

## 11

# Australian Labour Markets, Economic Policy and My Late Life Crisis

*RG Gregory*

Keith and I were born a handful of years apart but Keith always seemed to me to be much older, much better educated, much wiser and to embody more of the attributes that a top class academic needs. I still hold these views which were formed when I graduated from the University of Melbourne. They are largely a reflection of the truth, partly a reflection of Keith's extraordinary rapid rise up the academic ladder and partly a reflection of the fact that at the beginning of a career, a few years difference in age is very significant in terms of younger colleagues putting slightly older colleagues on pedestals.

When I was young, Keith was the brightest star among Australian labour economists. I watched as he glittered and shone and I admired his strong interest in economic history, his ability to write clearly and well, his ability to marshal an argument on his feet, his independence of thought and his concern for detail and precision.<sup>1</sup> I am ashamed to say that I am still extremely impressed that he was a full professor within five years of completing his PhD. I think it took me that long to produce three published papers.

Keith and I are fairly close in terms of our views of how the labour market works and in terms of worrying about where the labour market is going, what is happening to Australian society and what should be the research and policy priorities of the labour economics profession. We share

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<sup>1</sup> A typical example of Keith's outstanding attributes can be found in his Distinguished Labour Economist Essay, Hancock, K, 2004, 'Economists and Australian Wage Policy Before World War II', 7(4) *Australian Journal of Labour Economics* 411-438.

common values as you might expect of labour economists of our generation.

In many ways, the Australian labour market is not evolving in the way that I would like. My guess is that Keith feels much the same level of disappointment with the reduction in employment opportunities for the low skilled, the growing geographic and social pockets of the disadvantaged, and the increasingly heavy reliance on the welfare state. These are not recent problems. They are of long standing and have proved to be very unresponsive to various policy attempts to solve them. What I have learnt over the past decade or so about the low level of policy effectiveness in this area has made me feel less at ease with the role of economic advisor than at any other time in my life.

There are other sources of unease. As will become clear, my labour market and welfare research outcomes seem to be leading me in policy directions that sit uneasily with me. My hopes for a return to a more equal Australia in which all groups who want to work are fully employed and the evolution of the Australian labour market are in conflict. My value structure, my research and the outcomes of the economy are not fitting well together. On the assumption that perhaps Keith feels much the same way, here is my view of the key intellectual and policy problem that economists like Keith and I face.

The two most important economic events that helped form the intellectual and policy stances of Australian labour economists of our vintage occurred in the 1930s. These were the great depression and the Keynesian response. To a large extent the emotional commitment to economics of our cohort stems from the enormous tragedy and hardship of the 1930s and the promise of Keynesian economics. It was impossible for us to read Keynes and the Australian White paper on Full Employment without becoming excited and optimistic about the future.

The depression and the Keynesian revolution imprinted on our minds two important ideas. One was that the state should directly take responsibility for full employment. The other was that full employment could be achieved by sensible macro policies that focused on the levels of government expenditure and taxation, sensible monetary policy not overly concerned with inflation and sensible macro wages policies that kept productivity and wage growth more or less in balance.

These ideas were reinforced by our experience of the first quarter century after World War II. The briefest look at Australian economic outcomes was sufficient to maintain the excitement and belief that everything was all right. Full employment and good economic opportunities seemed the norm. Of course there was some unemployment, although the numbers now seem unbelievably low. In the 1966 issue of the first Australian Bureau of Statistics (ABS) Labour Force Survey the unemployment rate was 1.1 per cent. The number of unemployed married men was 19,000. Those receiving unemployment benefits were probably about one fifth of these numbers. There was some poverty, mainly confined to rural areas

and among the old, but everything seemed to be manageable. The Australian Gross Domestic Product (GDP) growth rate was high. Australia was absorbing large numbers of immigrants that were adding richness and diversity to our culture and we were building large cities and developing first-rate universities. They were good years.

Then, in the 1970s, the labour market began to shift direction and change in fundamental ways that are still occurring and are of fundamental importance to us all. I believe that the importance and origins of these changes are still not adequately appreciated, although their power to influence economic outcomes and policy ideas seems to be increasing with every passing year.

I will even go further and argue, in terms of the impact on basic beliefs among economists and the impact on policies for employment, wages and welfare, that the underlying trend shifts that began in the 1970s match the long run impact of the 1930s. The poverty of the 1930s encouraged government interventions into labour markets and the creation of an expanded welfare state. The General Theory encouraged the belief that macro problems could be solved by macro policy instruments. The changes beginning in the 1970s are leading our beliefs and policies in the opposite direction. As economists we are moving away from the belief that macro unemployment problems necessarily have traditional macro policy solutions. We are moving away from the Keynesian short run cyclical analysis of employment outcomes to a longer run and more complex perspective. We are moving towards less state responsibility for individual economic outcomes and less state responsibility for creating a more equal and egalitarian society.<sup>2</sup>

