THE PRICES AND INCOMES ACCORD: EMPLOYMENT AND UNEMPLOYMENT

F.H. Gruen

The 1983 Newcastle Lecture in Political Economy
Discussion Paper No. 75
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* I would like to express my thanks to Kim Chohan for her very valuable research assistance.
The Prices and Incomes Accord,

Employment and Unemployment

Abstract

1. This paper looks at incomes policies overseas to see how successful they have been and the conditions which seem to make it more likely that incomes policies are successful.

2. Short-run incomes policies do not seem to have achieved much change in the rate of growth of money wages in Britain, USA and Canada. Longer term policies have been successful in a number of countries including the Netherlands, Sweden, Norway and Austria - but in three of these four countries such success has crumbled after some years.

3. Successful incomes policies are assisted by a common view of the country's economic situation - a process helped by frequent exchanges of views on economic trends among economic technicians, business, labour and government.

4. The size and organisation of pressure groupups is also important. Where pressure groups are highly centralised, have power to commit their constituent organisations (as in Austria and Scandinavia) feasible incomes policy bargains
are far more likely to be achieved.

5. The second section of the paper, entitled "The uphill task of reducing unemployment", dissects employment changes in various ways. It is pointed out that, even though the Labor Party's promise of creating half a million jobs in three years would exceed the greatest number of jobs ever generated in any three year period (at least since figures were kept in this form from 1967 on), only some 15% of these jobs would have been available to reduce either open or disguised unemployment - if this job target had applied to the last three years (the remainder being required to employ the growing population).

6. A dissection of changes in unemployment is used to show how the stop-go growth of the last decade has led to the ratcheting up of Australian unemployment levels.

7. There is, in fact, considerable danger of the labour market becoming more segmented with the unemployed being very much at the end of the queue - behind most new entrants to the labour force, behind the hidden unemployed and behind immigrants attracted to the country during brief periods of high economic activity.
8. A prices and incomes accord is likely to face significant short run, hopefully teething, problems. But even if it does become possible to isolate the current excessive wage settlements in certain key areas, fundamental longer term problems remain.

9. If wage pressures resume as soon as the growth rate of employment begins to exceed the population rate — as they did in 1979/81 — we are confronted with a very depressing scenario which would condemn us to low long term economic growth and high unemployment levels for the foreseeable future.

10. Some observers despair of a centralised wage setting system achieving the requisite degree of wage restraint and advocate a more decentralised "market determined" system. Reasons are given why a decentralised system of collective bargaining may not, in fact, achieve any greater degree of wage restraint.
Introduction

Keith Hancock, the Vice-Chancellor of Flinders University, organised a symposium in 1979 to discuss "the potential contribution of incomes policy to alleviating Australia's economic problems."

In the first sentence of his introductory statement Keith Hancock sums up the principal argument used in favour of such policies "...Advocacy of incomes policies has typically stressed the shortcomings of alternative weapons for dealing with contemporary economic problems." Or, as Blandy put it in his concluding address at the same symposium: "there is substance to the view that incomes policy is a difficult, even dangerous, route for liberal democracies to take. But are the alternatives less unpalatable, less difficult and less dangerous?"

Incomes policies then are a bit like old age. Their main virtues are the unattractiveness of their major alternative. However, can we make an incomes policy work? This paper looks firstly at incomes policies overseas to see how successful they have been and the conditions which seem to make it more likely that incomes policies are successful. Secondly I look at Australian employment-unemployment relationships to ascertain the proximate conditions needed to reduce unemployment. Thirdly I want to discuss the likelihood - or should I say the possibility - that the Prices and Incomes Accord can give us the environment in which we can reduce unemployment significantly.
I. Overseas Incomes Policies

(a) How Successful?

The effects of incomes policies are by no means easy to disentangle from overseas experience. Not surprisingly, there have been a great number of studies at various levels of sophistication. Statistical attempts at quantifying the effects of incomes policies are only possible in the case of temporary or "on-off" incomes policies. As Andersen and Turner (1981) point out "even for such policies there is no one correct and generally agreed method for assessing the net impact on inflation" - or on the rate of growth of money wages for that matter. "However, most estimates indicate that temporary incomes policies have had a rather small effect, though the actual magnitude varies widely according to the method of estimation employed. Moreover, because prices and wages appear to rebound once policy is relaxed, there are no strong grounds for supposing that incomes policies have, in the past, led to a significant and durable reduction in inflation." These conclusions are based on evidence relating primarily to the U.S., U.K. and Canadian economies and correspond to similar findings for the U.S. by Pencavel (1981) and for the U.K. by Henry (1981) - though, as Barry Hughes (1982) has pointed out, the evidence is not wholly conclusive, for reasons given in Artis (1981).
If one wants to examine the effects of longer-term incomes policies, one is necessarily driven to cross-country comparisons - with all the substantial reservations which such cross-country comparisons must obviously be subject to. Barry Hughes (1982) has looked at the experiences of the 20 most important OECD countries to indicate which have performed best - or perhaps one should say least badly. He compares two periods 1959/68 to 1972/73 and 1974 to 1981. The two variables he considers to arrive at his standard are changes in inflation and changes in real GDP. After leaving out four countries because of special factors Hughes does find a rough average relationship suggesting that a five percentage point reduction in the annual inflation rate could be "bought" by a one percentage point reduction in the average annual GDP growth rate.1 His interest is in ascertaining which countries have done better than this average relationship. He finds that "the successes seem to be above all Norway, followed some way behind by Germany, Austria and perhaps the United States. Norway has been able to contain inflation on average over the period with the aid of about a two percentage point smaller reduction in growth" than the average experience would suggest. Hughes points out that over an eight year period that cumulates to a very large 15 to 20 percent higher GDP than would otherwise have

