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## **The effect of unfair dismissal laws on small and medium sized businesses**

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# The Effect of Unfair Dismissal Laws on Small and Medium Sized Businesses

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29 October 2002

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## Executive Summary

There has been an extensive criticism of the use of survey evidence to inform the debate on unfair dismissal (UFD) laws. Those who favour such laws have pointed to the apparent conflict between findings from open-ended questions such as ‘what factors impede your business from taking on more employees’ and closed-ended questions such as ‘please rate your level of concern about unfair dismissal laws’. Because few respondents mention unfair dismissal laws as impediments the open ended questions have been interpreted as supporting the inference that unfair dismissal laws are unimportant. As is discussed in section 3 of the report, this inference is invalid because the open ended questions do not yield an exhaustive listing of responses.

The only valid inference about UFD laws that can be made from responses to open ended questions relating to factors impeding employment are:

- that for between 1.4 and 5.6 per cent of businesses (depending on whether one looks at the AWIRS or various Yellow Pages surveys) unfair dismissal laws are among the most important impediments to taking on new employees; and
- that for most businesses unfair dismissal laws do not rate as the most important impediment to taking on new employees.

In order to make statistically valid inferences about the importance of UFD laws one needs to ask closed-ended questions. That is questions that specify a limited but exhaustive range of responses. The evidence from responses to this form of question has generally supported the view that UFD laws impose a significant burden on small and medium sized businesses.

This evidence has been criticised on the grounds that the questions asked were ‘leading’. A leading question is one that assumes the existence of facts that have not yet been established by the respondent’s previous answers. Thus, to determine whether or not a survey question is leading one needs to know what is established prior to the question being asked. For example, if one asks all businesses ‘the question “By how much do UFD laws raise your businesses’ costs?” Then, that can be considered as a leading question since it assumes that UFD laws raise businesses costs — an issue that is not yet established. But if one first asks businesses the question ‘Do UFD laws increase your businesses costs?’ and then ask only those businesses that respond ‘yes’ the follow up question ‘By how much do UFD laws increase your businesses costs?’ then that is no longer a leading question since it is asking about the magnitude of the cost impost the existence of which has already been established.

The survey that is reported on below was designed to use screening questions that first establishes the existence of an effect before asking about the magnitude or nature of that effect. In this way the questionnaire avoids asking leading questions.

### Summary of findings

The remainder of this report summarises results obtained from a computer aided telephone survey of businesses with less than 200 permanent employees. In all, 1802 completed interviews were obtained. Further details of the survey are in section 2 of the report. Responses from the survey were factored up to statements about the population of small and medium sized businesses by using weights that are constructed from the ABS business register.

### ***Results from questions put to businesses with one or more employees***

This section of the executive summary relates to the 79.1 per cent of small and medium sized businesses that were found in the survey to have at least one employee.

In terms of coverage of the UFD laws, 15.7 per cent of businesses are covered mainly by commonwealth law; 26.8 per cent are covered mainly by State law; 26.9 per cent are covered equally by State and Commonwealth law; and 30.7 per cent of businesses do not know what UFD laws they are covered by (see Table 3).

Some 62.6 per cent of businesses were unaware of the recent changes to Commonwealth UFD laws. Another 29.4 per cent of businesses were aware of the changes to the law but does not think that those changes will affect their businesses. Some 5.9 per cent of businesses were aware of the changes to the law and think that the changes will be good for their business. Finally, 2.1 per cent of businesses were aware of the recent changes to the law but think that those changes will be bad for their business (see Table 4).

UFD laws have resulted in large and intended changes in the recruitment and staff management procedures of small and medium sized businesses; some 69.8 per cent of firms said that the UFD laws had had some influence on their business' procedures (see Table 9) while 51.6 per cent of businesses reported that the laws had influenced their procedures for dealing with workers whose performance is unsatisfactory (see Table 11).<sup>1</sup> These changes are in the direction of what might be described as more formal and arguably fairer and more transparent human resource management procedures and practices (see Table 12).

These intended changes in human resource management procedures also have a number of unintended effects on firm behaviour that must be weighed against the intended effects in any assessment of the UFD laws. Some 47.9 per cent of small businesses reported that their recruitment and selection decisions are influenced by the UFD laws (see Table 13). These changes, more details of which are in Table 14, involve the following:

- 11.6 per cent of businesses reported greater use of fixed term contracts;
- 21.3 per cent reported that they employ more casuals and fewer permanent staff;
- 20.7 per cent reported that they employ more family and friends; and
- 26.6 per cent reported use of longer probationary periods.

The strongest effect on recruitment and selection decisions, however, was that 39.5 per cent of businesses reported that the UFD laws meant that there were certain types of job applicant that their business was less likely to hire (see Table 14). The types of job applicant disadvantaged by the UFD laws are: a person who has changed jobs a lot for no apparent reason (35.1 per cent of businesses); a person who is currently unemployed (15.9 per cent of businesses); a job applicant who has been unemployed for more than one year (27.4 per cent of businesses); a person who has been unemployed for more than two years (30.3 per cent of businesses) (see Table 15).

Some 44.3 per cent of respondents reported that the UFD laws make the management of their workforce more difficult than it would otherwise be (see Table 16). The nature of those adverse effects are as follows: 38.9 per cent reported reduced authority over their workforce; 40.8 per cent of businesses

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<sup>1</sup> Unless otherwise stated I use number of full-time employees as a measure of firm size. Unless otherwise stated all percentages reported in this executive summary are factored up to statements about the population as a whole.

reported that because of UFD laws it takes longer to resolve issues associated with poor performance; 37.9 per cent of businesses reported that poor performance by one worker is more likely to adversely affect the performance of other workers; and 38.3 per cent of businesses reported that more formality in dealing with workers makes communication between management and employees more difficult. See Table 17.

Earlier I observed that the UFD laws encouraged human resource management practices that were arguably fairer. In any assessment of the extent to which the laws have improved fairness/equity one needs to take into account any unintended side effects that act to reduce fairness or equity. There are three cases where this may happen. First, employees that are marginal in terms of their fit with a new employer are more likely to be dismissed during the probationary period and because of the disincentive to hire job applicants that have changed jobs several times for no apparent reason this may have a scarring effect reducing that person's chance of getting a job in the future. Second, the UFD laws make it less likely that a small or medium business will hire the long-term unemployed. Third, the increased formality and written documentation that is required by the UFD laws may disadvantage employees that are more suited to less formal supervision or are less literate than the average employee.

The UFD laws advantage those existing employees whose performance is such that they would be marginal or below marginal if they were new job applicants. Thus, the survey evidence presented here shows that the UFD laws cause firms to treat very differently people who are similar except in whether they hold a job. In this regard the UFD laws cause a violation of a basic principle of equity that equals should be treated equally.

Importantly, some 37.5 percent of businesses reported that the UFD laws would make it less likely that it would dismiss a worker whose performance is unsatisfactory. See Table 18. This underscores the reported loss of authority over their workforce.

Just over one-third of businesses reported that the existence of UFD laws increased their businesses costs. See Table 19. Factoring up to the national level yields an estimate of \$1329 million as the **lower bound** on the cost impost to small and medium business of compliance with the UFD laws — about \$296 per employee.<sup>2</sup> This cost impost is born most heavily by the smaller businesses. For example, the **lower bound** on the cost impost on businesses with one to five employees is \$437 million — about \$365 per employee (see Table 20).

The estimated cost imposts reported above represent **lower bounds** for three main reasons. First, I have employed a number of approximations in the analysis. These were all designed so that the approximate estimates were lower bounds. For example, some 18.2 per cent of respondents said that UFD laws increased their costs but were unable to quantify the magnitude of that cost increase. In the calculation of the \$1329 million figure given above these firms were assumed to have no cost increase. If one assumed that they experience the same cost increase as other firms then the estimated cost impost would be \$1625 million.

Second, the cost impost of UFD laws is a very difficult thing for businesses to quantify. Most importantly, the economically relevant concept of cost is opportunity cost. The latter concept of cost includes not only direct costs but also costs of actions or opportunities foregone as well costs of actions taken in response to the law. For example, where firms employ more casual workers there may be a difference between the cost to the firm of the same quantum of labour purchased at casual rates and at

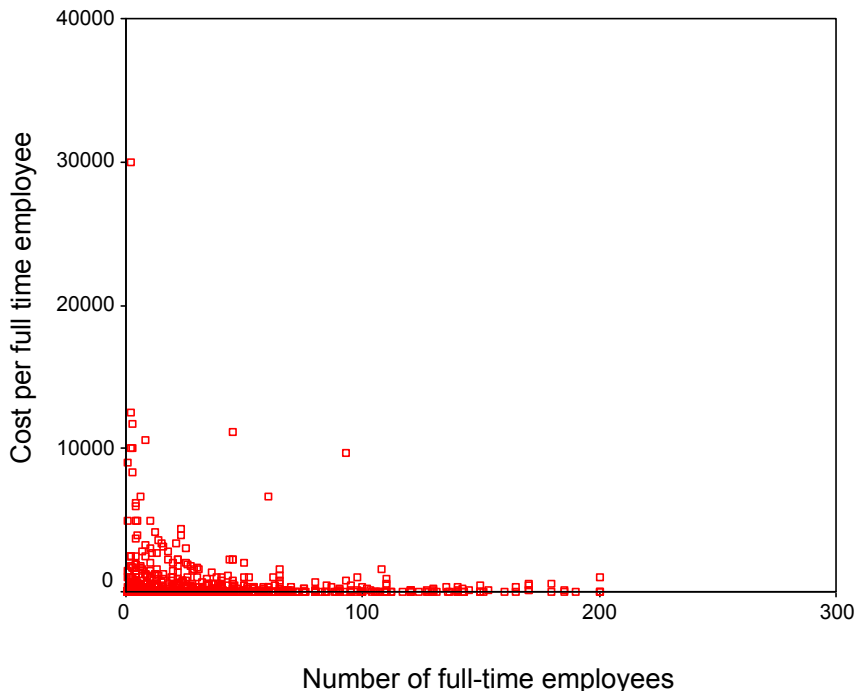
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<sup>2</sup> The average is calculated by dividing the estimated total cost for all firms by the estimated total number of employees for all firms. A larger number would be obtained by first calculating the average cost per employee for each firm and then factoring that number up to the population using firm weights.



permanent rates. The person interviewed in the firm may not be fully aware of all of these costs as they are dispersed throughout the firm. This latter concern is likely to be more relevant in larger firms where, for example, the human resource manager, line managers and supervisors may be more aware of the costs than is the CEO — in small businesses these functions are all rolled into the one job and thus there is less likely to be under reporting of cost imposts by such firms. For the reasons just given my assessment is that the cost impact on medium sized businesses is likely to be larger than suggested by examination of the raw responses.