It may seem a bit extreme that I equate the influence of the 1970s with the influence of the 1930s but this view seems to be gaining a stronger hold over me with each passing year. One obstacle I face in convincing sceptics of the comparability of the two periods is that the adverse economic effects of the 1930s were concentrated in time and therefore very noticeable. To take one example, male civilian employment in Australia fell by about 13 per cent between 1929 and 1932. Since the 1970s, however, male full-time employment has fallen 20 per cent, relative to population growth; a fall that is larger than that observed in the 1930s.<sup>3</sup> The fall since the 1970s, however, has been spread over three decades and, because of the welfare state, part-time employment and employment among women, the employment loss has not generated the same level of economic hardship. Nevertheless, this large male full-time employment loss is changing

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2 I am not really sure about this. To date policy has increasingly focused on helping families with children and delivered more income to pensioners but, on the other hand, policy seems to be creating more unequal access to good quality schooling and health care.

3 Perhaps measuring the impact of the 1930s in terms of employment loss is not quite right because those who worked in farming lost income rather than employment. For a discussion of the 1930s see the essays in Gregory, RG and Butlin, NG, 1988, *Recovery from the Depression*, Cambridge University Press.

fundamentally the nature of our society and the way we think about the role of economic policy and institutions.

There are other obstacles I face in convincing sceptics of the importance of the changes that began in the 1970s. One is that there has been a long delay between the beginning of the underlying shifts in the labour market and the gradual shift in economic ideas and policy responses. The policy effects of the 1970s have only become very noticeable almost two decades later in terms of the retreat from centralised wage fixing, macro employment policies and traditional industrial relations policies. The policy response in other important areas, for example, to wind back the welfare state, is only now just beginning about three decades later. Policies to reduce minimum wages in real terms are also only just beginning.

Another obstacle I face is that the adverse labour market shifts of the 1970s did not spread to all workers. Indeed, some parts of the labour market, especially the more skilled, have continued to make income gains along much the same path as before the 1970s. Those seeking part-time jobs have also done extremely well in terms of expanded opportunities. Consequently, not everyone sees, or experiences, the adverse effects that began in the 1970s. The situation is different from the 1930s experience when almost everyone was affected badly.

Finally, some will argue that collapsing many of the changes that have occurred since 1970, and attributing them to one decade, will inevitably exaggerate the importance of the 1970s but I think the basic idea is all right. A more serious point, I suppose, is that during the 1970s I was in my 30s and for an academic economist the age span 30 to 40 are usually the golden years. Whatever is absorbing, an individual's intellectual energy during this crucial decade will usually influence their thinking over their life span.<sup>4</sup> A younger person today focused on his research interests may not share my views of the importance of the 1970s just as an academic, two decades older than I am, will be reluctant to agree that any post World War II changes could match the influence of the 1930s, the period when they were young.

The plan of the rest of the chapter is as follows. The next few sections provide a brief, data-orientated economic history of the period since the mid-1970s to illustrate the key propositions. I then turn to some concluding remarks.

### **The productivity shocks of the 1970s**

Apart from the concern with the outbreak of inflation, and some focus on increases in unemployment, it was not generally thought at the time, that the 1970s would lead to fundamental changes in the labour market. There were a number of reasons why this period was not widely seen as a major turning point.

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<sup>4</sup> This was the period that I first began thinking of the bi-furcation of the labour market and began to develop my ideas on hysteresis.

First, when the 1970s began, the new Labor government strengthened and extended policies that were typical of the post-war years. Widows' pensions were expanded into sole parent benefits. Disability pensions were expanded. The real levels of unemployment benefits were increased. Then, to meet the inflation upsurge, the wage-fixing system became more centralised and more use was made of the Industrial Relations Commission.

Secondly, the full extent of the underlying shifts in technological change – that involved both a slow down in aggregate productivity growth, and a movement of demand against the unskilled – largely went unnoticed, overshadowed by arguments about the extent of the productivity response to the large real wage increases that were occurring. The large real wage increases of the mid-1970s focussed economic debate on the implications of moving up the demand curve for labour, in response to real wage increases. Attention was diverted away from the more fundamental and longer lasting adverse shifts of the labour demand curve. Employment of unskilled men in particular was falling during the 1970s, not primarily because average real wages had increased, but because the demand curve for unskilled labour was shifting as a result of technological change and increased competition from imports.