1. The countries left out are Spain, Italy and Greece who were politically unstable during the period and Japan because its unusually large productivity record had to come to an end sooner or later. Coe (1983) finds a statistically significant correlation between changes in growth and in inflation for all OECD countries for the periods 1970-81 and 1973-81 but not for earlier periods.
been the case. On the negative side are the U.K., Italy, Spain and Greece. These are countries which have experienced above average increases in inflation rates without achieving a relatively better growth performance. What stands out in this group - according to Hughes - is the pronounced lack of consensus. While such a cross-country comparison can be suggestive, it can rarely be more than that. There are too many uncontrolled - and uncontrollable - variables in a 20 economy comparison over two fixed time periods to carry conviction that the investigator has succeeded in isolating the effect of incomes policy and of consensus on the growth-unemployment-inflation performance of these different economies.

One's scepticism is reinforced by the very substantial changes which have taken place in the income policy success stories over the years. Again quoting Barry Hughes: "The striking thing about post-war advocacy of incomes policy is the way in which the star countries have changed over the years. For a long time the Netherlands was held up as an example, partly because of an agreement to cut real wages as a restorative to international competitiveness in the early 1950's. Then, when that experience ran into difficulties in the early 1960's, Sweden took over the role of trendsetter. But by the late 1960's that country too found its incomes policy disintegrating. Now Norway and Austria are put forward as model countries, particularly the latter since the Norwegians began to disagree in the late 1970's. It is a striking confirmation of my present point that neither
country rated a mention in Ulman and Flanagan’s survey of leading European incomes policy experience, a book published as recently as 1971."

In other words - macro-economic success by means of incomes policies has not been maintained in the different countries. Countries which seem to have an outstanding record have frequently had substantial setbacks after some years. One may wonder whether the recent stepping down by Kreisky, the Austrian Chancellor, may not lead to a similar deterioration in Austria’s outstanding record.

(b) Preconditions for success.

The preconditions for a successful incomes policy are perhaps best summed up in one word which is so often used by proponents of incomes policies: "consensus." In this context consensus basically means two things - firstly a common view of the economic situation and secondly a willingness to restrain temporarily the full exercise of market power by the various pressure groups in the economy. I shall discuss each of these aspects in turn.

(i) A common view of the economic situation.

In both Austria and Norway - the two countries currently held up as examples - there is a great deal of consultation and conferring between representatives of employers, employees and economic technicians. In Austria there is an officially sanctioned "exchange of views" on economic policy every three
months - an exchange which has taken place regularly for fifteen years. Economic forecasts are provided by Treasury, the Central Bank and the Economic Research Institute. The principal instrument of incomes policy in Austria is a 12 member Joint Wages and Prices Board on which government, employers and employees have equal numerical representation. However, the central guidelines-type decisions taken by the Board must be unanimous. It seems very likely that these decisions are heavily influenced by the economic forecasts received.

In Norway wage negotiations are carried on through centralised bargaining between the Trade Unions and the Employers' Federation - after a technical expert Committee under the chairmanship of the Norwegian Statistician has reported on likely trends under alternative wage and farm price scenarios. The Norwegian bargaining process has always paid a great deal of regard to the country's overall economic situation. It worked well until the late 1970's when negotiations between the central groups reached a deadlock, government arbitrated and imposed a prices and incomes freeze. Since then the Norwegian performance has been more lacklusture - with economic growth rates of zero or less than 1% per annum. For a more detailed discussion of Austrian and Norwegian incomes policies the reader is referred to "The Australian Economic Review", 1/83 p.14-28 and the references cited there.

A common way of looking at the economic situation seems to be of crucial importance in getting an incomes policy to work. Some of us were optimistic shortly after the summit that
Australia may get to a situation where we can emulate the sort of economic interchange of views and the building up of consensus which has been found beneficial in some European countries such as Austria and Norway. As Colin Crouch (1982) puts it in a perceptive sociological analysis of trade unions, if a government-trade union cooperative arrangement becomes deeply entrenched, "as it has, for example, in Austria or was for a long time in the Scandinavian countries, one may almost lose sight of the bargained nature of it. Unions and government become accustomed to a relationship in which, within a context of close cooperation over policy, they gain many little victories and make many little concessions over an extended time period". Alas, it takes more than one summit to build up the sort of consensus which exists when incomes policies are successful.