**Figure 1: Confrontation of cost per full-time employee with number of full-time employees**



Third, in designing the survey considerable attention was paid to reducing the scope for strategic responses that might result in upward bias to reported costs or adverse effects of the law. The existence of the survey was kept out of public knowledge so as to eliminate the chance of coordinated response by firms or industry groups. Screening questions were used so that only those firms that reported an effect were asked to quantify the size, magnitude or nature of that effect. This design reduces the extent to which firm’s responses can be said to be ‘prompted’ or ‘lead’ by the interviewer. Moreover, because the respondent does not see the whole questionnaire there is little scope for strategic responses on their part. This use of screening avoids asking leading questions but means that estimates based on factoring up the reported costs are in general biased downwards. In order to remove that downward bias one needs to estimate an econometric model that takes into account the effect of the screening question. I have not sought to remove that downward bias in this paper and thus the estimates should be viewed as lower bounds rather than unbiased estimates of the cost impact of UFD laws.

Responses to the cost impact question have been compared against number of full time employees to assess whether there were any unusual patterns in the responses that might suggest over reporting of cost impacts (see Figure 1). Few responses seemed sufficiently different from the others to be classified as ‘outliers’ on this analysis. Moreover the existence of some ‘outliers’ does not necessarily imply that the respondents were engaged in over reporting of costs. An alternative explanation is that these firms were

subject to unfair dismissal claims and the costs are those of lawyer's fees, lost time and any payout. These are all costs that are relevant for the evaluation of UFD laws. For this reason no 'outliers' were removed in the analysis.

Accommodation, Communications, Recreation, Transport and Manufacturing are the industries where UFD laws have their largest impact in terms of average costs per full-time employee. Construction is the industry most lightly affected by these laws followed by Finance and Health.

### ***Results from questions put to businesses with no employees***

The survey established that some 20.9 per cent of small and medium sized businesses currently have no employees. Of these 58 per cent have never had employees and 42 per cent have previously had employees. When asked about the role that UFD laws played in their decision to reduce the number of employees, 11.1 per cent reported that these laws had played some role in that decision. Factoring this up to the population as a whole results in the conclusion that there were 77 482 job losses in which UFD laws played a role. Of these there were 34 812 job losses in which UFD laws played a major role, 17 100 in which the laws played a moderate role and 25 572 job losses in which the laws played a minor role.

In interpreting the statement made above it is important to understand that it relates only to job losses by firms that went from employing workers to not employing workers but remained in business. It does not include job losses by firms that closed entirely nor does it include job losses in firms that remained in business and continued to employ fewer workers.

The other way in which UFD laws influence firms that currently have no employees is by discouraging such firms from hiring. Just over one fifth (21.1 per cent) of small businesses that currently have no employees say that they are likely to hire in the future. The bulk of these (17.9 per cent) reported that UFD laws would influence their decision whether or not to hire. Only, 3.2 per cent reported that these laws would have no effect on their decisions.

The firms without employees who thought that the laws were likely to impede their hiring of new employees responded that the laws would influence the nature of their recruitment and selection process, the procedures used with workers whose performance is unsatisfactory and their supervision and management of employees. There was general support for the proposition that the laws would make management of new employees more difficult. The majority of these firms thought that UFD laws would increase their costs if they were to hire but only a small number were able to quantify the extent of the cost increase. This suggests that such laws add an extra element of uncertainty for small businesses seeking to put on an employee and therefore contribute to the high failure rate for such businesses.

### **Estimating the overall impact of unfair dismissal laws on aggregate employment and unemployment**

Much of the attention in the debate on UFD laws has focussed on determining the impact on employment and the unemployment rate. This focus is undesirable and potentially misleading. The best indicator of the welfare cost of UFD laws is provided by the estimate of the extent to which it raises the costs of businesses. Given that entry and exit into small and medium business is largely unrestricted, the incidence of this increase in their costs is borne entirely by labour. The division of this burden between lower wages or reduced employment and higher unemployment is determined by the institutional structure of the labour market. Specifically, if the labour market is highly competitive and labour supply highly wage inelastic, then almost all of the effect of UFD laws would be felt in terms of lower wages and very little in terms of employment. If on the other hand the labour market is uncompetitive and wages are set either by the Australian Industrial Relations Commission (AIRC) or via bargaining then the bulk of the

incidence of UFD laws will be in lower employment and higher unemployment. The latter seems a more accurate description of the Australian labour market than the former.

Wages for low wage and unskilled workers are set by a combination of the unemployment benefit (via its influence on the reservation wage) and the minimum award wages set by the AIRC. A reasonable assumption is that wages set in this way are at most weakly related to the unemployment rate. Thus, the level of employment for such workers is set by the intersection of their labour demand curve and the administratively set wage while the work force and hence unemployment is determined by the intersection of their labour supply schedule and the wage. This suggests that the bulk of the incidence of UFD laws on low paid and unskilled workers will be through reduced employment and higher unemployment.

Assuming that wages of Australian workers are not influenced by the unemployment rate together with the assumption of a wage elasticity of demand of 0.7 and the finding that UFD laws raise the average cost per employee by at least \$296 per year yields an estimate that these laws reduce employment of workers on the average wage (about \$45 000 per year) by about 0.46 per cent.<sup>3</sup> The effect is much larger for workers on minimum wages (about \$20 500 per year) where the reduction in employment is about 1 per cent. Thus another dimension of the inequity caused by UFD laws is that the burden is borne most heavily in terms of increased unemployment by low wage and low skilled workers who are among the most vulnerable in the community.

It is important to emphasise that these are underestimates of the effect of UFD laws on employment because a lower bound on the cost impost is used in the calculation. Moreover, as was established earlier, UFD laws reduce the efficiency with which the labour market matches job seekers with jobs. This occurs in part because there are certain types of job applicant that firms are less likely to hire because of UFD laws. UFD laws also contribute to inefficiency in job matching because they cause small firms to put greater emphasis on hiring family and friends thereby further segmenting the labour market.

## **Conclusion**

Ultimately, decisions about what laws remain on the books are political ones. However, the results of this survey suggest that the economic case against the current set of State and Commonwealth UFD laws is rather straightforward. Usually such considerations involve a trade off between equity and efficiency, but in this case, the UFD laws cause both adverse equity and efficiency effects. These laws reduce equity in two main ways. First, as discussed above they result in unequal treatment of equals. Moreover, as the young are over-represented as job applicants, while older people are over-represented as incumbents, this unfair treatment has the potential to last over a person's lifetime. Equity effects that operate on such a scale should be given the utmost importance. Second, some of the people who are treated unfairly are those about which society should have great concern, namely the long term unemployed, the less literate and those who have difficulty with formal modes of supervision and communication.

The adverse efficiency effects arise because the UFD laws impose costs on firms. The lower bound on the estimate of these costs is \$1.3 billion, which is about 0.2 per cent of GDP. The best estimate of the costs is likely to be substantially above this lower bound.

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<sup>3</sup> The assumption that wages are weakly exogenous in the labour demand equation is standard, reflecting the particular nature of the Australian wage setting system. The assumed long-run wage elasticity of demand of 0.7 is that used in the Treasury Macroeconomic Model (TRYM).

## 1. Introduction

There is general agreement that unfair dismissal (UFD) laws change the behaviour of businesses and that compliance with those laws imposes costs on businesses. But beyond these two points there is considerable disagreement about:

- the nature of the change in firm behaviour. Those that support the UFD laws argue that they encourage firms to adopt fairer procedures for dealing with workers whose performance is poor. Those who question the effect of the laws suggest that they have a number of unintended effects on firm hiring practices that result in certain types of job applicants being treated unfairly. Thus in any assessment of the laws one needs to weigh the favourable intended effects on fairness against the unfavourable unintended effects on fairness;
- the magnitude of the cost impact on firms. Those that support the UFD laws seem to suggest that the cost impact on firms is negligible. But prior to this report there has been no Australian study that attempts to quantify the cost impact of unfair dismissal laws. Also such laws produce a direct effect on firm costs and an indirect effect via the wage setting arrangements. It is important to attempt to quantify both types of costs;
- the extent to which the laws reduce employment and increase the unemployment rate. This is an issue that cannot be addressed by simply asking firms how many additional workers would be employed if the UFD laws were removed since the reported reaction of an individual firm will not take into account the reactions of other firms nor will it take into account the indirect effects of unfair dismissal laws on the wage bargaining; and
- the extent to which surveys of firms can provide the evidence on the effect of UFD laws. Early on in the debate those who oppose UFD laws quoted surveys such as the Yellow Pages Small Business Index survey of 30 October 1997 which found that 79 per cent of small business would be better off if they were exempted from UFD laws and that 38 per cent of small businesses would hire new employees if they were exempted. These results were dismissed by those who support the UFD laws on the grounds that the questions were leading and that “the small business surveys have suffered

from having been conducted in a context where they are almost inevitably going to achieve predetermined results”<sup>4</sup>.