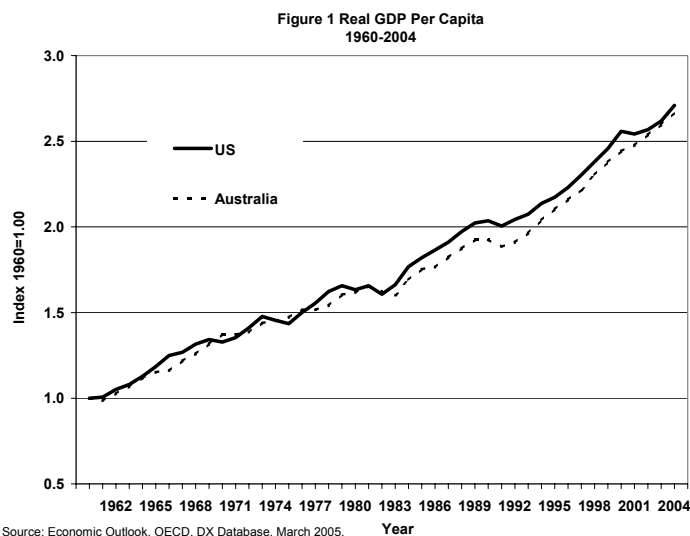
Thirdly, the initial employment shifts against unskilled labour were disguised as many males, upon losing employment, moved on to Veteran Pensions before the age of 65 years. As a result, unemployment rate increases were muted and labour macro-economists, much like today, focussed too much on the ABS unemployment rate and not enough on the number of males relying on the complete range of income support programs provided by the government.

Finally, not all the data pointed to fundamental changes in the economy. If attention is confined to the evolution of real GDP it is not possible to see why I am stressing fundamental labour market changes in the 1970s. Consider Figure 1 opposite which plots an index of the level of real GDP per capita for Australia and the United States. Real GDP per capita is a measure of the ability of each economy to produce goods and services for its citizens. Each series is indexed at 1960 to take the value 100.

It is very noticeable that the two GDP series are almost identical. It appears, at least in terms of changes in GDP per capita, that Australia can be regarded as a state of the United States. This close similarity of the series reminds us that any discussion of Australia should be put into a world context, even though this is not done here. For our purposes though, the feature to note is that there is no obvious break in the GDP per capita series during the 1970s. There is a slight slowing of growth but it is not that noticeable and certainly nothing approximating the 1930s experience.

So where is the empirical evidence that the 1970s marks the beginning or a new era for the Australian labour market? The evidence, developed over the next few pages, consists of two parts. First when the evolution of aggregate real wages and employment are placed side by side the sudden, dramatic and continuing disjuncture that began in the 1970s is clear. The

data cannot be explained by the usual macro-analysis without building into the analysis major shifts in the nature and rate of technological change. Secondly, despite the real wage moderation that extended over 15 years from the late 1970s there has been a startling fall in job opportunities for unskilled males and, as a result, a dramatic increase in welfare reliance. Again neither one of the outcomes are suggested by the path of GDP or can be explained without the emphasis being placed on the shifting pattern of technological change.



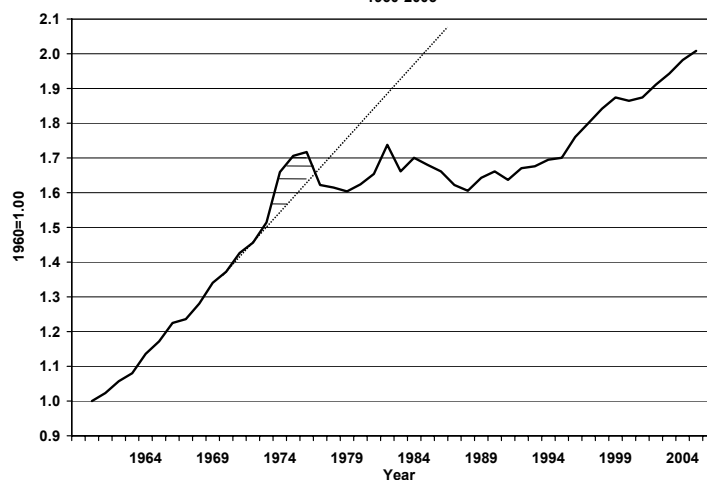
### The amazing history of aggregate real wages

Consider Figure 2 (*see over*) that plots real compensation per employee 1960-2005. The series divides into three epochs (i) there is steady growth during the 1960s and into the early 1970s when there is a marked lift (ii) then there is a long plateau of constant real compensation until the early 1990s and (iii) the series then returns to the 1960s growth rate.

During the mid-1970s there was widespread awareness of the lift in real compensation per employee between 1972 and 1975, produced in part by equal pay for women, and, in part, by above average real wage increases for men, encouraged initially by the new Labor government and the general feeling of enhanced national wealth flowing from increased exports of minerals and strong terms of trade. The employment policy debates, at the time, were dominated by discussions of the real wage overhang – the idea that real wages had run ahead of trend labour productivity and produced an overhang that inevitably would impact adversely on employment. The main debate, at the time, was whether an attempt should be made to use the centralised wage fixing system to reduce real wages

## LABOUR MARKET DEREGULATION

Figure 2 Australia, Real Total Compensation Per Employee Indices  
1960-2005



Source: Economic Outlook, OECD, DX Database, March 2005.

and return them to trend or whether to freeze real wages, by the application of price indexation of wages, and wait for productivity growth to restore the balance. I was in favour of the latter course of action since a projection of real wage growth, based on the 1960s trend, suggested that the overhang would be removed within a very short period of time – perhaps three years at the most. I believed that there would be some unemployment in the interim but that freezing real wages was by far the safest option. This projection has been included in Figure 2 as the dotted line and the real wage overhang is the shaded area.