Nor do we really know what it is that leads to successful consensus of this type, to the institutionalisation and peaceful resolution of industrial conflict. We do know that many countries - including Austria and the Scandinavian countries - which now have very successful resolution of industrial conflict have previously had many years of intense and frequently violent industrial conflict.

For consensus to prevail it may be helpful to have a small economy. In countries such as Norway, Austria and Sweden (with populations of 4, 7.5 and 8.25 million respectively) it is obvious that they have to compete on world markets and can price themselves out of these world markets. It is quite obvious to any literate inhabitant of such countries that they cannot
prosper by being self-sufficient and inward looking.

The contrast with Australia is marked. Here we are accustomed to wide swings in export prices and export profitability and some 5 to 10% increase in costs does not seem likely to affect the volume of Australian exports - at least in the short run. In other words, there is likely to be a much weaker short run link between export volume and internal costs here than in Austria and Scandinavia where alternative, more competitive sources of supply for the countries' export industries are an ever-present reality.

By contrast Australian discussion is often hypnotised by the geographical size of the country - and ignores the size of the economy, which is roughly on a par with that of Holland. No serious social commentators in the Netherlands would suggest that one could, "by means of selective protectionist measures....keep imports low during a reflationary programme" - as a group of La Trobe University economists suggested to Labor's Parliamentary Caucus recently.2

(ii) The size and nature of pressure groups - and the exercise of restraint.

The second factor likely to affect the ability to achieve consensus concerns the size, number and organisation of the relevant pressure groups. If the groups which need to be accommodated in any bargain are small in number and the negotiators on behalf of each group can "deliver", incomes policies are much more likely to succeed. The sheer number of pressure groups is important partly because the process of finding mutually acceptable solutions becomes much more difficult as the number of participants who need to be included in the negotiations rises, and partly because, as Olson (1982) has argued, the larger and more encompassing pressure groups are, the more likely it is that they will consider the effects of their actions on the economy as a whole.

If pressure groups are organised into highly centralised institutions which have power to commit their constituent organisations, they are much more likely to take into account the effect of their actions on productivity growth and on the economy as a whole. When pressure groups are numerous and relatively small they stand to gain most from redistribution - from gains made at the expense of consumers, of tax payers or the community as a whole, whilst large, all-encompassing groups tend to benefit mainly when the cake as a whole is growing.

Samuel Beer (1982), in his study of the British system discussed this issue in connection with what he called "the benefits scramble" - i.e. the growth in the number of
beneficiary groups as welfare state programmes grow in number and complexity: "The source of the problem is not lack of knowledge, but the structure of the situation, which continues to have compelling force even when participants recognize its tendencies. The numerical pluralism makes it difficult, if not impossible, to make and enforce a bargain, tacit or explicit, that would achieve moderation."

Both in Austria and in the Scandinavian countries trade unions and employers are organised into highly centralised institutions - institutions which have real power over their constituent members. Thus in Austria and Norway the central trade union body has control over the strike funds and has to approve strike action by individual trade unions. Trade union claims are thus automatically co-ordinated in advance and the trade union movement as a whole implicitly establishes some priorities among the various claims which it advances. Again, employers of any size in these countries are legally obliged to belong to the employers organisations - who bargain on their behalf with central trade union federations.

Contrast this with the position in Australia. Here the ACTU has much more difficulty - and much less power - both to coordinate the timing of claims and to prevent leapfrogging either by individual unions (e.g. the Builders Labourers' Federation) or in some hard core problem areas (e.g. the Kurnell oil refinery). As Braham Dabscheck (1983) put it recently "Both sides of industry, following self-interest, will come to agreements outside the terms of a system of centralised wage
determination. When challenged on their actions they will claim that their respective positions fall within the safety valve of "special and extraordinary conditions" contained in the summit's final communique. Furthermore, the ACTU is unlikely to discipline a member union for achieving a wage breakthrough nor will the Confederation of Australian Industry censure a member employer. The ACTU is a voluntary organisation of member unions and would, in all likelihood, use increases gained outside the centralised system as a justification to flow-on increases to other workers within the centralised system." In the light of the recent ACTU Congress this seems at present an unduly harsh judgement. A feature of the September 1983 ACTU Congress was the obvious commitment of some large left-wing unions such as the AMFSU to the Accord, to a centralised wage setting system and their opposition to some sectional claims which could destroy this system.