The areas of disagreement cited above together with the criticisms of survey based evidence have created an atmosphere of uncertainty about the effect of UFD laws and the role of surveys in providing empirical evidence on such issues. Thus if public policy on UFD laws is to be based on evidence there is a need for careful research that explicitly addresses the issues raised above.

Against that background, this project was commissioned by the Department of Employment Workplace Relations. The purpose of the project is to provide information on:

- the impact of UFD legislation on employment, with particular reference to small business, including the impact on:
  - whether or not to engage more people;
  - forms of engagement (eg probationary, fixed-term, casual or permanent, agency workers, contractors);
  - cost impacts (eg additional hiring costs, and costs associated with handling or avoiding unfair dismissal claims, such as legal and specialist advice, time away from the business etc.); and
  - the impact of changes to the UFD provisions of the *Workplace Relations Act 1996* that came into effect in August 2001; and
- if possible, the impact of UFD legislation on respondents who are in, or believe that they are in, the federal UFD jurisdiction, and the impact of UFD legislation on respondents who are in, or believe that they are in, a State UFD jurisdiction.

At the centre of the project is a set of questions on UFD laws that were included in the July 2002 Yellow Pages Business Index Survey. Details of the survey are in section 2. The questionnaire is at Appendix A. Methodological issues that arise in the use of surveys to collect evidence on the effects of UFD laws are discussed in section 3.

Dismissal of workers is covered by a complex web of State and Commonwealth Laws. Section 4 reports small and medium businesses’ understanding of which body of law is relevant to their business.

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<sup>4</sup> Associate Professor Rosemary Claire Hunter, University of Melbourne, Principal Researcher, Justice Research Centre, Law Foundation, evidence to the Senate Committee on Employment, Workplace Relations, Small Business and Education, 29 January 1999.

The survey established that some 79.1 per cent of small and medium sized businesses have at least one employee. Sections 5 to 9 relate to the effect of UFD laws on these businesses:

- section 5 reports on awareness of, and attitudes to, the recent changes in UFD laws;
- section 6 identifies three aspects of small business that may influence the degree to which they are affected by UFD laws;
- section 7 examines the extent to which UFD laws have had their intended effect in terms of altering the behaviour of firms when dealing with poor performance of workers in situations that might ultimately lead to dismissal. Section 8 measures some of the unintended effects of UFD laws on small businesses hiring, recruitment and staff management practices; and
- section 9 explores the cost to business of complying with unfair dismissal laws and examines how those costs vary with the number of employees.

In this report I have chosen to employ a number of simplifying assumptions in analysing the data. In each of these cases I have chosen an assumption that leads to an underestimate of the adverse effects of UFD laws on small business. Thus my estimates of these adverse impacts should be seen as lower bounds rather than my best estimate of these effects. This is most evident in the case of the cost impact of UFD laws on small business, where I estimate the lower bound of this cost impact to be \$1329 million. After application of more sophisticated econometric techniques to correct for certain downward biases the best estimate of this cost impact is likely to be substantially above the lower bound.

UFD laws also influence future hiring decisions of business currently without employees, section 10 examines the nature and magnitude of these effects.

Section 11 introduces a framework for quantifying the effect of unfair dismissal laws on aggregate employment and unemployment.

Conclusions are in section 12.

## 2. The survey

The survey was in the field from 17 July to 5 August 2002 administered by Sweeney Research. The sample frame used for the survey is the Desktop Marketing Systems (DtMS) telephone number database that lists all telephone numbers across Australia. The survey comprises a panel of small and medium sized businesses selected from this database.<sup>5</sup> That is, the same respondents are contacted every three months. Each quarter some of the panel drop out. In the latest wave this figure was 458 (25 per cent).

The sample is stratified according to industry, location and business size. The details of response rates are in Table 1 below. The central point to emerge from Table 1 is that there were very few cases (0.8 per cent) where the respondents terminated during the interview. The main reason that a respondent was not interviewed after contact was that the quota for the category in which the respondent belonged was full. In total 1802 completed responses were obtained.

Sweeny Research uses the ABS Business Register to calculate weights that can be used to factor responses up to make statements about the population of firms. The weights are inversely related to the probability that a firm in each stratum is selected into the survey. The strata in the survey comprise business size (measured by full-time employees), sector, metro and non-metro region and State or Territory.

**Table 1: Details of survey response rate**

	Business	Percent
Refused	186	5.7
Quota full	910	28.0
Appointment made but not required	329	10.1
Terminate during interview	25	0.8
Interviewed and completed response obtained	1802	55.4
<b>Businesses contacted</b>	<b>3253</b>	<b>100</b>

Results from the survey when factored up suggest that in the population 79.1 percent of businesses had employees and 20.9 per cent had no employees. Separate questions were put to businesses with no employees on the extent to which unfair dismissal laws would affect their future hiring decisions.

<sup>5</sup> The unfair dismissal questions were placed in the 38<sup>th</sup> wave of this panel.

### 3. Methodological issues in the use of surveys to collect evidence on the effects of unfair dismissal laws

#### 3.1. *Open-ended versus closed ended questions*

Much of the methodological debate in this area relates to the issue of the apparent conflict between survey based evidence obtained from *open-ended questions* and that obtain from *closed-ended questions*. An example of the former is provided by question 2h of wave 38 of the Yellow Pages Small/Medium Business Questionnaire which ask firms to list “any particular barriers or impediments which prevent you from taking on new employees at the moment”. In the July 2002 survey 5.6 per cent of firms mentioned employment conditions/unfair dismissal/industrial relations/safety and health. Comparable findings were obtained in the 1998 Yellow Pages survey and from the 1995 Australian Workplace Industrial Relations Survey (AWIRS) which found that just 1.4 per cent of respondents mentioned UFD laws as an impediment to taking on new employees.

In commenting on the 1998 Yellow Pages survey Waring and De Ruyter (1999) state that<sup>6</sup>

*... 59 per cent of small business proprietors who believed there were barriers to taking on employees as of August 1998. It is also interesting to note the converse 41 per cent of these businesses saw no barriers to employment growth.*

*As can be seen, unfair dismissal laws do not even rate a specific mention. They could be construed to come under the categories of ‘employment conditions’ or ‘red tape/regulations’. However, even these two responses together comprised no more than 17 per cent of respondents.*

These interpretations of the survey evidence are incorrect as there will have been impediments that were of secondary importance to each firm, and thus were not mentioned, but which when aggregated over firms are important in determining aggregate employment. Moreover, the key phrase in the particular question is “prevent you from taking on new employees” many firms may agree that UFD laws would influence their decision to employ but would be unwilling to agree with the stronger statement centred on the word “prevent”.

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<sup>6</sup> Waring, P., and A., De Ruyter. Dismissing the Unfair Dismissal Myth, Australian Bulletin of Labour, Vol 25, No. 3, September 1999, pp 251 -274. Similar comments were made by Associate Professor Rosemary Hunter and Paul Ronfeldt to the Senate hearing on 29 January 1999.



**Table 2: Number of impediments to putting on new employees, question 2h July 2002 Yellow Pages survey.**

Number of impediments mentioned	Percent
0	42.1
1	43.2
2	9.9
3	3.2
4	1.4
5	.2
6	.0
Total	100.0

A related issue is that when asked an open ended question the respondent is likely to answer in terms of what is ‘top of mind’ at that instant. Even when prompted with ‘anything else’, respondents typically provide a small number of factors rather than being exhaustive. Some evidence on this is provided by Table 2 which shows that only 14.7 per cent of respondents cited two or more impediments to taking on new employees and 4.8 per cent cited 3 or more impediments. Because the responses are not exhaustive of the factors impeding firms in taking on more employees one needs to be very cautious in the statistical inferences that one draws from responses to such open ended questions.

The only valid inferences about UFD laws that can be made from the responses to open ended questions about factors impeding employment are:

- that for between 1.4 and 5.6 per cent of businesses (depending on whether one looks at the AWIRS survey or the Yellow Pages Survey) UFD laws are among the most important impediments to taking on new employees; and
- that for most businesses UFD laws do not rate as the first or second most important impediment to taking on new employees.

The key point here is that it is invalid to conclude, on the basis of few responses mentioning UFD laws, that such laws are unimportant in influencing firm’s employment decisions. In order to quantify the effects of UFD laws on firms one must ask firms direct questions about UFD laws. And, for the reasons discussed above, in order to be able to make valid statistical inference about the nature and magnitude of the effect it is usually necessary to ask closed ended questions.

### ***3.2. Piloting of closed-ended survey questions***

When asking closed-ended questions it is important that:

- the wording of the question makes sense to the respondent and seeks information that the respondent can reasonably be expected to possess;
- the range of responses allowed encompass the responses that the typical respondent is likely to provide. That is one does not wish to ‘censor’ valid responses; and
- the range of questions asked cover the relevant issues that the respondent would canvass in a longer more conversational type interview.