It is now obvious that this projection of future wage outcomes was a long way from the actual outcomes. No one at the time predicted that real wages would be almost constant over the next 15 to 20 years. This sudden shift in real wage growth is one of the more important macroeconomic events in my life of watching the Australian economy. To some economists the fact of real wage constancy may not seem so interesting because they would argue that it was the result of policy interventions, such as the Accord and various real wage freezes and the impact of two serious recessions in the beginning of the 1980s and the 1990s. But to my mind this is not the way to look at this experience.

First, no economist predicted the real wage slowdown or predicted that policy interventions could maintain the level of real wages for so long. After a quarter of a century of real wage growth it seemed inconceivable that there would be about two decades of real wage constancy.

Secondly, the widely held macro view at that time was that only a few years of real wage constancy was needed to return the Australian labour market to full employment. It is when the long period of real wage constancy is placed against the poor employment record of the post 1975 period that the underlying problem becomes clear. Put simply, despite the

large real wage reductions – *relative to trend* – full-time employment, particularly among unskilled men, has continued to deteriorate (see the next section). Despite the real wage constancy there was no return to the pre-1975 labour market environment.

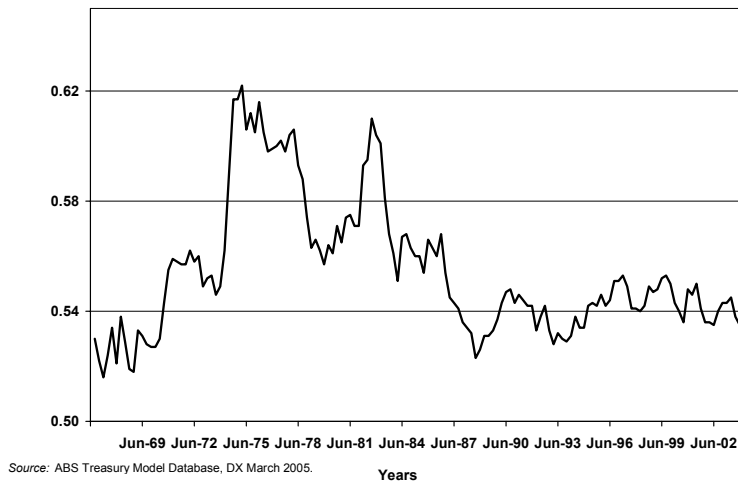
Thirdly, I interpret the combination of the real wage constancy and the poor employment record to suggest that the key issue of the 1970s was not how much employment would respond to a movement up a labour demand curve in response to a real wage increase. The key issue was why the underlying average rate of labour productivity growth was about to decline substantially over the next decade and a half so that real wages would not grow.

Finally, in addition to the marked slow down of average productivity growth, as reflected in real wages, there was a strong bias in the nature of productivity growth. During the first quarter century after World War II the growth in labour demands across skill categories were generally matched by the growth of labour supplies. Now that process has stopped as demand for unskilled labour has fallen faster than the supply.

Let me spend a little more time on the remarkable changes in wage outcomes before moving to employment outcomes. Another way of noting the importance of the sudden shift in underlying productivity growth is to look at the wage share of national income. It had been common, during the first two decades after World War II, for the national wage fixing authority to suggest that if labour productivity growth was approximately equal to real wage growth, the wage share would remain constant and full employment would prevail. Obviously, if there was a substantial productivity slowdown, unmatched by an average wage growth slowdown, there would be an impact on employment and the wage share.

Figure 3 presents the Australian wage share of GDP at Factor Cost. It also reveals a remarkable shift in much the same way as the real compen-

Figure 3 Wage Share of Gross Product at Factor Cost  
1966-2004



Source: ABS Treasury Model Database, DX March 2005.

Years

sation per employee series. During the mid-1970s the wage share of GDP increases by a very large amount, from around 54 to 59 per cent and remains well above 1960s level for almost two decades, after which it returns to more usual levels. Such a large increase in the wage share of GDP, for such a long period, would suggest large scale unemployment might ensue and this occurred. Unemployment rates increased from less than 2 per cent in the early 1970s to around 10 per cent at the peak of the recessions in the early 1980s and 1990s. The return of the wage share to 1960s levels, generated in part by approximate real wage constancy for 15 years, should have returned the labour market to full employment. The economy should be back on track. But it is not. Indeed the outcomes since 1970s have bifurcated the labour market into two; one part - the skilled labour market - has returned to the pre-1970s growth path and is experiencing growing employment and real wages. The other part - the unskilled labour market - has not. Real wages are increasing but employment is falling. The history of the past 30 years cannot be told within a macro framework stressing the macro imbalance between productivity and wages which once it is restored generates a new growth path of full employment. To understand what has been happening we need a more micro framework that stresses a wide ranging substitution in the economy away from male full-time jobs and, in particular, away from male unskilled jobs.