Dianne Yerbury (1981), discussing the previous wage indexation period, pointed out that centralised wage guidelines "face a difficult task in Australia - probably more daunting than in most other western-style economies - because of the constitutional constraints on the Federal government and the Commission, the duality of powers and the related multiplicity of systems and tribunals". Since that time inter-governmental working parties have achieved somewhat more consistency; in most States the relevant legislation now provides for state tribunals to have regard for national decisions and there are regular meetings of heads of tribunals. But it would still be true that Australia's multiplicity of trade unions, and of employer
organisations - not to mention the multiplicity of industrial
tribunals at both the Federal and the State level - makes it much
more difficult firstly for a common overall viewpoint to prevail
and for some central wage guidelines to hold.

Apart from a more common outlook, and reduction in the
number of pressure groups to a few peak organisations who can
effectively bargain on behalf of their members, the key to
success in incomes policies seems to be moderation in the
exercise of one's bargaining strength over the course of the
business cycle. As the Australian Economic Review put it, with
regard to Austria: "The preparedness of unions to exercise wage
restraint in order to maintain jobs is a key element, though the
sharp reduction in the number of foreign workers in the mid
1970's also played a part in the maintenance of low unemployment
rates."

Grubb, Jackman and Layard's (1983) study of wage rigidity
and unemployment in 19 OECD countries (including Australia)
strongly suggest that there is a relationship between real wage
rigidity in these countries and the growth of unemployment after
1973 and that real wage rigidity differences "explain" changes in
unemployment much better than the actual differences in the real
shocks confronting the different economies.
II  The Uphill Task of Reducing Unemployment

(a)  Some Past History

If Labor is to achieve its economic objective to any extent it must substantially reduce the disastrously high level of unemployment existing at present. As I will attempt to show later, this will be an exceedingly difficult task requiring not only skill on the part of the new Government in gradually stimulating the economy but also reforming key institutions so as to make sustained economic growth possible again.

Before assessing these issues in more detail, I would like to examine Australia's employment and unemployment record since the halcyon days of the later 60's when we had full employment and inflation rates of 3 or 4 percent.

For the purpose of examining our recent past and likely future employment prospects I have constructed a number of tables which enable us to dissect employment changes in various ways. For instance, by comparing Columns III and IV, the Tables enable us to find out quickly whether the amount of employment growth in any one year is greater or less than that necessary to employ the growing population (at unchanged participation rates). Columns V and VI tell us whether the difference between the growth in population and in employment has taken the form of changes in the amount of unemployment on the one hand, or in the participation rate on the other.
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Year ended July, Preliminary Figures ABS Cat. No. 6202.0. N Data are for fiscal years.

Source: ABS Cat. Nos. 6203.0, 6204.0, 3402.0, 3101.0.

Notes: Columns I + II = III; Columns IV + V = III + VI = VII
## TABLE II: CHANGES IN MALE EMPLOYMENT, POPULATION, PARTICIPATION RATES AND UNEMPLOYMENT (000's)

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* Year ended July, Preliminary Figures, ABS Cat. No. 6202.0

N Data are for fiscal years.

Sources: See Table I.

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* Year ended July, Preliminary Figures ABS Cat. No. 6202.0.
K Data are for fiscal years.

Sources: See Table 1.

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Sources and Explanations as in Tables I to III.

P, M and F being respectively persons, males and females.
I want to draw attention to a number of features of these tables:

(i) In Table IV the 17 year span available has been broken into 4 sub-periods. The first - from 1967 to 1973 - represents the period of predominantly full employment. At that time the economy generated on average about 14 percent more jobs than could be filled from population increase (at unchanged participation rates). It was a period of high levels of immigration and of substantial increases in female paid work force participation. At the same time, the male participation rate declined slightly (probably reflecting the long term trend towards early retirement). On average, unemployment was rising by around 4,000 per year during these years.

(ii) The second period - from 1974 to 1978 - is a period of recession when job generation fell short of the numbers required to employ the growing population by a yearly average of around 77,000. Slightly more than three-quarters of this shortfall (or 58,000) found its way into higher unemployment rates with the remaining job shortfall leading to lower participation rates. The lower participation rates for 1974 to 1978 were largely recession induced. They have led to the phenomenon of the hidden unemployed (documented by Stricker and Sheehan) - people who, when they cannot get jobs, leave the labour force rather than continue to look for employment. Two other features of this period should be mentioned explicitly. Firstly, the relative growth of part-time jobs. It suggests that the profit squeeze operating during a recession leads to the
substitution of part-time for full-time jobs. Secondly, the sharp drop in net migration which fell to less than half the level during the previous 6 year period. At its lowest point (in 1976) net permanent and long term migration was about one-seventh of the levels reached in 1969 and 1970.

(iii) In retrospect, the 1979 to 1981 period of large resource investments must be seen as a period of relative prosperity. Job generation during this 3 year period exceeded population growth by some 6 percent, leading to some small reductions in the level of male (though not female) unemployment. Another feature of this period which deserves comment is the very substantial increase in net long term and permanent migration which seems to have been induced by the employment growth of the 1979 to 1981 period.