In order to develop questions with these properties the questionnaire was piloted with six firms. The piloting was done sequentially whereby an initial questionnaire was developed and then put to the first firm. Questions that proved difficult were noted, as were response ranges that were inadequate. The respondent was then asked whether they thought that the questions adequately captured the effect of UFD laws on their business and their responses noted. The questionnaire was then adjusted in light of this information and put to the next firm in the pilot.

With pilot subjects selected randomly, at each stage one can infer that one-half of the population would have more problems with the pilot questions than the respondent and one-half would have fewer problems. Thus when one reaches the stage where the respondent raises no issues that would cause adjustment of the questions, then it can be inferred that one-half of the population would have no problem with the questionnaire. In the case at hand, the fifth and sixth respondents in the pilot raised no issues that would cause the questionnaire to be changed. Thus one can be reasonably confident that the questionnaire is an instrument that adequately captures the effect of UFD laws on small and medium sized businesses.

### ***3.3. What are leading questions and how was the questionnaire designed to avoid them?***

In evidence to the 1999 Senate Committee Associate Professor Hunter criticised much of the survey evidence regarding unfair dismissals as being based on ‘leading’ questions. She observes that

*It is what we call in law 'a leading question'. A question that simply asks, 'Would you be more likely to recruit if you were exempted from unfair dismissal laws?' is inevitably going to achieve a response which is very different from the response that you would get if you said, for example, 'What would help you to hire people?' That is a more open-ended question which allows the respondent to take into account the range of factors that might be impacting on them rather than simply drawing attention to a single factor which is presumed to be the only factor operating in this situation<sup>7</sup>.*

The point made by Associate Professor Hunter is an important one but unfortunately in the discussion cited above there is some confusion as closed-ended questions are seemingly equated with 'leading questions'. This is not correct. To understand why it is useful to refer to the Oxford Dictionary of Law which states that a 'leading question' is

*A question asked of a witness in a manner that suggests the answer sought by the questioner (e.g. You threw the brick through the window, didn't you?) or that assumes the existence of disputed facts to which the witness is to testify.<sup>8</sup>*

Thus, a question can be considered as leading if it assumes the existence of a fact that has not yet been established at the stage at which the question is asked in the survey. Leading questions can be avoided in surveys by employing screening questions that first establish the existence of a fact and then asking only those respondents that have reported the existence of that fact to provide more information about the extent or nature of the effect.

For example, in the survey developed for this report, question 11 seeks to establish whether or not the firm had permanent employees. Firms that had employees were then asked the following question

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<sup>7</sup> Professor Hunter, Senate 29 January 1999 EWRSBE 11

<sup>8</sup> Dictionary of Law, Oxford University Press Market House Books Ltd 1997

*Q12a Thinking about the processes and practices your business uses to: recruit and select staff, manage its workforce, and manage staff whose performance is unsatisfactory – which of the following statements best describes the extent to which unfair dismissal laws influence the operation of your business?*

1. *The laws have a major influence on what we do.*
2. *The laws have a moderate influence on what we do.*
3. *The laws have a minor influence on what we do.*
4. *The laws have no influence on what we do.*

Those firms that responded that unfair dismissal laws have no influence on what they do were asked no further questions about the effect of those laws. Firms that reported some effect were asked questions about the nature and magnitude of those effects. Screening questions were used in this way later in the survey to establish the existence of facts about the cost imposed of UFD laws before asking respondents questions that presumed the existence of such a cost imposed. In this way the questionnaire avoided asking leading questions.

To reiterate, the central point to emerge from the discussion above is that one can only determine whether or not a question is leading by looking at its place in the whole questionnaire and particularly at whether respondents are asked appropriate screening questions to establish that an effect exists before they are asked about the nature or magnitude of that effect.

#### **4. Coverage of unfair dismissal laws**

Almost one-third of businesses did not know whether they are covered by State or Commonwealth UFD law, 15.7 per cent of businesses reported that they are covered mainly by Commonwealth law, 26.8 per cent reported that they are covered mainly by State law and 26.9 per cent reported that they are covered equally by State and Commonwealth laws.

**Table 3: Coverage of unfair dismissal laws by jurisdiction**

Q19 Appendix A.	
Mainly covered by Commonwealth law	15.7
Mainly covered by State law	26.8
Covered equally by State and Commonwealth law	26.9
Don't know	30.7
<b>Total</b>	<b>100.0</b>

## 5. Awareness of and attitudes to recent changes in Commonwealth unfair dismissal laws

Almost two thirds of businesses reported that they were unaware of the recent changes to Commonwealth UFD laws. Of those that were aware of the changes the majority thought that the changes would not affect their business. Just under 6 per cent thought that the changes would be good for their business.

**Table 4: Awareness of, and reaction to, recent changes to unfair dismissal laws**

Q 20 Appendix A.	Per cent
I am unaware of the changes so cannot comment	62.6
I am aware of the changes but do not think they will affect my business	29.4
I am aware of the changes and think they will be good for my business	5.9
I am aware of the changes and think they will be bad for my business	2.1
<b>Total</b>	<b>100.0</b>

## 6. Three important features of small and medium sized businesses

Within the small and medium business sector there is considerable heterogeneity. Two aspects of the latter are particularly important in assessing the effect of UFD laws. First, the smaller is the business the younger it is — firms with one to five employees are on average 16.3 years old while firms with more than 100 employees are on average 36.7 years old (see Table 5). This suggests that the management of smaller firms is likely to be less experienced than that of larger firms. Also smaller firms are known to have higher failure rates than larger firms.

**Table 5: Average age of business by number of full-time employees**

	Number of full time employees					
	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+
Average age	16.3	22.0	26.2	29.1	36.9	36.7
Standard deviation	15.1	20.2	21.4	22.8	23.9	27.6

This leads to the second feature of this sector, that very small firms are intensive employers of casual and part-time workers while larger firms are predominantly employers of full-time workers (see Table 6, Table 7 and Table 8).

**Table 6: Number of employees by type of employment and size of business**

	Size of business (number of full time employees)						Total
	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+	
Number of Casual employees	570232	291737	164423	97711	64353	33381	1221837
Number of part-time employees	430313	93844	65827	86154	44042	45568	765748
Number of full-time employees	1194509	677231	636790	832120	535218	621784	4497652
Ratio of casual to full-time employees ×100	47.74	43.08	25.82	11.74	12.02	5.37	27.17
Ratio of part-time to full-time employees ×100	36.02	13.86	10.34	10.35	8.23	7.33	17.03

The differences in employment type by size of business reflects the operation of a number of economic forces. An important consideration is that the attractiveness of being a full-time employee varies with firm size and age because the probability of a business failing varies with size and age. Thus the expected value to the employee of being a full-time ‘permanent’ employee also varies with firm size and age.

A related point that has not been made before is that because of the higher failure rates by small business the expected benefits to employees from UFD laws that cover small and medium business will be less than the expected benefit from such laws that cover larger businesses.

All businesses face fluctuating demand but differ in the most cost effective strategy for managing the business in that environment. Smaller businesses are typically younger and have less experience in managing demand fluctuations and also have less scope than larger businesses to shift workers within the firm to meet demand fluctuations. These provide additional reasons why small business relies more extensively on the use of casual and part-time employees to vary their labour force and meet the demand fluctuations.

An important feature of the data obtained from this survey is that it shows a high degree of heterogeneity. Table 7 and Table 8 report two measures of central tendency (the mean and median). If the distribution of the data is symmetric then the mean and median are equal. Thus for each firm size category the average number of full time employees (bottom row of Table 7) is approximately equal to the median number of employees (bottom row of Table 8). This is not, however, true for the casual employees or part-time employees where the average is typically above the median indicating a form of heterogeneity.

**Table 7: Average number of employees by type of employment and size of business**

	Size of business (number of full time employees)					
	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+
Average number of Casual employees	1.2	3.2	3.9	3.9	8.8	7.5
Average Number of part-time employees	0.9	1.0	1.5	3.4	6.0	10.4
Average Number of full-time employees	2.6	7.3	14.9	32.9	70.9	138.4

**Table 8: Median number of employees by type of employment and size of business**

	Size of business (number of full time employees)					
	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+
Median number of Casual employees	0	0	0	0	1	2
Median Number of part-time employees	0	0	0	1	1	5
Median Number of full-time employees	2	7	15	31	66	131

The relevance of this heterogeneity among the small and medium business sector to an assessment of the costs and benefits of UFD laws arises because the objective of the laws is, in part, to compensate workers who are unfairly dismissed. Such compensation should be related to the economic value the worker places on the benefits of being employed by the firm that are destroyed by the act of UFD. But the quantum of benefits to the worker from such attachment vary according to firm size and employment type (larger firms usually provide better and more extensive benefits than do smaller firms). Moreover, the probability that a worker's attachment to a firm will be destroyed by firm failure varies with firm size, age, industry etc. Thus, the expected benefit of being attached to a firm varies with all of these factors. The heterogeneity of the small and medium business sector means that the loss suffered by a worker by being unfairly dismissed will vary considerably depending on the factors just listed. This makes it rather difficult to implement a legal remedy that can deliver compensation that approximately matches the economic loss to the worker who is unfairly dismissed. Moreover, because the expected benefit to a worker of continued employment by a small firm is much less than the expected benefit of continued employment by a large firm the application to small firm UFD claims of compensation payments that are relevant for large firms would result in overcompensation of workers dismissed from small and medium firms and consequent unjustifiably high costs imposed on such businesses.

