The path to full employment

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Introduction

In the 1980s, we began to live in economies rather than societies or communities. It was also the period that unemployment persisted at high levels in most OECD countries. The two points are not unrelated. Unemployment arises because there is a lack of collective will. It does not arise because real wages are too high or aggregate demand too low. These are only proximate causes, if causes at all. The lack of collective will has been the principal casualty of the influence of rationalism In this paper the proximate cause of unemployment is shown to be a persistent deficiency of aggregate demand. But the underlying cause is that the rise of free market ideology has meant that we are n longer prepared to bear some costs ourselves to ensure others have employment. The only way we will return to full employment is if the costs and benefits of economic activity are shared. The public sector must be the vehicle to restore the collective will.

Several writers, including Layard, Nickell and Jackman, (1991), have argued that the persistently high unemployment experienced by OECD countries is sourced in the labour market institutions and government welfare.

Mitchell (1996) argues that the two decades of high unemployment are due to excessively restrictive fiscal and monetary policy stances by OECD governments. This has resulted in GDP growth in OECD countries generally being below that required absorbing the labour force and labour productivity growth. The battle against unemployment has been largely abandoned in order to keep inflation at low levels.

He also substantiates the link between movements in the unemployment rate and capital expenditure. The restrictive policy pushed real interest rates to high levels for extended periods that resulted in lower than otherwise private capital expenditure. Further, public capital expenditure cuts exacerbated the situation. As growth declined and unemployment rose, the resulting high cyclical budget deficits led to further cuts in public capital spending

The pursuit of balanced budgets also narrowed the range of policy instruments used. It is now very difficult to raise income or other taxes to provide flexibility to the budget position, although effective marginal tax rates have been increased through more extensive means testing of welfare benefits. Accordingly, there has been an excessive reliance on monetary (interest rate) policy despite the bluntness of this instrument.

Orthodox economists have overlooked this reality. Piore (1979, p.10) argues that:

> Presumably, there is an irreducible residual level of unemployment composed of people who don't want to work, who are moving between jobs, or who are unqualified. If there is in fact some such residual level of unemployment, it is not one we have encountered in the United States. *Never in the post war period has the government been unsuccessful when it has made a sustained effort to reduce unemployment.* (emphasis in original)

In this paper, it is argued that the solution to persistent unemployment is for the Government to act as a Buffer Stock Employer, plus the reintroduction of incomes policy. Further deregulation of the wages system cannot be justified.

Unemployment, real GDP growth, labour productivity and labour force growth

The August 1997 statistics revealed an unemployment rate of 8.7 per cent. Australia has now experienced the longest period of high unemployment in its history. Some interesting aspects of this history are summarised in Table 1.

Table 1 Summary Labour Market Statistics

Labour market measures as at February	1978	1983	1988	1993	1997
Unemployment-vacancy ratio	13.4	44.4	10.4	35.0	14.5
Part-time/Full-time ratio (%)	14.8	17.0	19.0	22.6	24.8
Part-timers who want to work more (%)	13.5	19.9	19.9	30.3	27.1
Unemployed who want full-time work (%)	83.1	87.3	80.1	84.1	78.9

Source: ABS *The Labour Force*, Cat. No. 6203.0

Since 1978, there have been around 2.4 million jobs created of which over 50 per cent have been part-time. In that time, the labour force has grown by 2.7 million. The unemployment-vacancy ratio clearly indicates that there has been a persistent demand constraint imposed on the labour market. The rise in importance of part-time work has often been interpreted as a reaction to the desire by workers for more flexible work arrangements. The number of part-time workers who want to work more has more than doubled which indicates that the demand constraint and structural changes towards casualisation have been forced upon the work force. This is reinforced by the steady percentage of unemployed workers who desire full-time work. The slight dip in the recent years must be seen in the context of movements in hidden unemployment, which we summarise in a later section. We conclude that the underlying unemployment rate is significantly worse than indicated by official figures.

Table 2 GDP growth gaps for Australia

Period	Average Labour Force Growth (% per annum)	Average Productivity Growth (% per annum)	Average Real GDP growth (% per annum)	Average Growth Gap (% per annum)
1973-78	1.91	0.16	0.79	1.34
1978-83	1.57	-0.86	-2.69	3.4
1983-88	2.30	1.05	4.23	-0.88
1988-93	0.38	3.21	2.81	2.22
1992-97	1.02	1.57	2.24	-0.25

For the unemployment rate to remain constant, real GDP growth must be equal to the sum of labour force and labour productivity growth, **other things equal**. In the midst of on-going debates about labour market deregulation, minimum wages and taxation reform, the most salient, empirically robust fact that has pervaded the last two decades is that the actual GDP growth rate has rarely been above this required rate. Tables 2 substantiates that point.