(iv) By almost any criterion, the deterioration in the labour market in the last 2 years dwarfs anything we have experienced in the preceding 15 years. The unemployment increase in these 2 years exceeds the increases recorded during the 5 year period 1974 to 1978. The reduction in total employment in the 12 months ended July 1983 is 4 times larger than the reduction in any of the previous 16 years (cf Table I).

3. Regressing changes in the number of full-time jobs on changes in the number of part-time jobs one gets, surprisingly, a significant negative relationship (a Student T value of 2.3 for quarterly changes over the period August 1974 to November 1982 - using seasonal dummies as additional explanatory variables). One would normally assume that changes in both types of jobs would be positively correlated, reflecting underlying changes in the level of economic activity. One finds, for instance, a significant positive relationship between changes in the number of full-time male and female jobs (for the same period and using the same seasonal dummies as in the previous regression mentioned in this footnote).
In percentage terms it is the largest reduction for thirty years.

(v) The Labor Party's campaign promise to create some 500,000 jobs in three years may not sound very ambitious, given the levels of open and disguised unemployment in the economy. But it exceeds by some 37,000 the greatest number of new jobs generated in the economy in any three year period since 1967.4

(vi) 500,000 jobs over a three year period averages out at 166,700 jobs a year. In the year ended July 1983, 146,800 jobs would have needed to be generated in order to employ the growing population (at unchanged participation rates). In other words, even if 166,700 jobs had been generated in 1982/83, only around 20,000 of these jobs would have been available to reduce either open or disguised unemployment.

(vii) From Table I, which looks at labour market changes for men and women together, we find that over this 17 year period there have been only four years (i.e., 1968/9, 1969/70, 1972/3 and 1979/80) when the amount of employment generation exceeded that required to cater for the growing population. In the aggregate over these four boom years, employment generation exceeded population growth by 236,100. Yet unemployment declined by only 22,600 in the aggregate during these years. In other words some 90 percent of the excess job generation contributed to higher

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4. In terms of rates of growth, 500,000 extra jobs implies a growth rate of 8% in the number employed, such a triennial rate of growth was achieved from 1967 to 1972 - but has not been achieved since. During the investment/resource boom years (1978/81) the triennial growth rate was slightly below 6.5 percent.
participation rates rather than to lower recorded unemployment.\(^5\)

(b) Unemployment - A Possible Dissection of the Changes

Unemployment is the difference between the number in the labour force and the number in employment. Similarly changes in unemployment can be pictured as the result of changes in the labour force and changes in the level of employment. We can decompose changes in the labour force as resulting from changes in the population and changes in the participation rate. Similarly we can decompose changes in employment into changes in output and changes in productivity per worker employed. In symbols:

(1) \( U = LF - E \)
(2) \( \Delta U = LF - \Delta E \)
(3) \( \text{Let } LF = \text{Pop. } \frac{LF}{\text{Pop}} \)
(4) \( \text{and } E = \text{G.D.P. } \frac{E}{\text{GDP}} \)

5. An examination of Tables II and III shows that this is an area where male and female employment experiences diverged substantially. Over this 17 year period, female participation rates have tended to rise whilst male participation rates have generally declined. (This is particularly true of older males). As a result, in the three boom years when male employment growth exceeded population growth, the decline in male unemployment was substantially greater than this excess. The trend increase in female participation rates shown in Table III, seems to have slowed down over these 17 years.
After some manipulation we can then write:

\[ \Delta U = \Delta \text{Pop.} \frac{\Delta F}{\text{Pop.} F} + \text{Pop.} \frac{\Delta F}{\text{Pop.} F} - E \left( \frac{\Delta \text{GDP}}{\text{GDP}} - \frac{\Delta \text{GDP}}{E} - \frac{E}{\text{GDP}} \right) \]

where:

\[ U = \text{unemployment} \]
\[ LF = \text{the Labour Force} \]
\[ E = \text{employment} \]
\[ \text{Pop.} = \text{Population (between the ages of 15 and 64 years)} \]
\[ \frac{LF}{\text{Pop.}} = \text{the Participation Rate} \]
\[ \text{GDP} = \text{Gross Domestic Product} \]
\[ \frac{\text{GDP}}{E} = \text{Labour Productivity} \]

In words, (5) can be expressed as follows: The change in unemployment equals the change in population times the participation rate (Pop. \( \frac{\Delta F}{\text{Pop.} F} \)) plus the change in the participation rate times the population (Pop. \( \frac{\Delta F}{\text{Pop.} F} \)) minus employment multiplied by the difference between the percentage growth rate of GDP and the percentage growth rate in labour productivity \( (E \left( \frac{\Delta \text{GDP}}{\text{GDP}} - \frac{\Delta \text{GDP}}{E} - \frac{E}{\text{GDP}} \right)) \).