## **7. Intended effects of the unfair dismissal laws**

Perhaps the main objective of UFD laws is to encourage firms to engage in better human resource management practices particularly when dealing with workers whose performance is unsatisfactory. The first question to ask about such laws is whether they influence firm behaviour in any way. As can be seen from Table 9 some 69.8 per cent of firms said that the UFD laws have some impact on what they do; 23.3 per cent reported that the impact was major, 24.6 per cent reported that the impact was moderate and 21.9 per cent reported that the impact was minor.

**Table 9: Effect of unfair dismissal laws on the behaviour of small and medium sized businesses**

Q 12a Appendix A.	Weighted
The laws have a major influence on what we do	23.3
The laws have a moderate influence on what we do	24.6
The laws have a minor influence on what we do	21.9
The laws have no influence on what we do	30.2
<b>Total</b>	<b>100.0</b>

One effect of the law was to encourage 29.7 per cent of firms to seek advice as to how to mitigate the effect of UFD laws on their businesses. Part of this advice will relate to how to improve human resource management and can be considered as an intended effect of the laws.

**Table 10: Whether, businesses sought advice on how to mitigate adverse effect of unfair dismissal laws**

Q12b Appendix A	Weighted
Sought advice	29.7
Have not sought advice	39.1
Don't know	0.8
Refused	0.1
Memo item: businesses not influenced by the law	30.2
<b>Total</b>	<b>100.0</b>

The central purpose of the UFD laws are to encourage firms to engage in fair, and transparent human resource management procedures when dealing with workers whose performance is unsatisfactory. As can be seen from Table 11 the UFD laws have changed the behaviour of 51.6 per cent of firms in regard to the procedures used with workers whose performance is unsatisfactory.

**Table 11: Whether, unfair dismissal laws influence procedures for dealing with workers whose performance is unsatisfactory**

Q13.2 Appendix A	Weighted
Describes very well	29.1
Describes somewhat well	22.5
Does not describe at all	16.6
Don't know	0.9
Refused	0.7
Memo item: businesses not influenced by the law	30.2
<b>Total</b>	<b>100.0</b>

It is clear from the data that the UFD laws have caused firms to implement the two main practices that are considered to be part of good human resource management of poor performers namely, provide a warning, and provide an opportunity to respond (see Table 12).

It is also clear that the UFD laws have encouraged firms to provide workers who are about to be dismissed with reasons (see Table 12), something that is widely viewed as central to fairness.



**Table 12: Procedures used when dealing with workers whose performance is unsatisfactory**

Q 16 Appendix A	Uses formal procedures with worker whose performance is unsatisfactory	Documents in writing an employees poor performance	Provides a worker whose performance is unsatisfactory with a warning	Provides a worker whose performance is assessed as unsatisfactory with an opportunity to respond	Provides reasons to a worker whose performance is considered sufficiently unsatisfactory to justify termination
Describes very well	31.4	34.4	42.0	40.9	42.1
Describes somewhat well	15.3	8.9	7.8	7.2	7.0
Does not describe at all	4.8	8.1	1.7	1.9	1.6
Don't know	<0.05	<0.05	<0.05	0.6	0.2
Refused	<0.05	0.1	0.1	1.0	0.7
Memo item 1: businesses not influenced by the law	30.2	30.2	30.2	30.2	30.2
Memo item 2: businesses whose performance procedures are not influenced by the laws	16.6	16.6	16.6	16.6	16.6
Memo item 3: businesses who responded don't know or prefer not to answer to screening question	1.6	1.6	1.6	1.6	1.6
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

The choice of a legal remedy for UFD also creates two intended effects that are not necessarily beneficial.<sup>9</sup> The first of these is increased formality in procedures with workers whose performance is unsatisfactory. The second is documentation in writing of a workers poor performance. As can be seen from Table 12, while these strategies were less strongly evident than the three beneficial strategies they were nonetheless very evident in firm responses to the UFD laws. This raises two questions about the equity effects of UFD laws. First do they treat workers equally? Or does the increased formalism and reliance on documentation disadvantage those workers that are less literate and less suited to formal modes of supervision? These questions cannot be addressed fully from the information in the current survey, however, in the next section I report evidence that the increased formalism is viewed by management as making their task more difficult.

## 8. Unintended effects of the unfair dismissal laws

Unintended effects of UFD laws fall into three categories. The first of these are effects on recruitment and selection procedures which are discussed in section 8.1. The second category of unintended effects relates to adverse effects on management and supervision practices, and is discussed in section 8.2. The

<sup>9</sup> I categorise these as intended effects as they are central to a legal remedy. Without formalism and documentation the legal remedy would be unworkable as it requires evidence.

third category of unintended effect arises where the UFD laws result in firms being less willing to dismiss workers whose performance is unsatisfactory. These effects are discussed in section 8.3.

### ***8.1. Effect on recruitment and selection procedures and decision***

Given that UFD laws have the effect of making it harder to dismiss an employee for poor performance it is natural for firms to react by changing their recruitment and selection procedures so as to reduce their chance of hiring someone who turns out to be a poor match or a poor performer. Some 47.9 per cent of businesses reported that the UFD laws influenced their recruitment and selection procedures (see Table 13)

**Table 13: Whether, unfair dismissal laws influence recruitment and selection procedures**

Q13.1 Appendix A	Weighted
Describes very well	22.1
Describes somewhat well	25.8
Does not describe at all	21.6
Don't know	0.2
Refused	<0.05
Memo item: businesses not influenced by the law	30.2
<b>Total</b>	<b>100.0</b>

UFD laws have resulted in only a small increase in the use of fixed term contracts by small and medium sized businesses, this is probably because given the high failure rates of small business such contracts would provide more permanency to employees than is afforded by the standard employment contract and it would be difficult for small business to credibly commit to such contracts. A more popular choice was the use of casual workers. This strategy has the advantage, for small business, of extending the use of a form of employment with which they are very familiar. Increased employment of family and friends was also about equally popular response by small business (see Table 14). Again this is a form of employment with which small businesses are familiar.

**Table 14: Nature of effect on recruitment and selection procedures**

Q14 Appendix A	My business puts more employees on fixed term contracts	My business employs more casuals and fewer permanent workers	My business employs more family and friends	My business uses longer probationary periods for new employees	Because of unfair dismissal laws there are certain types of job applicant that my business is less likely to hire
Describes very well	8.1	16.7	12.5	18.6	29.6
Describes somewhat well	3.5	4.6	8.2	8.0	9.9
Does not describe at all	35.8	26.6	27.3	20.7	6.9
Don't know	0.5			0.7	0.7
Refused	<0.05	0.1			0.8
Memo item 1: businesses not influenced by the law	30.2	30.2	30.2	30.2	30.2
Memo item 2: businesses whose performance procedures are not influenced by the laws	21.6	21.6	21.6	21.6	21.6
Memo item 3: businesses who responded don't know or prefer not to answer to screening question	0.2	0.2	0.2	0.2	0.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

The most frequently reported responses were use of longer probationary periods and screening out of certain types of job applicants. The former strategy while understandable makes the probation period more difficult for both employees and employers. This strategy also has important equity effects on workers. To understand this consider a worker who is a marginal match when viewed from the perspective of their new employer. The UFD laws create an incentive for the employer to lift the criteria used to determine what is satisfactory in the probationary period. Thus one effect of the UFD laws is that more people will be dismissed in the probationary period. Such dismissals show up on the worker's CV either as terminations or as changes in job for no apparent reason.

When asked about what categories of job applicants they would be less likely to hire 35.1 per cent of firms said that they would be less likely to hire someone who had changed jobs a lot for no apparent reason (see Table 15). Thus the selection strategies UFD laws cause businesses to adopt, are likely to disadvantage certain types of workers with consequent adverse effects on equity and on efficiency. The latter arises because the increased rate of dismissal in probationary periods can lead to the person having a reduced chance of getting a job. This adverse effect of unfair dismissal laws on the probability of getting a job is compounded for workers who become unemployed for more than one year as the UFD laws make it far less likely that businesses will select job applicants with these characteristics (see Table 15).

**Table 15: Types of job applicant less likely to be hired because of unfair dismissal laws**

Q15 Appendix A	A person who has changed jobs a lot for no apparent reason	A person who is currently unemployed	A person who has been unemployed for more than one year	A person who has been unemployed for more than two years
Describes very well	28.0	7.8	16.5	22.2
Describes somewhat well	7.1	8.1	10.9	8.1
Does not describe at all	4.1	23.3	12.0	9.1
Don't know	0.2	0.3	0.2	0.2
Refused	0.1	<0.05	<0.05	<0.05
Memo item 1: businesses not influenced by the law	30.2	30.2	30.2	30.2
Memo item 2: businesses whose performance procedures are not influenced by the laws	21.6	21.6	21.6	21.6
Memo item 3: Business where unfair dismissal law has no effect on type of person hired	6.9	6.9	6.9	6.9
Memo item 3: businesses who responded don't know or prefer not to answer to screening question	1.9	1.9	1.9	1.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

### *8.2. Effect on supervision, management and performance of employees*

Some 46.1 per cent of businesses reported that the UFD laws influenced the way in which their business supervised or managed employees. And, 44.3 per cent of businesses reported that the UFD laws made it more difficult to manage and supervise their workforce.