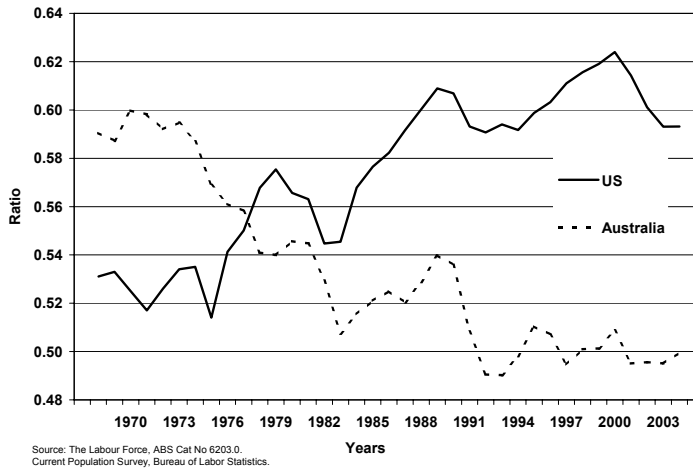
### **Full-time employment growth**

To show clearly the macro evidence for the labour market disruption Figure 4 presents the full-time employment population ratio for Australia and the United States. Now there is clearly a large change beginning in the 1970s. At 1970 the Australian full-time employment ratio was around 8 percentage points above that of the United States and then the Australian ratio begins to fall and incurs a nine percentage point drop by the early 1990s. The United States ratio, on the other hand, begins to increase from the mid-1970s. There is a 19 percentage point turnaround in the relative position of these two countries. This is an extraordinary change.

It is important to pause to put the patterns of Figures 2, Figure 3 and Figure 4 together and be clear of the links between them. Despite a substantial fall in real wages, relative to trend (Figure 2), full-time employment (Figure 4 opposite) has fallen 17 per cent. Furthermore, although the decline seems to have been recently arrested in Australia, there is no evidence of a recovery of the full-time employment population ratio after real wages have begun to increase. The economy seems to have moved to a new growth path of real wage increases and full-time employment stability at a much lower level.

Of course, full-time employment falls are not necessarily bad. It all depends on the incidence and reason for the change. Early retirement freely chosen by wealthy workers will not generally be regarded as a bad

Figure 4 Persons, Full-time Employment to Population Ratio, 15-64  
1968-2004



thing. Similarly, young people turning away from a job to pursue a university degree might also be regarded as a good thing. On balance though, the evidence suggests that most of this job fall is undesirable and has been forced upon workers through lack of job growth. The evidence clearly shows that most of the job loss is concentrated on the unskilled.

The question is usually raised at this point as to why I am concentrating so much on full-time employment when it is widely known that part-time employment has grown so strongly in Australia. The reason is that I am emphasising the relationship between employment and government income support. Those who work part time – mainly students and married women – are not the groups that are accessing government income support. Income support is almost exclusively the preserve of those who would normally rely on full-time employment for their income.

### Male job loss for different skill levels

Most of the loss of full-time employment has been concentrated upon men and particularly the least skilled. To show the changing male employment loss by skill categories, I use Census data readily available in machine readable form since 1981. It would be very useful to go back to the 1971 Census but that it not such an easy thing to do at this point.

Skill characteristics are measured by post school qualification attainment as stated in the Census.<sup>5</sup> Those with higher and bachelor degrees are

5 By confining the analysis to the last two decades we are not addressing the full extent of male job loss over the longer period. Nevertheless, there is still a substantial job loss to be explored. The full-time employment rates for males fell 16 per cent between the 1981 and 2001 Census dates.

LABOUR MARKET DEREGULATION

placed in the skilled group, those with Diplomas, Certificates or Vocational qualifications are placed in the middle skill group and those without formal qualifications are placed in the unskilled group. Three broad categories are chosen to keep the analysis as simple as possible.

Table 1 presents employment-population ratios for the two extremes of the skill levels of the male skill job distribution for 1981 and 2001. It also narrows the focus to the male age groups 25-34, 35-49 and 50-59 years to avoid any complications arising from education decisions in the 16-24 year age group and early retirement in the 60 years and over age group.

**Table 1 Males, 25-59 by Age Group and Skill Level  
1981 and 2001 Australia Census**

	Percent 1981 Census		Percent 2001 Census	
	Skilled	Unskilled	Skilled	Unskilled
<i>Proportion Employed Full-Time</i>				
25-34	79.9	75.9	76.6	60.1
35-49	86.6	79.1	80.0	62.3
50-59	84.8	68.6	72.7	51.9
Total 25-59	83.0	75.3	77.4	58.9
<i>Single - Proportion Employed Full-Time</i>				
25-34	72.7	63.9	72.6	53.3
35-49	83.1	63.9	73.4	50.5
50-59	76.3	53.1	67.8	41.9
Total 25-59	75.2	61.6	72.3	50.2

*Definitions -*

Skilled is defined where education level is bachelor degree or higher, Unskilled defined as having no qualifications.  
Full-time is working more than 35 hours per week.