Let us briefly examine each of these expressions and their behaviour. The change in population, it might be argued, has little to do with economic conditions, but is the result of demographic factors and depends on the number of people reaching
adulthood and the age of retirement respectively. However, as we saw in the last column of Tables I to IV, migration responds, with a lag, to changes in Australian employment conditions. According to a regression I have run, 30% of the change in the labour force resulting from changing participation rates shows up in a compensating - presumably migration induced - change in the workforce in the next twelve months.6

The second term - i.e. the change in the participation rate times the population (Pop_\frac{\Delta LF}{Pop}) - has been the subject of many recent empirical studies which I do not propose to summarise here.7 Suffice it to say, it is now well recognised that changes in participation rates are, to some degree, induced by changing employment conditions. What this means, of course, is that the measurement of unemployment is always, to some extent, arbitrary, subjective and imprecise. Using the ABS definition of unemployment, there is a group of "discouraged workers" or "hidden unemployed" not included in the official statistics.

In recent times the participation rate peaked at 61.9% in September 1980 and has since declined to just below 60% in January 1983 and again in the preliminary August 1983 figures.

6. The regression using annual data of the first two terms of expression (5) above gives the following result:

$$\Delta \text{Pop.} \frac{\Delta LF}{\text{Pop}} = 118.5 + 0.297 \text{Pop.} \Delta (\frac{\Delta LF}{\text{Pop}})_{t-1}$$

$$(2.22)$$

$${R}^2 = 0.26 \quad \text{D.W.} = 1.32$$

7. For the most recent contribution to this literature, which does, in fact summarise a good deal of it, I refer to McMahon and Whittingham (1983).
Given that the civilian population aged 15 years and over is approaching 11.5 million, a one percentage point change in the participation rate will change the number counted as unemployed by some 115,000.

The third term gives the increase in the number employed. It is obtained by multiplying the difference between the GDP growth rate and the labour productivity growth rate by the number employed. Obviously it is the main proximate factor likely to reduce unemployment. How much employment growth there is depends not just on the economy’s growth rate but on the difference between that growth rate and the percentage increase in productivity per person. During an upswing, such as the one we expect in 1983/84, productivity growth per person is likely to be high. This is partly because hours worked per person normally rise at such a time of economic recovery and partly because output per hour worked also tends to increase. As a result, employment grows less rapidly during periods of recovery from a deep recession than one would normally expect from such an output growth rate.

According to Statement No. 2, Treasury expects output to expand by some 5\% from June 1983 to June 1984. If the trend labour productivity growth rate since 1973/74 of around 1.8\% prevailed in 1983/84, employment could be expected to increase by some 200,000 (i.e. given the 5\% output expansion). However, Treasury expects the labour productivity growth rate to be 3.5\% at such a time of recovery from deep recession - reducing employment growth to less than 100,000. Given both population
increases and the possibility of some increase in the participation rate as economic activity improves, it is not difficult to see why Statement No. 2 foreshadows some increases in unemployment in spite of a 5% June-on-June growth rate.

What is needed to reduce unemployment is a sustained improvement in our economic growth performance. The type of stop-go growth performance of the last ten years cannot reduce unemployment since:

(i) stop-go growth leaves us with higher rates of population increase which result from the immigration decisions taken during the brief periods of satisfactory economic activity;

(ii) high short-run labour productivity growth rates when coming out of recessions reduce the rates of employment growth which would normally accompany GDP growth rates of, say 5% or more;

(iii) many "hidden unemployed" tend to re-enter the workforce and secure jobs before those counted as officially unemployed.

There is, in fact, considerable danger of the labour market becoming more segmented with the unemployed being very much at the end of the queue - behind most new entrants to the labour force, behind the hidden unemployed and behind immigrants attracted to the country during brief periods of high economic activity.8

8. A decomposition of changes in unemployment rates according to equation 5 is given in Appendix 1.
III. The Accord - Prospects and Alternatives

It is time to return to the main topic. Can prices and incomes policies help us in our current situation? The conclusion which I draw from my wide-ranging (rambling?) account of overseas incomes policies is that they can certainly not be regarded as a cure all - a quick fix - for the stagflationary problems which confront us. That does not necessarily mean that they can make no contribution to the solution of our problems. However, they can only make such a contribution if an incomes policy leads to some pretty fundamental changes in both attitudes among and the organisation of Australia's pressure groups - among what the Austrians characteristically call the "social partners".

The lesson from countries with relatively decentralised union movements such as the U.K. and Australia seems to be that even if it becomes possible to achieve consensus during a crisis (e.g. a sudden, large increase in unemployment) it is exceedingly difficult to make such consensus stick at a later, more normal stage.

In a paper given to the 1979 Labor Economists Conference, the present Minister for Industrial Relations, Ralph Willis, distinguished between two types of trade union cooperation with an incomes policy. The first is a purely temporary form of cooperation (perhaps better to be labelled acquiescence) resulting from an emergency situation of the kind experienced in
the U.K. in the mid-seventies and - it seems to me - the situation in Australia in the second half of 1982 when unemployment was rising on the average at around 28,000 a month (i.e. about 0.4% a month).