The Waste of High Unemployment

A major thrust of the free market ideology is to eliminate the so-called microeconomic inefficiencies. In their 1991-92 Annual Report, the Industry Commission in Australia estimated that an upper limit on the costs of these inefficiencies would be around $22 billion or $1250 per capita per annum. This was an overestimate that the Industries Commission has since backed away from.

The scale of these losses is dwarfed when they are compared with the macroeconomic inefficiency of unemployment that are shown in Table 3. The losses from persistently high unemployment are more than 30 per cent more than these Industry Commission estimates. The calculations do not allow for any labour force responses to the additional jobs and thus ignore the scale of hidden unemployment. In that sense they understate the magnitude of the losses. The hidden unemployment estimates presented in the next section would indicate that the daily losses from macroeconomic inefficiencies are more likely to be in the range of $156 million or $3100 per capita per annum more than twice the alleged microeconomic inefficiencies.

Table 3 The Losses from High Unemployment

Year	Unemployment Rate (per cent)	Added Jobs at a 2 per cent Unemployment rate	Daily GDP Bonus $m per day	Added GDP Per Capita $ per annum
1972	2.7	37768	4.0	108
1973	2.3	17692	1.9	51
1974	2.7	44170	4.7	126
1975	4.9	182816	20.0	525
1976	4.8	176062	19.7	512
1977	5.7	235998	26.4	677
1978	6.4	283126	32.7	829
1979	6.1	268928	32.0	802
1980	6.0	270552	32.3	799
1981	5.7	254464	30.8	752
1982	7.1	354300	42.8	1026
1983	9.9	554836	68.7	1627
1984	8.9	493282	63.3	1480
1985	8.2	453280	58.8	1357
1986	8.1	463610	59.6	1356
1987	8.1	475146	62.2	1393
1988	7.1	409318	53.9	1187
1989	6.2	343758	44.9	972
1990	7.0	424642	55.3	1180
1991	9.5	639600	83.8	1766
1992	10.8	751916	101.3	2111
1993	11.0	771902	107.8	2223
1994	9.7	677282	97.1	1983
1995	8.6	593496	84.9	1712
1996	8.6	598900	86.9	1730

Source: ABS AUSSTATS and author's calculations.

Hidden Unemployment

Mitchell *et al.* (1995) published estimates of hidden unemployment based on a regression method first developed by Perry (1971). Updated estimates are provided in Table 4. Recorded unemployment has doubled since 1978, but this alone grossly understates the severity of the decline in the labour market. Over the same period of there has been a 39 per cent rise in hidden unemployment.

Table 4 Males, Females, Persons - Unemployment and Hidden Unemployment (000's)

February	Males		Females		Persons	
	Recorded Unemployment	Hidden Unemployment	Recorded Unemployment	Hidden Unemployment	Recorded Unemployment	Hidden Unemployment
1978	256.4	104.9	226.4	254.7	482.8	359.6
1983	431.6	116.4	308.7	310.6	740.3	427.0
1988	356.0	132.3	288.8	303.3	644.8	435.7
1993	633.4	184.1	410.4	426.3	1043.8	610.4
1997	513.6	143.0	392.5	357.5	906.1	500.5

Table 5 provides a comparison between the actual reported unemployment rate and the "adjusted unemployment rate" which adds the hidden unemployed to the numerator and to the labour force. Once these discouraged workers are included, the underlying unemployment rate is around 14.4 per cent, significantly higher than is reported in the official figures.

Table 5 Actual Unemployment Rates and Adjusted Unemployment rates (per cent)

February	Males		Females		Persons	
	Unemployment Rate	Adjusted Unemployment Rate	Unemployment Rate	Adjusted Unemployment Rate	Unemployment Rate	Adjusted Unemployment Rate
1978	6.2	8.5	9.7	18.7	7.5	12.3
1983	9.8	12.2	11.8	21.1	10.6	15.7
1988	7.5	10.1	9.1	17.0	8.2	13.0
1993	12.7	15.8	11.4	20.8	12.2	18.0
1997	9.8	12.2	9.8	17.2	9.8	14.4

Adjusted Unemployment Rate = Actual and Hidden Unemployment divided by the Potential Labour Force.