Source: Census of Population and Housing, Household 1% Sample File, Australia, 1981 and 2001.

There are clear relationships between full-time employment, population ratios and skill characteristics and the relationships have become stronger over the 20-year period. Male full-time employment ratios in 1981 are marginally higher for the skilled. Among males 25-34 years of age, for example, the employment-population ratio among the skilled is 4 percentage points higher than among the unskilled. Among older age groups the employment gaps are larger. For example, there is a 16 percentage point employment gap between skilled and unskilled men 50-59 years of age.

By 2001, the situation has changed markedly. There have been very large falls in male employment-population ratios among all skill groups, but particularly among the unskilled. For example, among the skilled, 25-34 years of age, the employment-population ratio fell 3.3 percentage points over the two decades but among the unskilled the job loss is an extraordinary 15.8 percentage points. Employment falls of these magnitudes extend across all age groups.

The large employment falls among unskilled men have produced full-time employment-population ratios that are extremely low - 60.1, 62.3 and 51.9 per cent - for the unskilled in the age groups 25-34, 35-49 and 50-59

years respectively. Such low employment rates might be expected to have a range of important economic and social effects.

### The growth of the welfare state

Where did all the unskilled male workers go? How are they supporting themselves? Figure 5 plots the loss of male jobs since the 1970s by first taking the 1970 male full-time employment-population ratio, 15-64 years, as the base and multiplying it by the male full-time population of work force age at each year after 1970 and then subtracting the actual level of male employment. On this basis, the economy has lost 1.4 million male jobs relative to the 1970 employment-population ratio. Figure 5 also indicates that each recession has moved the job loss up a further notch and, as a result, male employment, as a proportion of males 15-64 years of age, has fallen 24.5 per cent since 1970. One full-time male job in four has disappeared.

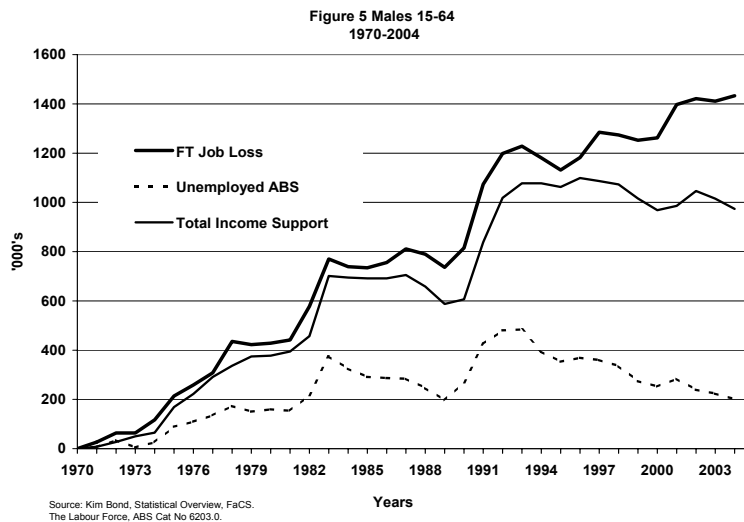


Figure 5 also includes an unemployment series derived by taking the ABS estimate of the number of unemployed men seeking full-time employment and subtracting male unemployment at 1970. In this way job falls can be compared with ABS unemployment increases.

A comparison of these two sets of data reveals a noticeable disjunction between employment and unemployment. Not only is the gap between the two series considerable but it is continually widening. After each recession ABS unemployment falls, but full-time employment losses among males, after allowing for population increases, tend to continue. A good way to illustrate this point is to notice that ABS unemployment today is approximately the same level as in 1982 but since then male employment, relative

to the male population 15-64 years, has fallen by almost one million. Linking the change in male full-time employment to changes in ABS unemployment does not give a good match. Males displaced from employment do not, over time, lead to parallel increases in ABS unemployment.

So what are the answers to the questions we posed earlier? What are these unemployed unskilled males doing? How are they supporting themselves? The answers are clear and also to be found in Figure 5.

We take the number of males receiving income support, primarily NewStart, Disability Pensions and Education Allowances, subtract the 1970 income support levels and add this series to Figure 5 to enable a comparison of income support increases with job losses. Unlike the ABS unemployment series there is a close parallel between income support and employment changes. Employment losses match increases in income support. The small gap between employment losses and income support increases, indicates quite clearly that individuals are not leaving employment to retire on private income. Individuals are moving from full-time employment to full-time government income support.