The second type of trade union cooperation - which Willis implicitly regards as a more permanent form of cooperation - is one where the basic aim of incomes policy "is to bring about a more equitable distribution of income, wealth and economic power." During the course of his paper Willis recognised firstly that "if the redistribution policies are too ambitious" the likely result will be action which "would defeat the objective of restoring full employment" and secondly that "unions may in some circumstances be required to make the sacrifice of refraining from pursuing claims that in the absence of the policy (i.e. a successful prices and incomes policy-HFG) they would feel confident of winning".

The critical question is whether acceptable movements to what Labor sees as greater equity can also be economically realistic in the sense of working in the longer run and - AT THE SAME TIME be acceptable to the trade union movement - in the way in which they have worked and been accepted in Austria for at least 12-15 years. The Accord speaks of Prices and Incomes Policies "designed to bring about an equitable and clearly discernible redistribution of income".

If greater equity means redistribution away from profits, then there is no scope for such redistribution at present and for some time into the future. On the contrary there needs to be a
sizeable redistribution towards profits so that we can (1) get back to the sustained economic growth rates of the pre-1973 period, or alternatively (2) attain an increased ability to withstand the greater shocks which the external world has imposed on the Australian economy in the last decade.⁹

The issue of "greater equity" and how to achieve it requires much more hard-headed discussion than it has so far received. As was pointed out in the 1983 National Wage Case, attempts to compress real income differentials by means of plateau indexation or flat increases as the normal form of adjustment for inflation, produces "strong resentment from those affected" and creates pressure for restoration of relativities. No doubt some redistribution is possible through the tax and income maintenance system, but the glib agreement that the economic cake is currently distributed inequitably hides a great deal of disagreement as to how it should - or can - be redistributed more equitably.

The problems the prices and incomes accord is likely to encounter can be grouped into those of the short run and the longer run. In the short run it is necessary for centralised wage guidelines to become established - just as the indexation decision of the Arbitration Commission had to run the gauntlet of militant union action after the April 1975 National Wage Decision

⁹. On the other hand, given the Treasury scenario and forecasting framework from Statement No. 2, profits should increase substantially in 1983/84. I refer to the 5% June-on-June growth rate, accompanied by a 3.5 percent increase in productivity per person and an increase in earnings which lag behind the increase in the expenditure deflators (reflecting in turn the introduction of the Medicare Levy).
which established the indexation regime. The current "maverick" settlements in the Heinz factory and in the building industry may be more difficult to contain than parallel problem areas in 1975.

The principles enunciated in the 1983 National Wage Case appear very well designed to re-establish a centralised wage policy. Provided the various principles are adhered to by the parties, Australia may be added to the list of countries with successful centralised systems. However this would require very substantial changes in the autonomic behaviour of individual unions and, at this stage, one cannot reasonably assess the probability of success.

But even if it does become possible to isolate or even reverse some of the excessive settlements, longer-term wage pressures may manifest themselves again as soon as economic recovery commences. If wage pressures resume as soon as the growth rate of employment begins to exceed the population growth rate - as they did in 1979/81 - we are confronted with a very depressing scenario which would condemn us to low long term economic growth and high unemployment levels for the foreseeable future. This vicious circle can only be broken by a Prices and Incomes Accord if the trade union movement acts in the long term interests not only of their members but also of their potential members.

Given that the maintenance of real living conditions of the currently employed is likely to be accorded first priority by the trade union movement, it should at least become the second priority to increase the rate of growth of employment. This
implies a moratorium on union actions which raise real labour costs - and thus undermines the likely rate of growth of employment and of economic activity. However unions may require more tangible evidence that such wage restraint on their part will, in fact, increase the rate of growth of employment. Perhaps the newly-created EPAC - which is supposed to concern itself with the Prices and Incomes Accord - can examine how such connections can best be established and guaranteed.

Some observers - including Mr John Howard, the Deputy Leader of the Liberal Party (and his former Department, the Treasury) - despair of a centralised wage setting system achieving the requisite degree of wage restraint and advocate scrapping the system - or at least downgrading it - in favour of a more decentralised "market determined" system. It is not at all clear that a decentralised system of collective bargaining would achieve a lower average rate of growth of real labour costs. Firstly, collective bargaining encourages certainly in the short run - a greater reliance on trials of strength between the two sides of industry. Even if average money wage growth were no greater, the ability of unions to raise labour costs during such a trial of strength has to be allowed for. Secondly, collective bargaining in a heavily unionised country (such as Britain) does not seem to achieve greater wage restraint.