Low Pay

In the late 1970's and early 1980's, there was a spirited academic debate in Australia about the relationship between real wages and unemployment (see, for example, Riach and Richards, 1979, and references therein). This issue disappeared during an era of wage moderation and a declining wage share, but then the rigidity of the centralised wages system was challenged in the mid-1980's. The focus shifted from the *absolute* level of money (and real) wages to the capacity of the wages system to accommodate an increased degree of wage flexibility, through a change in the structure of *relative* wages. Since 1987, measures have been adopted to both deregulate and decentralise the wages system, culminating in the acceptance of Enterprise Bargaining by the IRC in October 1991, which was based on the view that enterprise specific wage outcomes promoted improvements in workplace efficiency.

The OECD has been influential in the debate through its *Jobs Study* (1994) in which the benefits of labour market liberalisation are asserted, via stronger growth and higher average levels of employment, that offset the social implications of wider wage differentials and the associated growth of low wage jobs.

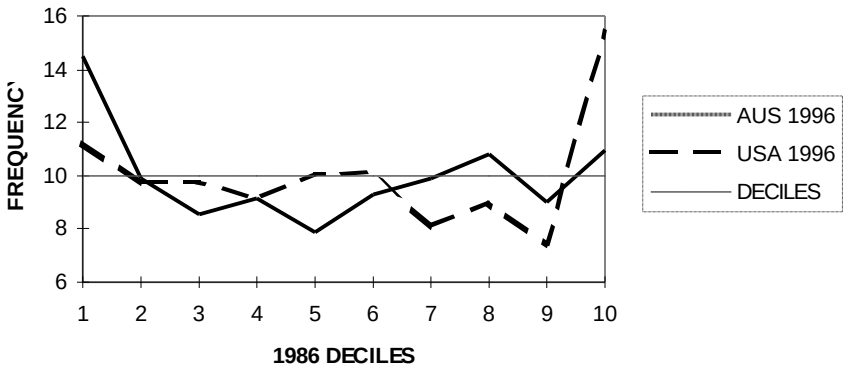
The recent strong growth of employment in the USA and low unemployment rate appears to support the claim that the prerequisite for sustained employment growth and falling unemployment is a deregulated system of wage determination with a relatively low level of minimum wages.

When the US and Australia wage distributions are examined, Australia was relatively more successful in generating low wage full-time jobs for both males and females and in aggregate than the USA over the decade since wage indexation was abandoned, in the context of the net increase in full-time employment for each country and their corresponding 1986 wage distributions (see Figure 1). This is revealed by the respective 1996 frequencies associated with the first two deciles of the 1986 Australian full-time distribution, with the second decile corresponding to 78% of the median (see Gregory 1996 for similar

computations for the period 1976-91). Thus, in a relative sense, low wage employment in Australia has not been inhibited by the compressed wage distribution in Australia (see Table 6). The computation procedure is described by Morris, Bernhardt and Handcock (1994) and Watts (1997a). The increase in the dispersion of the male full-time wage distribution has not been confined to the era of Enterprise Bargaining, however, (see Watts and Mitchell, 1990).

Using educational attainment as a proxy for skill level, the ratio of the unemployment rates of low and high skilled is much higher in the USA, but the definitions of high and low skill do not coincide with those used for the Australian data (see Nickell, 1995, and Watts, 1997b). Unfortunately the data post-1992 is not strictly compatible.

FIGURE 1 COMPARISON OF DEFLATED FULL-TIME WAGE DISTRIBUTIONS: AUSTRALIA & USA 1986-96



Source: Australian data: Weekly total earnings of adult employees by occupation, *Distribution and Composition of Earnings and Hours* (Cat. 6306.0) - 1986.
Transition from Education to Work (Cat. 6227.0) - 1996.
USA data: Usual weekly earnings of employed full-time wage and salary workers by occupation sex race and Hispanic origin 1986, 1996 (unpublished data).
Current Population Survey, BLS 1986, 1996.

The low skilled who have a higher rate of unemployment may have a greater incidence of discouraged unemployment in one country, so that relative rates of unemployment do not necessarily reflect relative rates of excess supply. Easy access to welfare benefits, other than unemployment benefits, for example, may reduce their labour force participation rate, thereby reducing their unemployment rate. Consequently employment to population ratios (E/P) were also computed.