**Table 16: Effect of unfair dismissal laws on management supervision and performance of employees**

Q13.3 Appendix A	Law has effect on way business supervises and manages employees	Law makes management of workforce more difficult than it would otherwise be
Describes very well	20.1	25.4
Describes somewhat well	26.0	18.9
Does not describe at all	22.9	25.2
Don't know	0.6	0.2
Refused	0.3	0.1
Memo item: businesses not influenced by the law	30.2	30.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

When asked about the nature of adverse effects some 38.9 per cent of businesses reported that the UFD laws reduced their authority over their workforce, 40.8 per cent reported that it now takes longer to resolve issues associated with poor performance, 37.9 per cent reported that poor performance by one worker is more likely to spill over and adversely influence the performance of other workers (see Table 17).

**Table 17: Nature of effect of unfair dismissal laws on management and supervision**

Q17 Appendix A	Reduce authority my business has over its workforce	Takes longer to resolve issues associated with poor performance	Poor performance by one worker is more likely to adversely affect the performance of other workers	More formality in dealing with workers makes communication between management and employees more difficult
Describes very well	23.9	29.6	26.9	26.5
Describes somewhat well	15.0	11.2	11.0	11.8
Does not describe at all	5.2	3.1	6.1	5.8
Don't know	0.2	0.4	0.3	0.1
Refused				0.2
Memo item 1: businesses not influenced by the law	30.2	30.2	30.2	30.2
Memo item 2: businesses whose performance procedures are not influenced by the laws	25.2	25.2	25.2	25.2
Memo item 3: businesses who responded don't know or prefer not to answer to screening question	0.3	0.3	0.3	0.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Earlier it was observed that legal remedies require more formal interaction between employees and employers, when asked about this some 38.3 per cent of businesses reported that the increased formality required by the UFD laws made communication with employees more difficult. This is likely to be a significant problem for small businesses where flexibility is part of their competitive advantage. Moreover, as discussed earlier, the increased difficulty in communication may well disadvantage certain types of employees with consequent adverse equity effects.

### ***8.3. Effect on decisions to terminate a worker whose performance is unsatisfactory***

The objectives of unfair dismissal laws are to improve the fairness with which employees are treated by encouraging employers to engage in fair and transparent human resource management practices. Ideally, such laws would not discourage employers from dismissing an employee whose performance is unsatisfactory. However, as reported in Table 18 for 37.5 per cent of firms the UFD laws made it less likely that they would dismiss a worker whose performance is unsatisfactory. This finding underscores the finding made above that businesses felt that the UFD laws reduced their authority over their workforce.

**Table 18: Effect of unfair dismissal laws on decision to terminate a worker whose performance is unsatisfactory**

Q.13.6 Unfair dismissal laws make it less likely that my business would dismiss a workers whose performance is unsatisfactory	Weighted
Describes very well	19.9
Describes somewhat well	17.6
Does not describe at all	30.9
Don't know	1.2
Refused	0.1
Memo item: businesses not influenced by the law	30.2
<b>Total</b>	<b>100.0</b>

## 9. Cost impact of the unfair dismissal laws

One third of businesses reported that UFD laws increased their costs when compared to a situation where there were no laws (see Table 19).

**Table 19: Effect of unfair dismissal laws on businesses costs**

Q.13.5 Compared with a situation where there were no unfair dismissal laws, unfair dismissal laws increase my businesses costs	Weighted
Describes very well	17.0
Describes somewhat well	16.4
Does not describe at all	34.7
Don't know	1.5
Refused	0.2
Memo item: businesses not influenced by the law	30.2
<b>Total</b>	<b>100.0</b>

The cost impost of UFD laws is a very difficult thing for businesses to quantify. Most importantly, the economically relevant concept of cost is that of opportunity cost. The latter concept of cost includes not only direct costs but also costs of actions or opportunities foregone as well costs of actions taken in response to the law. For example, where firms employ more casual workers there may be a difference between the cost to the firm of the same quantum of labour purchased at casual rates and at permanent rates. The person interviewed in the firm may not be fully aware of all of these costs as they are dispersed throughout the firm. Thus it is likely that some respondents incorrectly responded that the laws imposed no costs on their business. This latter concern is likely to be more relevant in larger firms where, for example, the human resource manger, line managers and supervisors may be more aware of the costs than is the CEO — in small businesses these functions are all rolled into the one job and thus there is less likely to be under reporting of cost imposts by such firms. For this reason the raw survey numbers provide an under estimate or lower bound on the cost to small business of complying with UFD laws.

Taking the reported costs and factoring them up to the population of small and medium business yields an estimate of \$1329 million as the cost to small and medium sized businesses of complying with the

UFD law. This estimate is arrived at by assuming that the 18.2 per cent of businesses that reported a cost impost but could not quantify the size of that cost impost actually experienced a zero cost impost. Thus the estimate of \$1329 million should be seen as a lower bound (see Table 20). To put this figure in perspective it represents about 0.2 per cent of Australian annual GDP.

If those who could not quantify the cost increase have a similar cost increase as those that did provide an estimate then, a more plausible estimate of the cost increase would be \$1625 million. The bulk of this cost increase is borne by small business. However, one should exercise caution here as the discussion at the top of this page suggests that there may be systematic under reporting of costs by larger businesses.

**Table 20: Estimated lower bound of cost impost from unfair dismissal laws by size of business**

Q18 Appendix A	Size of business (number of full-time employees)						Total
	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+	
Total cost (\$million)	436.709	225.213	177.990	271.218	119.825	98.327	1329.282
Employees (million)	1.195	0.677	0.637	0.832	0.535	0.622	4.498
Average cost per full time employee (\$)	365	333	279	326	224	158	296

The estimated total cost of UFD laws by industry and size of business is shown in Table 21 below. Communications (\$344 million) and Manufacturing (\$291 million) are the industries faced with the largest dollar burden from compliance with UFD laws. Estimated employment of full-time workers by industry and size of business is shown in Table 22 below. The ratio of total cost for the industry to number of employees in the industry provides a lower bound on the estimate of average cost per employee that is reported in Table 23.<sup>10</sup> The average cost of UFD laws vary considerably by industry. As is shown in Table 23, Accommodation, Communications, Recreation, Transport and Manufacturing are the industries where unfair dismissal laws have their largest impact in terms of cost per full-time employee.

<sup>10</sup> This method of calculating the average was chosen because it results in a lower figure than the alternative which is to calculate the average cost per full-time employee for each firm and then factor those averages up to the population using firm weights.

**Table 21: Lower bound on estimated total cost of unfair dismissals by industry and size of business (number of full-time employees), \$million**

Q18 Appendix A	Size of business (number of full-time employees)						Total
Industry	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+	
Manufacturing	17.2	88.4	47.8	26.6	92.4*	18.6*	291.0
Construction	14.3	16.9	7.3*	11.0*	4.1*	0.7*	54.3
Wholesale trade	5.0	8.3	28.6	37.1*	0.6*	9.6*	89.2
Retail Trade	48.8	8.6	19.8	27.1	7.6*	9.8*	121.7
Transport	40.7	6.0	1.5*	25.4*	0.9*	1.1*	75.6
Communications	158.9	25.2	37.7	93.3	9.0*	20.1*	344.2
Finance	2.0	12.3*	0.0*	8.6*	0.3*	0.3*	23.6
Health	9.2	11.0	10.2*	1.5*	0.0*	37.6*	69.4
Recreation	86.5	13.1	1.0*	26.0*	4.9*	0.5*	132.0
Accommodation	54.0	35.5*	24.2*	14.6*	0.0*	0.0*	128.3

\* Note average is based on very few observations and should be treated with great care.

**Table 22: Estimated total number of employees by industry and size of business (number of full-time employees), persons.**

Q18 Appendix A	Size of business (number of full-time employees)						Total
Industry	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+	
Manufacturing	66385	94554	88397	169948	135511*	101164*	655959
Construction	168815	64652	28435*	50102*	31467*	10051*	353522
Wholesale trade	115276	55194	61257	84275*	24153*	52296*	392451
Retail Trade	237900	145547	148361	136933	108919*	104399*	882059
Transport	68872	22582	23454*	50420*	28445*	20334*	214107
Communications	274229	131179	105206	133807	83058*	80274*	807753
Finance	44646	16337*	28552*	24667*	20024*	32150*	166376
Health	78308	67299	55620*	62948*	33811*	142712*	440698
Recreation	90389	45358	44048*	69299*	54305*	18207*	321606
Accommodation	49688	34529*	53450*	49722*	15525*	60198*	263112

\* Note average is based on very few observations and should be treated with great care.

**Table 23: Estimated lower bound of cost per full-time employee attributable to unfair dismissal laws by industry and size of business (number of full-time employees), \$ per full-time employee per year\***

Q18 Appendix A	Size of business (number of full-time employees)						Total
Industry	1 to 5	6 to 10	11 to 20	21 to 50	51 to 100	100+	
Manufacturing	259	935	540	157	682*	184*	444
Construction	85	261	257*	220*	132*	74*	154
Wholesale trade	44	150	467	440*	26*	183*	227
Retail Trade	205	59	133	198	70*	94*	138
Transport	591	265	64*	504*	30*	55*	353
Communications	579	192	359	697	108*	251*	426
Finance	45	755*	0*	348*	17*	8*	142
Health	118	164	183*	23*	0*	263*	157
Recreation	957	290	22*	375*	89*	29*	410
Accommodation	1087	1027*	453*	295*	0*	0*	488

\* Note average is based on very few observations and should be treated with great care.