The very large incidence of job loss over the past three and a half decades must have had a significant social impact that extends into all parts of the social fabric. For example, it is often suggested that marriage rates among men are positively related to their command over economic resources and perhaps as an outcome from such large job losses, less women become married and depend upon welfare in their own right. Figure 6 opposite takes the male full-time loss, as in Figure 5, and compares it to the growth of income support among women. The income support data for women is constructed in a similar way to the data of Figure 5. Female income support numbers of 1970 are subtracted from actual numbers that we observe over the post-1970 period so that we can match income support increases to male full-time job losses.

There is an extraordinarily close relationship between the loss of male full-time jobs and the growth of female income support. There is almost a one to one correspondence. In Figure 7 opposite, we divide income support into four income support categories, unemployment benefits, income support for partners of unemployed men with children, lone parents and those with disability. Once again it is clear that unemployment benefits seem to be a trivial part of the story. The growth of income support is primarily in income support programs not directly related to the labour market involvement of women.

## Concluding comments

Where does this leave us? The previous sections have clearly documented a major loss of full-time jobs among men that has led to the rapid growth of welfare among the Australian population. These changes have been occurring over three decades and they all began during the 1970s.

LABOUR MARKETS AND ECONOMIC POLICY

Figure 6 Labour and Welfare, Males and Females  
1970-2004

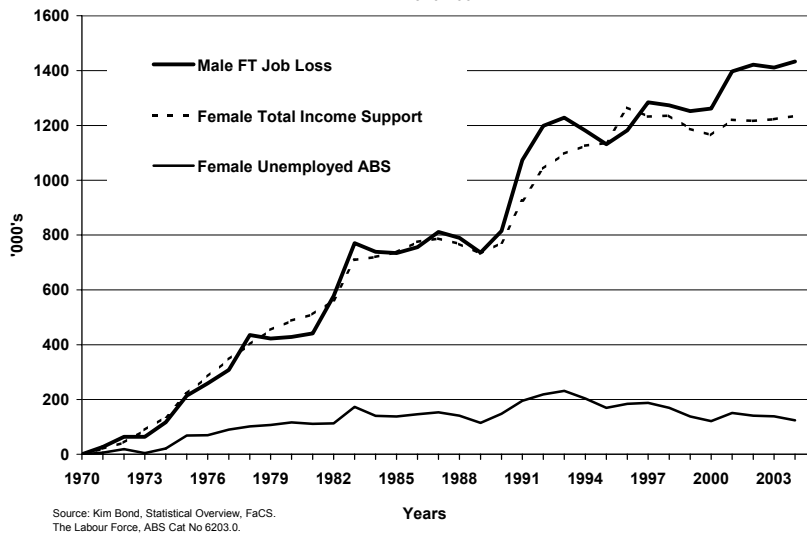
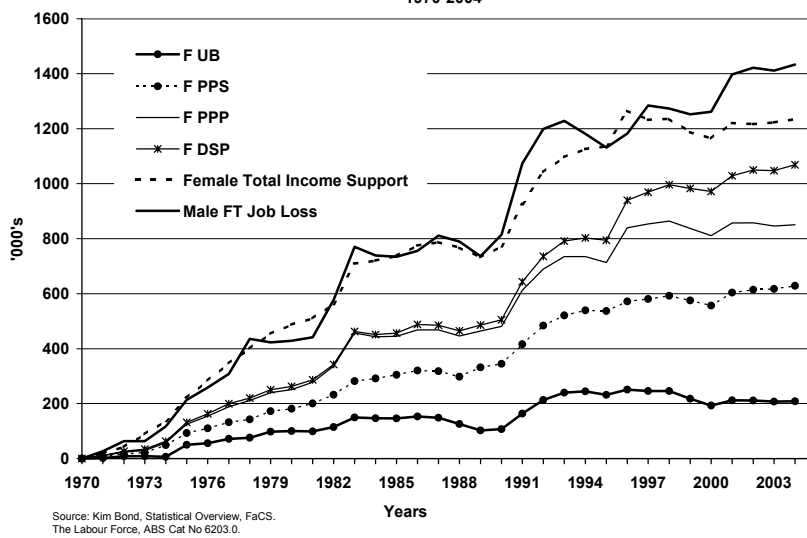


Figure 7 Labour and Welfare, Females Workforce Age  
1970-2004



Here is the major intellectual and policy crisis. The Australian economy seems to have returned to a high growth rate path much like the 1950s and 1960s. Real wage wages are increasing at a trend rate similar to the 1950s and 1960s, GDP is growing quickly and, across the board, Australians are becoming richer. Even welfare recipients are partly sharing in the economic gains in that most welfare payments have been indexed to average wage increases. The ability to combine work and welfare is also easier than at any other previous time. There is a lot of good news.

But the underlying bifurcation of the labour market and the underlying employment problem that began in the 1970s remains. Approximately, one fifth of Australians are now depending primarily on income support from government. All the policy interventions we have tried – across the board real wage freezes, large expansions of the education and training sectors, changes in immigration policy to focus on skilled immigrants, labour market deregulation and the weakening of trade unions – may have had positive effects but if so they are not enough to generate good employment outcomes for the unskilled and disadvantaged. If these policies contributed to the recent growth record almost all the gains went to the existing employed in terms of real wage increases.

