insights into either of these dynamics, other than some apparent uncertainty on how to correctly apply trial periods.

¹ The indicators are: Protection of permanent workers against individual and collective dismissals; Protection of permanent workers against (individual) dismissal; Specific requirements for collective dismissal; and Regulation on temporary forms of employment.

- 26 The ability of employers to find alternative ways to achieve flexibility has been used to explain comparable findings regarding policies in Sweden and Germany, where employment protection laws were relaxed for small firms. Studies on the impact of those policies also found no significant effect on behaviour in aggregate.
- 27 In relation to hiring of disadvantaged job seekers, it is possible that other policies have a more decisive role in employers' hiring decisions.
- 28 The level of use of trial periods and employers' perception that the policy led to a reduction in uncertainty and dismissal process costs, suggest that trial periods have been useful in increasing the ease of doing business. However, we have learned that, while increasing options for achieving flexibility, it hasn't increased the degree of flexibility significantly beyond what was already achievable before.
- 29 Treasury and MBIE advise that, on balance, the policy appears to make a positive, if small, contribution to the range of regulatory options for achieving labour market flexibility and increasing the ease of doing business; without significantly increasing the number of short-term employment relationships or worker turnover. It also appears that any temporary job insecurity arising from trial periods is not significantly deterring employees from changing jobs.

Next Steps

- 30 Officials have advised me that there is an opportunity to establish whether this policy could be of further benefit to employers, or to assist disadvantaged job seekers into sustainable work, particularly health and disability clients who do not require up-skilling. It clearly fits as part of a range of initiatives within Better Public Services Result Area 1 to encourage people on benefits into work.
- 31 The Sector Workforce Engagement Programme (SWEP) takes a holistic, collaborative approach to improve employers' access to reliable, appropriately skilled staff (from within NZ or from abroad) at the right time and place, while giving priority to domestic job seekers. The programme provides an opportunity to engage with employers on the use of trial periods alongside other matters, such as recruitment, training and retention. It is expected that by engaging with employers through SWEP, officials will better understand the relative value of different types of employment arrangements in achieving quality job matching, as well as any implementation barriers relating to trial periods (e.g. insufficient/misleading information) that may be remedied to further improve outcomes.
- 32 Depending on the presenting labour market issues identified by employers, trial periods could complement the existing tools used by the programme, which work over a longer time horizon (e.g. assisted workforce planning and forecasting), to meet employers' workforce requirements.
- 33 On 11 April, MSD and MBIE launched a new process for employers supporting work visa applications. It requires employers recruiting for low-skilled or un-skilled roles to engage with Work and Income as part of their 'genuine attempt' to recruit (the "front loaded labour market check"), before they are able to support a migrant worker on an Essential Skills visa². This will provide another opportunity to discuss the 90-day trial policy with employers as a means to increase employers' willingness to consider hiring disadvantaged job-seekers instead.

2 There are around 8,500 low-skilled or un-skilled ANZSCO (Australia New Zealand Standard Classification of Occupations) levels 4 and 5 roles for which Essential Skills visas are granted each year.

- 34 MBIE has informed Treasury officials that it has no plans to change its monitoring of the policy at this time. However, changes may be made after engaging with employers through SWEF.

Consultation

- 35 MBIE and MSD were consulted in the preparation of this paper. The Department of Prime Minister and Cabinet (DPMC) was also informed.

Financial Implications

- 36 There are no direct financial implications arising from this noting paper. It is expected that costs associated with any further implementation of the policy will be met from within agencies' respective baselines.

Disability Perspective

- 37 The approach outlined in this paper aligns with the New Zealand Disability Strategy and Disability Action Plan 2014-2018 priorities to increase economic and employment opportunities for disabled people.

Publicity

- 38 The research will be released as a Treasury Working Paper on 17 June 2016, but it was important that Cabinet first had an opportunity to consider the findings. Treasury will circulate the working paper to its normal distribution list. In addition, it will issue a media advisory on the working paper which includes a brief description of the paper's findings.
- 39 There has already been some media interest in the research findings, including a request for the paper's release under the Official Information Act 1982, and further interest is anticipated, given the delay in release. Treasury will be the first point of contact for media, but a set of both key messages and questions and answers on the research findings and policy implications has been provided by the Treasury, and is attached to this paper.

Recommendations

40 The Minister of Finance recommends that the Committee:

- 1 **note** that the Treasury commissioned Motu Economic and Public Policy Research to undertake research into the effects of 90-day trial periods;
- 2 **note** that while the research report notes that trial periods may have altered some firms' behaviour at a micro level, the study did not find any significant economy-wide effects (either positively or negatively) on: the number of jobs, the likelihood of employment of disadvantaged job seekers, or job churn; although there was weak statistical evidence of increased hiring in the construction and wholesale trade industries;
- 3 **note** that this research will be released on 17 June 2016, and a media organisation has already requested its release under the *Official Information Act 1982*;
- 4 **note** that the lack of economy-wide impacts may be because employers were already finding ways to achieve flexibility within the labour market, or that the cost savings were relatively small and temporary;
- 5 **note** that there is evidence that employers value trial periods to provide flexibility through reducing costs and risks in hiring and simplifying dismissal processes;
- 6 **note** that Treasury and the Ministry of Business, Innovation and Employment (MBIE) have advised that, on balance, the policy appears to make a positive, if small, contribution as part of a suite of regulatory tools aimed at achieving labour market flexibility and increasing the ease of doing business; without significantly increasing the number of short-term employment relationships or worker turnover; and that any temporary job insecurity arising from trial periods is not significantly deterring employees from changing jobs;
- 7 **note** that the Sector Workforce Engagement Programme provides an existing opportunity for employers to engage with MBIE and MSD about their workforce requirements; and that these engagements could include exploring employers' views on trial periods, which may help identify whether further opportunities exist to improve the value of trial periods, such as reshaping the information that is provided to employers.

Hon Bill English
Minister of Finance

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