



Unemployed finally get chance to work

June 16, 2005

More firings could be good news for the long-term jobless, writes Andrew Leigh and Justin Wolfers.

AFTER a season of *Big Brother* ("you're evicted"), *The Amazing Race* ("you're eliminated") and *The Apprentice* ("you're fired"), it is no wonder that unfair dismissals are back on the political agenda.

Yet the truth is that businesses don't have things so bad: Australia has the sixth-weakest employment protection of 28 OECD countries. And just like those reality shows, these reforms are more about ratings than substance. At most, exempting firms with fewer than 100 employees will shift one in seven workers outside the scope of the unfair dismissal regime.

How will the changes affect the unemployment rate? So far, two opposing arguments have been mounted. From the union movement, we have heard that the changes will make it easier to fire workers. More firing, more unemployment.

On the flip side, employer groups and the Federal Government have argued that the changes will make firms more likely to hire workers. More hiring, less unemployment.

Economic theory tells us both sides are right, so we need to look to empirical studies to see how these competing effects balance out. Despite the Prime Minister's best misrepresentations to the contrary, the most careful cross-country studies have found little evidence of a robust relationship between employment protection and the unemployment rate.

While his supporters point out that high employment protection in Europe may be a cause of high levels of unemployment, opponents note that Europe had even higher employment protection and substantially lower unemployment in the 1960s.

The closest reform that we can think of was a 2004 German law that exempted some small businesses from employment protection laws.

Afterwards, a careful study by Thomas Bauer, Stefan Bender and Holger Bonin found that this law had essentially no effect on the German labour market. If John Howard thinks his unfair dismissals reforms will bring the headline unemployment rate down from 5.1 per cent to 4 per cent, we should bring in Darryl Kerrigan to tell him he's dreaming.

Yet, while the unfair dismissals reforms probably won't affect the overall unemployment rate, they are likely to have two positive effects. Oddly, both have been ignored in the Australian debate.

First, less employment protection will mean more hiring and more firing and, hence, more job churning.

For those with jobs, this may not sound like a particularly enticing prospect. But for the unemployed, it matters a lot. The flip side of greater certainty that those with jobs will remain employed is greater certainty that the unemployed will remain unemployed.

With decreased hiring, those without work are likely to remain jobless for longer. Indeed, cross-country evidence shows a robust relationship between employment protection and higher long-term unemployment. Making hiring and firing easier will help spread the burden of unemployment across the workforce.

Since we know that the worst results of unemployment come from the de-skilling and depressing effect of prolonged joblessness, this provides a powerful equity argument for reform. Moreover, this also yields an important efficiency argument: if adverse macroeconomic shocks cause long-term unemployment to rise, it can take decades for the economy to recover.

Indeed, it took a decade for Australia's unemployment rate to return to its level before the Reserve Bank-induced recession in 1990-91.

Research by Olivier Blanchard and Justin Wolfers finds that countries with less strict firing laws recover more robustly following adverse economic shocks. Those who benefit most from a rapid recovery are the most disadvantaged in Australian society.

The equity and efficiency arguments in favour of relaxing Australia's unfair dismissals regime have received little play in the mainstream press.

Perhaps this is because both are more nuanced than the simplistic mantra that making dismissals easier will create or destroy jobs.

But we also think there is another reason why these two arguments have not been made: the long-term unemployed are not represented in the political debate.

This is a pity.

Unfair dismissals reforms probably won't bring down the jobless rate, but they may make being unemployed a whole lot less painful.

Dr Andrew Leigh, Dr Justin Wolfers are economists at the Australian National University, the University of Pennsylvania respectively.

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