Table 6 Comparison of full-time earnings distributions by gender: Australia and USA, 1986-1996

	1986			1996		
	D1/D5	D9/D5	D9/D1	D1/D5	D9/D5	D9/D1
Australia						
Persons	0.69	1.64	2.37	0.65	1.67	2.57
Males	0.70	1.60	2.40	0.60	1.70	2.70
Females	0.75	1.51	2.00	0.70	1.50	2.20
USA						
Persons	0.49	1.90	3.87	0.47	2.20	4.63
Males	0.50	2.00	4.30	0.50	2.00	4.30
Females	0.50	1.90	3.50	0.50	2.10	4.20

Source: See Figure 1.
Note: Columns represent decile ratios, so that D1/D5 is the ratio of the first to the fifth decile (median).

The ratio of unemployment rates for Australia has increased marginally over the decade, but the employment ratio has declined signifying a relative improvement in employment opportunities for the low skilled (see Watts, 1997b). The figures for the USA (1986-92) signify the opposite trends with the relative employment outcome improving for the high skilled but the unemployment ratio improving for the low skilled. The ratios exhibit volatility from year to year, so it would be unwise to draw any firm conclusions from these data.

Table 7 Wage and full-time employment growth rates by gender: Australia & USA: 1986-96

	Weekly Earnings Growth (%)		Full-Time Employment Growth (%)	
	Males	Females	Males	Females
Australia	65.3	67.9	1.5	23.7
USA	28.3	44.1	12.5	20.1

Source: See Figure 1.

The Australian full-time wage distribution is more compressed than the corresponding US distribution, but has exhibited more *relative* flexibility with respect to low paid employment over the last decade, so that reducing the structure of awards and discontinuing Safety Net adjustments is not justified (see also Gregory, 1996, p.93).

Overall full-time employment outcomes have not been consistently superior in the USA (see Table 7). The unemployment rate differential between Australian males and females and their US counterparts worsened relatively over the decade, yet Australian women experienced a faster rate of full-time employment growth. In addition, Australian median, weekly earnings growth for male and female was markedly greater than for their USA counterparts.

Houseman (1995) quoted in Gregory (1996) documents the decline in average real wages per hour over the period 1979-93 of US employees by all levels of education, except for college graduates. Gregory (1996) concludes that the US population has not become better off relative to Australians, despite faster employment growth. Mishel (1995) argues that a relative wage reduction of low skill workers in the USA implies a high explicit cost per job associated with the increased employment.

Given the apparently inconsistent pattern of employment change of males and females across the two countries, a more plausible source of the uneven full-time employment growth for males and females in Australia is a combination of occupational segregation and structural change with the associated growth of part-time employment. The overall cause of the inadequate employment growth has been the absence of sufficient demand in the economy, due to the failure of the government to adopt stimulatory monetary and fiscal policy.

A model of full employment and price stability

Mitchell (1996, 1997) proposes the Buffer Stock Employment (BSE) model as a permanent solution to unemployment. The government would act as a buffer stock employer and continuously absorb workers displaced from the private sector. Price stability would be maintained by paying these 'buffer stock' employees the award minimum. The BSE proposal would automatically increase government employment and spending as jobs were lost in the private sector, and decrease government jobs and spending as the private sector expanded.

The model implies rising budget deficits. Why should we ignore the deficit implications? The 1996 Nobel Prize winner for Economics, William Vickrey (1996) argues that "the 'deficit' is not an economic sin but an economic necessity. Its most important function is to be the means whereby purchasing power not spent on consumption, nor recycled into income by the private creation of net capital, is recycled into purchasing power by government borrowing and spending. Purchasing power not so recycled becomes non-purchase, non-sales, non-production, and unemployment".

Foreign capital markets judge the economy by what it can deliver by way of long-term investment opportunities. A fully employed economy with lower crime rates and increased purchasing power would be appealing, even if the budget deficit is higher.

To implement the change, the government would have to raise deficit finance from debt issue even though taxes for higher income earners could be increased. Bond sales play an important role in supporting the overnight interest rate that is exogenously set by the Reserve Bank. Deficit spending without Treasury bond sales would generate excess reserves in the banking system, so that government debt helps to maintain a positive overnight interest rate for private banks. The idea of crowding out in this real world environment is meaningless.

Where would the work be? Work is often associated with the jobs that profit seeking private firms offer in return for wages, but if income is only linked to this narrow concept of work, many of the working age population will remain unemployed. Beyond the scope of this paper is the wider debate about what will constitute work in the next century. The BSE model provides an ideal solution to both the current unemployment problem and the future need to extend the range of employment activities that society deems to be worthy of reward by income.

