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Making it easier to fire workers really does lower the unemployment rate [1]

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We're all used to the idea that making the labour market more flexible, which is a code for making it easier to fire workers, lowers the unemployment rate. I think we've all also seen the counter-argument that this is tosh. It's never quite laid out why it is but it must be so there. Fortunately we've now got some more empirical evidence to bolster our case about flexibility increasing employment [3]:

> Using 1981?2009 data for the 50 states, this article examines the relationship between economic freedom and the unemployment rate, the labor force participation rate, and the employment-population ratio. After controlling for a variety of state-level characteristics, the results from most specifications indicate that economic freedom is associated with lower unemployment and with higher labor force participation and employment-population ratios.

The advantage of American data is that the various states are rather closer together in their overall culture than are the (fewer) countries of Europe. It's thus easier to see the effects of variations in economic freedom without having too much confounding data. But there we have it, greater economy freedom, including those hiring and firing laws, leads to lower unemployment. We should thus be deconstructing some of our own wasteful regulations and laws around this point in order to lower our own unemployment rate.

I'd also make a rather more speculative point. Why is it that people don't want to believe this finding? As above, we've known it for a long time but there's a great reluctance to believe it. And I think it's because people really don't understand the job churn in the economy.

If you think that a rise in unemployment of 100,000 means that 100,000 people have been fired then you might well think that making it harder to fire people will lead to a reduction in the number of people in unemployment. But the truth is that this isn't what causes a rise in unemployment at all. There are always 100,000 people getting fired. More than that actually: some 3 million jobs, or 10% of the total, are destroyed in the UK economy each year. That's that destruction part of capitalism. This rate doesn't, particularly, rise in recessions nor fall in booms either. That's a reasonably constant rate at which the economy destroys the things that people do for a living.

What does change in a recession is how many new jobs are being created: thus the balance, between those fired and those hired, changes. The actual unemployment numbers that we see are the end result of this complex process. If unemployment rises by 100,000 in one month it's not the result of 100,000 more people being fired. It's the result of 100,000 of that (roughly) 250,000 who get fired every month not finding a new job. Unemployment isn't best thought of as a result of people being fired therefore: it's a result of people not getting hired.

At which point the economic freedom argument begins to make intuitive sense. The more economic freedom, the less regulation stopping you from doing things, the more things will get tried and done.The

less the cost of firing an undesired worker the more of them will be hired: demand curves do indeed work that way. So far so true: my speculation is that those who don't get this point are those who don't really understand why unemployment occurs. It simply isn't because people get fired because people get fired all the time. It's that they don't get rehired at times which is what causes unemployment.

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