## 10. The effect of unfair dismissal laws on businesses with no employees.

UFD laws can influence businesses with no employees in two ways. First the laws may have caused businesses to shed employees. This issue is investigated in section 10.1. Second, the laws may discourage business that currently have no employees from putting on a new employee. This issue is investigated in section 10.2.

### *10.1. Extent to which unfair dismissal laws caused businesses to shed employees*

As shown in Table 24 some 58 per cent of businesses that currently have no employees have never had employees, while 42 per cent have had employees at some stage in the past.

**Table 24: Maximum number of employees engaged by firms that currently don't have employees**

Maximum number of employees (Q 22 Appendix A)	Percent
Never had employees	58.0
1	5.9
2	8.0
3	8.1
4	2.8
5	5.3
6	3.7
7	.7
8	5.1
9	.8
More than 10	1.5
<b>Total</b>	<b>100.0</b>

When asked about the role that UFD laws played in their decision to reduce the number of employees, 11.1 per cent reported that these laws had played some role in their decision. Firms that previously had employees, but currently do not have employees, were asked what was the maximum number of people they had employed. Factoring this up to the population as a whole results in the conclusion that there were 77 482 job losses in which UFD laws played a role. Of these there were 34 812 job losses in which UFD laws played a major role, 17 100 job losses where UFD laws played a moderate role and 25 572 job losses where the laws played a minor role.

In interpreting the statement made above it is important to understand that it relates only to job losses by firms that went from employing workers to not employing workers but which remained in business. It does not include job losses by firms that closed entirely nor does it include job losses in firms that remain in business and continue to employ some workers.

**Table 25: Influence of unfair dismissal laws on firms that previously employed but currently have no employees**

Q23. Influence of UFD laws on firm's decision to reduce number of employees	Percent of firms that currently have no employees	Total number of jobs lost
A major influence	4.6	34,812
A moderate influence	2.7	17,100
A minor influence	3.8	25,572
Not an influence at all	30.9	na
Memo item: Firms that have never employed	58.0	na
Total	100.0	77,482

In the debate on the impact of UFD laws on employment it is often suggested that survey evidence might be biased because businesses have an incentive to overstate the effect of UFD laws. While I disagree with this proposition, it is necessary to emphasise that the importance of the findings in Table 25 is that even the most trenchant critic of survey evidence cannot suggest that these businesses have an incentive to overstate the effect of UFD laws as they currently do not employ any workers and are unlikely to do so in the future.

***10.2. Extent to which unfair dismissal laws discourages businesses that currently have no employees from hiring***

Just over one-fifth (21.1 per cent) of small businesses that currently have no employees say that they are likely to hire in the future. The bulk of these (17.9 per cent) reported that UFD laws would influence their decision to take on new employees (4.6 major influence, 7.0 moderate influence, 6.3 per cent minor influence). Only 3.2 per cent reported that UFD laws would have no influence.

Firms that currently have no employees but are contemplating hiring generally feel that if they do hire then UFD laws will influence most aspects of their relationship with the new employee (see Table 26).

**Table 26: Features of relationship between firm and worker that firms without employees feel would be influenced by unfair dismissal laws if they were to hire a new employee**

Q 26. Extent to which firm is influenced by UFD laws	Feature influenced			
	Recruitment and selection	Procedures with workers whose performance is unsatisfactory	Supervision and management	Make management of workers more difficult
Describes Very Well	8.5	9.3	6.6	7.5
Describes Somewhat	6.4	5.1	5.4	6.9
Does Not Describe At All	2.4	2.9	5.3	3.3
Dont know	.5	.5	.5	.1
Memo 1: Unlikely to hire	78.9	78.9	78.9	78.9
Memo 2: UFD laws have no effect	3.2	3.2	3.2	3.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

More than half of the 21.1 per cent of firms currently without an employee who are likely to hire reported that complying with that UFD laws would raise their businesses costs if they put on a employee. However, when asked almost all of these businesses were unable to say by how much their costs would be increased by unfair dismissal laws.

### **11. The effect of unfair dismissal laws on aggregate employment and the unemployment rate**

Much of the attention in the debate on UFD laws has focussed on determining the impact on employment and the unemployment rate. This focus is undesirable and potentially misleading. The best indicator of the welfare cost of UFD laws is provided by the estimate of the extent to which it raises the costs of businesses. Given that entry and exit into small and medium business is largely unrestricted, the incidence of this increase in their costs is borne entirely by labour. The division of this burden between lower wages or reduced employment and higher unemployment is determined by the institutional structure of the labour market. Specifically, if the labour market is highly competitive and labour supply highly wage inelastic then almost all of the effect of UFD laws would be felt in terms of lower wages and very little in terms of employment. If on the other hand the labour market is uncompetitive and wages are set either by the Australian Industrial Relations Commission (AIRC) or via bargaining then the bulk of the incidence of UFD laws will be in lower employment and higher unemployment. The latter seems a more accurate description of the Australian labour market than the former.

Wages for low wage and unskilled workers are set by a combination of the unemployment benefit (via its influence on the reservation wage) and the minimum award wages set by the AIRC. A reasonable assumption is that wages set in this way are at most weakly related to the unemployment rate. Thus, the level of employment for such workers is set by the intersection of their labour demand curve and the administratively set wage, while the work force and hence unemployment is determined by the intersection of their labour supply schedule and the wage. This suggests that the bulk of the incidence of UFD laws on low paid and unskilled workers will be through reduced employment and higher unemployment.

Assuming that wages of Australian workers are not influenced by the unemployment rate together with the assumption of a wage elasticity of demand of 0.7 and the finding that UFD laws raise the average cost per employee by at least \$296 per year yields an estimate that these laws reduce employment of workers on the average wage (about \$45 000 per year) by about 0.46 per cent.<sup>11</sup> The effect is much larger for workers on minimum wages (about \$20 500 per year) where the reduction in employment is about 1 per cent. Thus, another dimension of the inequity caused by UFD laws is that the burden is borne most heavily in terms of increased unemployment by low wage and low skilled workers who are among the most vulnerable in the community.

It is important to emphasise that these are underestimates of the effect of UFD laws on employment because a lower bound on the cost impost is used in the calculation. Moreover, as was established earlier UFD laws reduce the efficiency with which the labour market matches job seekers with jobs. This occurs in part because there are certain types of job applicant that firms are less likely to hire because of UFD laws. UFD laws also contribute to inefficiency in job matching because they cause small firms to put greater emphasis on hiring family and friends thereby further segmenting the labour market.

## **12. Summary and conclusion**

The results of this survey suggest that UFD laws have a range of equity effects and clearly adverse efficiency effects. On the positive side the laws do result in what might be regarded as fairer practices when dealing with workers whose performance is unsatisfactory. But against this must be set a range of

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<sup>11</sup> The assumption that wages are weakly exogenous in the labour demand equation is standard, reflecting the particular nature of the Australian wage setting system. The assumed long-run wage elasticity of demand of 0.7 is that used in the Treasury Macroeconomic Model (TRYM).

unintended effects of the laws that have adverse equity effects. Two of these are particularly important. First, as discussed in earlier sections the laws result in unequal treatment of people who are equal except that one person is a marginal job applicant while the other person is a marginal job incumbent. Moreover, the young are over-represented as job applicants, while older people are over-represented as incumbents, thus the unfair treatment documented above has the potential to last over a person's lifetime. Second, some of the people who are treated unfairly are those about which society should have great concern, namely the long-term unemployed, the less literate and those who have difficulty with formal modes of supervision and communication.

The adverse efficiency effects arise because the UFD laws impose costs on firms. The lower bound on the estimate of these costs is \$1.3 billion, which is about 0.2 per cent of annual Australian GDP.

**Appendix A: Questions on unfair dismissal laws included in the July 2002 Yellow Pages Small Business Survey**

**SECTION 4 : UNFAIR DISMISSAL**

Now I would like to ask you some questions about unfair dismissal laws. That is the laws which relate to the processes followed when dismissing a worker.

<p>Q11. ASK OR RECORD AUTOMATICALLY</p> <p>Firstly, could I just confirm that you employ one or more employees on a full time, part time or casual basis?</p>	<p>(Continue) Yes ..... 1 (Go to Q21) No ..... 2</p>
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<p>Q12a. Thinking about the processes and practices your business uses to, recruit and select staff, manage its workforce; and manage staff whose performance is unsatisfactory - which of the following statements best describes the extent to which unfair dismissal laws influence the operation of your business?</p>	<p>(CONTINUE) { The laws have a major influence on what we do ..... 1 The laws have a moderate influence on what we do ..... 2 The laws have a minor influence .... 3</p> <p>(GO TO Q19) The laws have no influence ..... 4</p>
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<p>b. Has your business sought advice on how to avoid exposure to unfair dismissal claims?</p>	<p>Yes ..... 1 No ..... 2 Don't know ..... 3 Prefer not to answer ..... 4</p>
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<p>Q13. As I read out each of the following statements please say whether the statement describes your business situation very well, somewhat well or not at all. At any stage you can say that you don't know or ask to move to the next question.</p>					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. Unfair dismissal laws influence the way in which my business recruits and selects workers. ....	1	2	3	4	5
2. Unfair dismissal laws influence the procedures that my business uses with workers whose performance is unsatisfactory. ....	1	2	3	4	5
3. Unfair dismissal laws influence the way in which my business supervises and manages workers	1	2	3	4	5
4. Unfair dismissal laws make management of my businesses' workforce more difficult than it would otherwise be.....	1	2	3	4	5
5. Compared with a situation where there were no unfair dismissal laws, unfair dismissal laws increase my businesses' costs.....	1	2	3	4	5
6. Unfair dismissal laws make it less likely that my business would dismiss a worker whose performance is unsatisfactory.....	1	2	3	4	5

