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Job Probation: What Was All the Fuss About?

The sound and fury from the Labour Party and the unions about the government's introduction of a 90-day employment probation period for small businesses was extraordinary.

Across the Tasman the Rudd Labor government in its Fair Work Bill plans essentially to re-enact the Howard government's legislation on unfair dismissals.

This involves roughly the equivalent of a 12-month probation period for small employers and a 6-month period for larger employers. (In fact there are no logical grounds for this distinction.)

Curiously, few, if any, New Zealand journalists pointed out the contrast.

Even a few international reference points, and some dispassionate reporting of the policies that more successful countries have adopted, would surely help the task of promoting better policies for New Zealand.

Almost all OECD countries have probation periods; Britain (under a Labour government) is another with a 12-month period.

In the so-called 'right to work' states in America, provisions about dismissals are left to voluntary agreement: unless contracts specify otherwise, firms are free to dismiss at will, just as workers are free to quit at will.

Union claims that such measures "strip away worker protections" are Marxist class-welfare nonsense. What strips away worker protections is legislation that restricts competition or deprives workers of the freedom to supply their labour on the terms they prefer.

Mandatory unjustifiable dismissal rules (such as were retained and indeed extended in the Employment Contracts Act 1991) come at a cost to both firms and workers.

In a study for the Business Roundtable (*The Employment Contacts Act and Unjustifiable Dismissal: The economics of an unjust employment tax,* www.nzbr.org.nz), US labour economist Charles Baird pointed out that, for firms, mandatory dismissal restrictions reduce employment flexibility and discourage start-ups, and for workers they reduce employment opportunities and wages.

Firms which have to cover the cost of capital invested in them will rationally reduce wages or employment if they have to bear the risk of dismissal claims.

Extrapolating from US research, Baird estimated that dismissal laws could be reducing workers' income by 7% and reducing overall employment by 1-3%.

Such laws also hit the most marginal workers hardest, because their job opportunities are the most limited. The most disadvantaged job seeker should be able to say to an employer:

"Give me a chance. I know I've a bad employment record and done time in prison, but I'm determined to get my life back together. I believe I can do the job you're offering but if things don't work out you're free to dismiss me, no questions asked."

Until the recent law change, such an employment contact was unlawful in New Zealand, or at least unenforceable, and even now it is only possible for 90 days in small firms.

Like many of the privileges given in the past to unions, the imposition of dismissal restrictions is motivated by the hoary myth of labour's unequal bargaining power.

Even the left-wing blog The Standard recently disowned this argument, noting correctly that wages are determined by supply and demand in the

labour market (for given levels of productivity), not unions and collective bargaining.

The best protection for workers is a flexible labour market operating at full employment, which is fostered by a minimum of restrictions on employment arrangements.

There will always be some bad employment relationships (with faults on both sides), just as there are bad marriages, but it is folly to treat dysfunctional situations as the norm.

It is likely that most workers would prefer higher wages to restrictions on dismissals if they were free to choose their conditions of employment.

This is clear from empirical evidence. As American judge Richard Posner has written:

"One piece of evidence that job security is not really efficient is that outside of the unionized sector (which now employs less than 20 percent of the nation's labour force) … employment at will is the usual form of labour contract. The worker can quit when he wants; the employer can fire the employee when the employer wants."

The situation was similar in the non-unionised sector of the New Zealand labour market prior to the ECA.

As the Baird study argued, common law freedom of contract should be restored to all New Zealand employment relationships. Greater labour market flexibility to preserve jobs should be a top priority in the present tough economic climate.

In a freer environment there will be a multitude of individual approaches to the issue of unjustifiable dismissal.

At-will or on-notice contracts should not be prescribed or legislatively favoured, but nor should they be restricted. In this area and many others, governments don't know best how to regulate employment contracts.

National's goal of boosting wages and other incomes to Australian levels by 2025 won't be achieved with inferior policies.

While it falls well short of where Australia is at, a 90-day probation period is a step in the right direction.

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