In a recent historical study of British unemployment in the interwar period, two U.K. academics Sean Glynn and Alan Booth (1983) show that trade unions generally succeeded in maintaining money wages in the face of very adverse economic circumstances.
"Although the trade unions tended to ignore the unemployed, the persistence of heavy unemployment and declining union membership does not appear to have had a disastrous effect on bargaining power. The unions struggled to preserve the increased wages and shorter hours gained before 1922, and in general they succeeded. There were, of course, many instances of wage cuts, but the fact remains that between 1923 and 1937 average weekly earnings remained almost constant in money terms. The most striking aspect is that industrial and regional wage differentials showed little tendency to increase. Over this same period, retail prices fell by about 15 per cent. The general strike may be seen in one aspect as a major test case on wages and with the exception of the miners, it was not a defeat. Money wages were maintained, real wages for the majority rose, and, on the whole, unions were able to avoid trading wages against employment. There are several reasons why trade union strength and solidarity prevailed in the face of highly adverse economic conditions and the sharp reduction in membership. Ultimately, however, the strength of organised labour rested upon the payment of unemployment benefit, which in turn reflected political power and the political and industrial modus vivendi......Of course, it was widely accepted in academic, financial, and government circles that "wage inflexibility" or "excessive wages" was the basic cause of unemployment and other economic difficulties........There is no doubt that by 1930 British industry faced higher unit costs than in 1914, and that there had been a serious loss of international competitiveness........In the absence of flexibility, greater, regional variations, and higher labour mobility might have developed, but with limited change in the real world money wages were not flexible, and devising alternative policies from this premise. An application of the classical, or free market, solution was never really approximated in the face of formidable constraints. In theory, prices and wages can always adjust to the available capital stock; in practice, this was increasingly less likely after 1914."

In other words, a more atomistic market may be possible in say the ASMAN economies, but is likely to lead to extremely bitter and protracted struggles in heavily unionised economies such as Britain or Australia. In the end, there is no guarantee that a wholesale or even a partial dismantling of a centralised
system would achieve the desired flexibility of real wages.

Even a heavily nonunion labour market - such as the U.S. - is still far removed from an idealised auction-type market. As Daniel Mitchell (1983) argued recently "Indeed, in the late 1970s and early 1980s, there developed in the U.S. a considerable literature on "implicit contracting" in the labor market. In essence, this literature purports to explain wage stickiness in nonunion firms - where no contract is available to explain it - on the theory that an implicit contract exists between employer and employee which has much the same effect as an explicit contract. Regardless of the validity of the explanations offered in the implicit contracting literature, the empirical fact remains: wage stickiness seems to exist regardless of institutional arrangements."

The conclusion which I draw from these international - and intertemporal - comparisons is that the centralised/decentralised wage determination debate which is currently under way here does not come to grips with our fundamental problems - how to make our economy more responsive to outside shocks, (alternatively how to reduce real wage resistance to real outside shocks), how to recover the sustained economic growth performance of earlier years. Just as I argued earlier that a prices and incomes policy is not likely to be a cure-all for our stagflationary problems, neither - I would maintain - is an abolition of our centralised wage settling procedures.
APPENDIX I - A decomposition of unemployment changes

This Appendix provides a decomposition of unemployment changes - using unemployment changes in percentage points as the basic unit. It updates tables originally prepared on a calendar year basis in Discussion Paper No. 32, Economic Stabilisation in Australia: Inflation and Unemployment by Malcolm Gray and Fred H. Gruen, Centre for Economic Policy Research. This formula used for the table is:

\[
\frac{\Delta U}{LF} \times 100 = 100 \frac{\Delta Pop}{Pop} + 100 \frac{\Delta LF}{LF} - \frac{\Delta Pop}{Pop} - 100 \frac{E}{LF} \frac{\Delta GDP}{GDP}
\]

\[
= 100 \frac{\Delta U}{LF} - \frac{\Delta GDP}{GDP} \times \frac{E}{LF}
\]

For derivation of this formula see page three of the above paper by Malcolm Gray and Fred H. Gruen.
## APPENDIX : TABLE A

Annual Percentage Changes in Unemployment and Their Decomposition
Australia

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<tr>
<th>Years</th>
<th>Average Annual Percentage Change in Unemployment</th>
<th>Decomposition of Changes into</th>
<th>Population (15 and over)</th>
<th>Participation Rate</th>
<th>Domestic Output*</th>
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**Sources:**
- The Labour Force, Australia. ABS Cat. Nos. 6203.0, 6204.0.
- Quarterly Estimates of National Income and Expenditure, Australia. ABS Cat. No. 5206.0.

* Domestic Output and Labour Productivity calculations based on Gross Domestic Product.
### APPENDIX: TABLE B

Annual Percentage Changes in Unemployment and Their Decomposition
Australia

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**Sources:** The Labour Force, Australia. ABS Cat. Nos. 6203.0, 6204.0.
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ABS Cat. No. 5206.0.

*Domestic Output and Labour Productivity calculations based on Non-Farm Gross Domestic Product.*
Bibliography