<p><b>Q14. IF Q13 (1) = CODE 1 OR 2 (DESCRIBES WELL OR SOMEWHAT) CONTINUE – OTHERWISE GO TO Q16</b></p> <p>You said that unfair dismissal laws influenced the way in which your business recruits and selects workers. As I read out the following could you say whether they describe very well, somewhat well or not at all, how unfair dismissal laws influence your recruitment and selection practices and procedures...</p>					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. My business puts more employees on fixed term contracts.....	1	2	3	4	5
2. My business employs more casual workers and fewer permanent workers.....	1	2	3	4	5
3. My business employs more family and friends.	1	2	3	4	5
4. My business uses more formal screening of potential employees.....	1	2	3	4	5
5. My business uses longer probationary periods for new employees.....	1	2	3	4	5
6. Because of unfair dismissal laws there are certain types of job applicant that my business is less likely to hire.....	1	2	3	4	5

<p><b>Q15. IF Q14 (6) = CODE 1 OR 2 (DESCRIBES WELL OR SOMEWHAT) CONTINUE – OTHERWISE GO TO Q16</b></p> <p>Can I follow up on your response? Again please tell me whether the following describes your business very well, somewhat or not at all...</p>					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. Because of unfair dismissal laws we would be less likely to hire a person who has changed jobs a lot for no apparent reason.....	1	2	3	4	5
2. We would be less likely to hire a person who is currently unemployed.....	1	2	3	4	5
3. We would be less likely to hire a person who has been unemployed for more than one year...	1	2	3	4	5
4. We would be less likely to hire a person who has been unemployed for more than two years.	1	2	3	4	5

<p><b>Q17. IF Q13 (4) = CODE 1 OR 2 (DESCRIBES WELL OR SOMEWHAT) CONTINUE – OTHERWISE GO TO Q.18</b></p> <p>You said that unfair dismissal laws make it more difficult to manage your workforce. As I read out the following could you say whether they describe very well, somewhat well or not at all, how unfair dismissal laws make it more difficult to manage your workforce.</p>					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. Unfair dismissal laws reduce the authority my business has over its workforce .....	1	2	3	4	5
2. It takes longer to resolve issues associated with poor performance of a worker.....	1	2	3	4	5
3. Poor performance by one worker is more likely to adversely affect the performance of other workers	1	2	3	4	5
4. Unfair dismissal laws require more formality in dealing with workers and this makes communication between management and employees more difficult.....	1	2	3	4	5
<p><b>Q16. IF Q13 (2) = CODE 1 OR 2 (DESCRIBES WELL OR SOMEWHAT) CONTINUE – OTHERWISE GO TO Q.17</b></p> <p>You said that unfair dismissal laws influence the procedures that your business uses to deal with individual workers whose performance is unsatisfactory. As I read out the following could you say whether they describe very well, somewhat well or not at all, ways that unfair dismissal laws influence your businesses' procedures.</p>					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. My business uses formal procedures when dealing with workers whose performance is unsatisfactory.....	1	2	3	4	5
2. My business documents in writing an employees' poor performance. {Instruction to interviewer: If queried by respondent "document in writing" includes the taking of diary notes and other notes when an employee is warned or advised about poor performance, or unsatisfactory conduct}	1	2	3	4	5
3. My business provides a worker whose performance is unsatisfactory with a warning.	1	2	3	4	5
4. My business provides reasons to a worker whose performance is considered to be sufficiently unsatisfactory to justify termination.....	1	2	3	4	5
5. My business provides workers whose performance is assessed to be unsatisfactory with an opportunity to respond. ....	1	2	3	4	5



<p>Q18. <b>If Q13(5) = Code 1 or 2 (Describes well or somewhat) continue – others go to Q9</b></p> <p>You have said that unfair dismissal laws increase your businesses' costs. Thinking of the costs in time and money of complying with the law and reducing your businesses' potential for exposure to unfair dismissal claims. By how much, in dollars per year, do unfair dismissal laws increase your businesses' costs.</p> <p><i>(Instruction to interviewer: If response is that it is hard to quantify costs prompt by asking for best estimate. If response is that costs vary from year to year ask for cost in best year and cost in worst year and take midpoint. If a range is given code midpoint of the range)</i></p>	<p>_____ \$ per year</p> <p>Can't say ..... 1</p>
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<p>Q19. Which of the following best describes the unfair dismissal laws relevant to your business?</p> <p>Are you...</p>	<p>Mainly covered by Commonwealth law..... 1</p> <p>Mainly covered by State law..... 2</p> <p>Covered equally by State and Commonwealth law..... 3</p> <p>Don't know ..... 4</p>
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<p>Q20. The Australian Government made several changes to the unfair dismissal laws in August 2001. Which of the following statements best describes your reaction to those changes?</p>	<p>I am unaware of the changes so cannot comment. .... 1</p> <p>I am aware of the changes but do not think they will affect my business..... 2</p> <p>I am aware of the changes and think they will be good for my business..... 3</p> <p>I am aware of the changes and think they will be bad for my business..... 4</p>
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**NOW GO TO C1**

**CONTINUE IF HAVE NO EMPLOYEES**

<p>Q21. You said you currently have no employees. Has your business ever had any employees that includes both casual and permanent employees?</p>	<p>(Continue) Yes ..... 1                  (Go to Q24) No ..... 2</p>
<p>Q22. What was the maximum number of people your business employed at any one time?</p>	<div style="border: 1px solid black; width: 150px; height: 40px; margin-left: auto; margin-right: auto;"></div>
<p>Q23. Which of the following best describes the extent to which unfair dismissal laws were a factor in your businesses' decisions to reduce the number of employees?</p>	<p>A major influence ..... 1                  A moderate influence ..... 2                  A minor influence ..... 3                  Not an influence at all ..... 4</p>
<p>Q24. Which of the following statements describes how likely your business is to take on employees in the future?</p>	<p>(Continue) { Very likely ..... 1                  { Somewhat likely ..... 2                  (Go to Q28) { Unlikely ..... 3                  { Don't know ..... 4                  { Prefer not to answer ..... 5</p>
<p>Q25. You said that you are (ANSWER IN Q24) likely to hire employees in the future. Now I would like to ask you some questions about unfair dismissal laws and how you think they might affect your decisions to put on additional employees in the future.</p> <p>Which of the following best describes your opinion about the extent to which unfair dismissal laws would influence your decisions about whether to take on employees in the future.</p>	<p>(Continue) { The laws would have a major influence ..... 1                  { The laws would have a moderate influence ..... 2                  { The laws would have a minor influence ..... 3                  (Go to Q28) { The laws would have no influence ..... 4</p>

Q26. You said that unfair dismissal laws might influence future hiring decisions. I would like to follow up by asking some more detailed questions about the nature and extent of that influence. As I read out each of the following statements please say whether the statement describes your business situation very well, somewhat well or not at all.					
	<b>Describes Very Well</b>	<b>Describes Somewhat</b>	<b>Does Not Describe At All</b>	<b>Don't Know</b>	<b>Prefer Not to Answer</b>
1. If my business puts on employees, unfair dismissal laws would influence the way in which my business recruits and selects workers .....	1	2	3	4	5
2. If my business puts on employees, unfair dismissal laws would influence the procedure that my business uses with workers whose performance is unsatisfactory.....	1	2	3	4	5
3. If my business puts on employees, unfair dismissal laws would influence the way in which my business supervises and manages those employees	1	2	3	4	5
4. If my business puts on employees, unfair dismissal laws would make management of my businesses' workforce more difficult than it would otherwise be .....	1	2	3	4	5
5. If my business puts on employees then, compared with a situation where there were no unfair dismissal laws, unfair dismissal laws would increase my businesses' costs .....	1	2	3	4	5

<p><b>Q27. If Code 1 or 2 in Q26 (5)</b></p> <p>You have said that if you were to put on an employee then, unfair dismissal laws would increase your businesses' costs. Thinking of the costs in time and money of complying with the law and reducing you businesses' potential for exposure to unfair dismissal claims. By how much, in dollars per year, do you think that unfair dismissal laws would increase your businesses' costs if you put on an employee?</p> <p><i>(Instruction to interviewer: If response is that it is hard to quantify costs prompt by asking for best estimate. If a range is given code midpoint of the range)</i></p>	<p>_____ \$ per year</p> <p>Can't say ..... 1</p>
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<p><b>Q28.</b> If you were to put on employees, which of the following best describes the unfair dismissal laws relevant to your business?</p> <p>Are you...</p>	<p>Mainly covered by Commonwealth law..... 1</p> <p>Mainly covered by State law ..... 2</p> <p>Covered equally by State and Commonwealth law..... 3</p> <p>Don't know ..... 4</p>
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<p>Q29. The Australian Government made several changes to the unfair dismissal laws in August 2001. Which of the following statements best describes your reaction to those changes?</p>	<p>I am unaware of the changes so cannot comment. .... 1  I am aware of the changes but do not think they will affect my business. .... 2  I am aware of the changes and think they will be good for my business. .... 3  I am aware of the changes and think they will be bad for my business. .... 4</p>
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