Numerous service jobs could provide immediate benefits to the society, when filled by BSE workers. These include urban renewal projects and other environmental and construction schemes (reforestation, sand dune stabilisation, river valley erosion control and the like), personal assistance to pensioners, assistance in community sports schemes, and many more.

Opponents of the scheme have argued that substantial numbers of the current unemployment are unskilled and require retraining. The argument, however, is often accompanied by solutions such as minimum wage cuts, which allegedly, would provide the incentive to employers to take these unskilled workers on. The

argument is inconsistent. Either the unskilled require extensive re-training, or there are circumstances where they can work if offered an opportunity. There is no evidence that reducing minimum wages increases total employment. There is strong evidence that firms lower hiring standards and provide the required training with employment opportunities as the labour market tightens.

Under the BSE scheme, wages are paid which correspond to the bottom of the wage structure. A healthy person should quickly develop adequate skills for these types of jobs. Where training is required, the BSE scheme would provide integration with public sector training schemes and at least give the trainees guarantees after the training period.

What would this cost? Assuming that full employment coincides with 2 per cent unemployment, the BSE scheme would lead to around 625,000 people gaining public sector employment ignoring hidden unemployment (in June 1997). At the ACTU Living Wage level of $400 per week, on-costs of 20 per cent, an average income tax rate of 25 per cent, and an average unemployment benefit payment of $161 per week, the extra employment would cost the Government in net terms around $7.4 billion over a year. Assuming an average productivity level, the extra outlays would result in a lower Budget deficit as a proportion of GDP.

The costs are overstated because they ignore the extra expenditure effects that arise as the buffer stock employees increase their incomes. Over a year, this spending would create extra employment in the private sector, reduce the buffer stock employment levels, and increase tax revenue and reduce outlays.

The unemployment benefits scheme would be abolished. Anyone unemployed would be required to work if they wanted an income. While beyond this paper, the other categorical transfer schemes would also be replaced by a negative income tax (see Mitchell, 1997).

The relative costs of this scheme are best illustrated by referring back to Table 3. At average productivity levels, the current cost to Australia in foregone production with the unemployment rate above 2 per cent is a staggering $87 million dollars per day at the current unemployment rate (ignoring hidden unemployment). These daily losses are permanent and at the same time the Government also foregoes tax revenues. Taxes amount to about 23 per cent of GDP. The lost taxes therefore amount to around $7.3 billion per year. The BSE proposal is thus a very cheap option. In addition, the high unemployment places increased costs on the health system, and is associated with increased family breakdown and higher crime rates.

The administration costs would be non-zero, but so are the administrative costs associated with high unemployment, which extend well beyond the costs of running the unemployment benefits system. The administrative costs of running the health system, the judicial system and the family court system would all be lower under the BSE proposal.

If the increased spending led to depreciation, through rising imports, a comprehensive incomes policy would be required to reduce inflationary pressures. Everyone would have to agree to allow real depreciations to stick, as part of the return to the collective will. The scheme itself would not force up labour costs.

Incomes Policy

Watts (1997a) argues that a deregulated wages system, founded on the capacity to pay, promotes static (allocative) inefficiency by retarding resource re-allocation. It also leads to dynamic inefficiency because the presence of low wage labour encourages the adoption by firms of low productivity, labour intensive techniques and does not provide the incentive for physical capital investment and employee training (see also Hancock, 1987, Harrison and Bluestone, 1989 and Buchanan and Callus, 1993).
High-sustained rates of capital investment are critical both to high rates of economic activity and employment as well as ongoing increases in labour productivity. Thus it is questionable whether a

deregulated and decentralised wages system promotes a high sustainable rate of employment growth and real wage increase.

Further, under Enterprise Bargaining, the authorities have foregone any direct influence over the *absolute* level of aggregate wage outcomes, but there is the latent threat of interest rate increases and ultimately increases in unemployment, if the rate of money wage inflation is deemed to be too high.

An incomes policy based on wage adjustments geared to changes in the levels of prices and productivity, not only provides an environment of certainty with respect to per unit labour costs, but enables a higher sustainable rate of employment consistent with modest inflation.

Conclusion

Australia's persistently high unemployment rate is largely the outcome of demand deficiency. The Buffer Stock Employment model proposed by Mitchell should be seriously debated. Further wage deregulation is not warranted, rather an incomes policy should be reintroduced..

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