The labour market bifurcation problem cannot be cured by Keynesian economic expansions of the sort that economists of my generation believed in for so long. The 1930s recession, and Keynesian response to address it, was much more about short run demand fluctuations. Our current problem is of much longer standing and seems to be stubbornly insensitive to our policy interventions.

What should we do? If we adopt the analysis of basic microeconomics and we believe in the theories that we teach undergraduates, the problem at one level, disappears. The answer from Economics 1 is clear. To return to full employment all relative wages across skill categories need to change. This is not the mantra that the labour market needs to be deregulated. Rather the labour market needs to be deregulated and the wages of the disadvantaged should fall by a considerable margin to create jobs for them. Furthermore, along with the real wage falls the real level of welfare payments need to fall as well to make sure that the labour supply side of the market also encourages employment. The unskilled and disadvantaged are being presented with a trade-off; substantially lower wages and welfare payments for more employment. Some of this adverse trade-off could be ameliorated with some sort of earned income tax credit but the tax credit would need to be substantial and the experience in the United Kingdom to date has not been encouraging.

You can see why I am ill at ease. Substantially lower wages for the unskilled and disadvantaged, at least in relative terms and probably in absolute terms, and substantially lower welfare payments in return for additional jobs is not the labour market I want. But is there any other way to turn?

It could be argued that I am too pessimistic on supply side adjustments and perhaps the supply of unskilled male labour could be reduced to match the shrinking demand. It is often said that more training of the unskilled will fix the problem. If only that were true and we could easily change the unskilled and disadvantaged into skilled and advantaged workers. I am in favour of more training but I really *cannot* believe that it will make a very large difference. We have already embarked on a considerable expansion of training and education with no noticeable macro employment effects. We have added at least two years of schooling to the young population over the past quarter century, university enrolments have increased enormously and still the problem remains.

It could also be argued that economic growth will fix the problem. I was more optimistic on this front than I am now. I am disappointed that the considerable gains from the strong economy over the past decade have mainly gone to those who are not disadvantaged and that no inroads have been made on the employment problem of the unskilled and the growing numbers on income support. The 'economic growth miracle' of the Australian economy has just managed to stop the increase in welfare support for men but not for women. Looking ahead it is hard to believe that economic growth will be even faster and suddenly make larger inroads into the unskilled groups.

Perhaps it could be argued that there is no crisis and that there is nothing wrong with one fifth of the workforce depending on welfare payments or combining welfare with part-time or intermittent work. At this moment, the Australian electorate seems not too unhappy with the size of the welfare bill and there is no widespread opposition to the lone parent and disability reforms that are about to be introduced. There is opposition to the Howard government's proposals for a Fair Pay Commission to set minimum wages on economic criteria and new Industrial Relations laws but it is difficult to judge how widespread this is. But, given the lack of progress in creating jobs for the unskilled during the past decade of strong growth I am worried about the next economic downturn. Our experience to date is that each economic downturn reduces the level of unskilled male employment which, when the economic upswing begins, does not return to previous levels and therefore the welfare population increases considerably. If there is a downturn in the near future, with a considerable loss of full-time employment, the 'let's live with the welfare budget' scenario becomes less tenable.

Perhaps the problem of lack of jobs for the unskilled will go away? After all we did not foresee the extent of the adverse demand shift against the unskilled and maybe technological change and product demands will shift employment growth patterns back to the unskilled group. Perhaps, but I don't think so.

It seems therefore that policy choices are becoming more difficult for economists of my vintage who were able to believe for so long that all labour market groups could gain from policies directed towards economic

growth. We believed, and it was true for the first quarter century after World War II, that higher growth coupled with good anti-cyclical policies could benefit all. Now most of the gains seem to go to those with good jobs. We seem to be faced with harder and harder choices which are blurred by politicians claiming that no worker will be made worse off by the reform processes under way.

These difficult issues that I have focused on are not unique to Australia. The labour market in the United States has also been subject to bad outcomes for the low skilled and the low paid. There, however, the problem has been low wage rates and low levels of income support rather than low employment levels for the unskilled. For Australia the major problem in the years ahead, I am sorry to say, will be probably be how to manage a move in the direction of the United States system with a wider income distribution and less income support not related to work. The loss of unskilled jobs, and the growth of the number of people on welfare, are continually exerting pressure in this direction. Indeed, it can be argued that Australia has already begun this process with reforms designed to worsen pay and conditions for the less skilled when employed, and less income support when they are not employed, in the hope that these two adverse effects of reform will be more than offset by more jobs..

I began this chapter by suggesting that Keith and I have similar views, at least with regard to what we would like from the labour market, but it seems clear to me that the world has changed and we do not know how to deliver what we want or even whether it is possible.