

Miracle Economies Are In The Eye Of The Beholder: Our Failure To Create Sufficient Full Time Jobs.

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Many of the papers at the Conference have emphasised the improved economic outcomes of the Australian economy over the last decade. Commentators have highlighted the lower rate of inflation, higher productivity growth and the development of a sounder financial system. Many good things have happened but looking back over the discussion of the last two days there seems to be perhaps a little too much optimism and also perhaps an unwarranted degree of satisfaction with the 1990s outcomes.

To rebalance the discussion I focus on three major areas where performance has been worse than during the 1980s: an inadequate growth of full-time jobs, a widening of the distribution of earnings among full-time workers and a rapid growth of those of working age whose principal source of income is government pensions or benefits. These areas pose the major policy problems of the coming decade.

There is no evidence to date that the “miracle” economy has begun to consistently generate better performance in any of these areas. Maybe it is too early to detect a change. Perhaps, in response to the current upswing in the interest rate cycle, these outcomes may deteriorate further.

A Continued Shortage of Full-Time Jobs?

The poor performance in full-time employment generation is particularly noticeable if the Australian record is compared to that of the US (Figure 1). From the mid 1960s through to the early 1970s, the Australian full-time employment-population ratio was approximately 14 per cent above that of the US. We were a high employment economy. Then the dramatic slide in the Australian full-time employment-population ratio began. The full-time employment population ratio fell 16 per cent between 1970 and 1983, by which time it was below that of the US.

Australian full-time employment began to increase from the depths of the recession in the early 1980s but since 1990 the full-time employment-population ratio has fallen once more - a further 4 per cent - and the full-time employment population ratio of the US has increased a further 3 per cent.

Such a poor Australian performance during the 1990s raises two questions. Why has the unemployment rate fallen and if a smaller proportion of the population is working full-time, how are those without a full-time job supporting themselves?

The answer to the first question is straightforward. Unemployment has fallen during the 1990s, despite the lack of full-time job growth, because labour supply has contracted. This is easily seen by comparing the change in the full-time employment population ratio with the Australian full-time labour supply which is constructed by adding the unemployed who are seeking full-time work to the full-time employed (Figure 2). Full-time labour supply, defined in this way, has declined dramatically over the last twenty-five years and the decline has been larger in the 1990s than the 1980s.

During the 1980s the unemployment decline is principally explained by employment growth. During the 1990s the unemployment decline is principally explained by supply reductions. Indeed, if full-time employment growth was only to keep pace with population growth over the next decade, and if individuals continued to withdraw from the full-time labour force at the average withdrawal rate of the 1990s, the unemployment rate would fall to less than 5 per cent by 2005. But as we will see it seems unlikely that labour supply will continue to fall at such a substantial rate.

Not all declines in full-time employment are necessarily a bad thing. For example, voluntary withdrawal from full-time employment to pursue education, to raise children or to retire on a self-funded pension would be regarded as good outcomes. This leads us to the second question. How are individuals, who previously would be employed full-time, supporting themselves?

Table 1 provides a substantial part of the answer. The first row lists the increase in the population, 15-64 years, for three periods: 1970 to 1980, 1980 to 1990 and 1990 to 1998. The third period does not cover the complete decade because we have not been able to obtain all the data we need on a consistent basis for the whole period¹.

The second row lists the additional full-time jobs created in each period. The strong employment growth during the 1980s is readily apparent as is the poor

¹ The data on the number of welfare recipients is taken from P. Whiteford, (2000). Over the last two years full time employment has grown more strongly but the performance of the 1990s is still not as good as the 1980s. The number of welfare recipients has fallen slightly over the last two years.

performance of the 1990s. During the 1980s the ratio of additional full-time jobs to the population increase of working age was 45 per cent. During the 1990s this ratio was 15 per cent.

The third row lists the increase in the number of individuals 15-64 years who are receiving welfare benefits and pensions as their principal source of income. During the 1970s and 1990s but not the 1980s, the increase in the number of welfare recipients exceeded the increase in full-time jobs. The increase in welfare recipients during the 1990s, as a ratio of the population increase, is an astounding 70 per cent. The failure of the labour market to provide income support from full-time work is clear. Those who cannot find full-time work are being supported by the welfare system.

The fourth row of Table 1 lists the population increment that is not supported either by full-time work or welfare payments. Little is known about this group but the increase during the 1990s is quite small².

To learn a little more about the extraordinary increase in welfare recipients since 1970 we have divided them into three groups; the unemployed, those with disabilities or illnesses and those with parenting responsibilities. Each of these groups account for about one third of benefit and pension recipients. Each group has increased over the last three decades, 459,000 over the period 1980-1990 to an increase of 743,000 between 1990-1998 (Table 2). There are some noticeable patterns. It is only during the 1970s that the increase in the number of unemployed was the major contributor to the increase in the number of welfare recipients (accounting for 52 per cent of the increase). During the 1990s the increase in the unemployed accounted for 37 per cent of the increment.

Finally, to further emphasise the failure of the labour market to create full-time jobs we provide an estimate of the “potential full-time labour force” defined as all those employed full-time, those seeking full-time work or receiving their principal income source from welfare payments (Figure 3). The level of welfare recipients as a proportion of the “potential full-time labour force” has increased from 5.4 to 15.8 to 19.1 and to 25.7 per cent for 1970, 1980, 1990 and 1998 respectively. At 1970, one in twenty members of the “potential full-time labour force” were supported by

² During the 1970s and 1980s some of this group would have been supported by student allowances.

government pensions and benefits. By 1998 the ratio had increased to one in four. The comparison of the size of the potential labour force with the full-time unemployment rate (Figure 3) makes clear that those supported by unemployment benefits represent only about one third of the “potential full-time labour force” without a full-time job.

Since 1970, and relative to the population 15-64 years, the “potential full-time labour force” has increased 6 percentage points and is approximately the same as the proportion of the US population employed full-time. As the full-time employment-population ratio has fallen in Australia most of the job loss has gone into government benefit and pensions rather than unemployment.

In response to the exceptionally poor performance of the labour market during the 1990s the Australian government is seeking to reduce the number of people on welfare by applying sticks and carrots to encourage individuals to take up employment. To find full-time employment for the “potential full-time labour force” over the next decade, however, is a far greater task than just finding jobs for the unemployed. For example, to move from where Australia is now to a full-time employment-population ratio similar to the US requires an additional 1.4 million full-time jobs, and this is without including a job creation allowance to meet population growth. To achieve the ratio of full-time employment to the “potential full-time labour supply” reached at the beginning of the 1990s requires an additional 415 thousand full-time jobs over and above the demands generated by population growth. Against an annual growth of full-time jobs of 53 thousand between 1990 and June 2000, these job creation rates are a large task. They require a number of years of very strong employment growth similar to the last year and yet current indications - evidenced by interest rate increases and the prospect of more to come - suggest that this fast rate of employment growth cannot continue.

The Next Decade: How Might More Full-Time Jobs Be Created?

Given the general level of optimism expressed over the last two days it might be thought that there was a clear view as to the solution to the lack of full-time job growth and a way forward to change the poor outcomes of the 1990s. But the problem was largely ignored, partly because the labour market focus was on recent declines in the unemployment rate and partly because many structural features of the economy - except for the ability to produce full-time jobs - seems to have improved.

At the beginning of the last decade the most common policy suggestion to create more full-time jobs was to deregulate the labour market to create an environment in which real wage falls could occur, particularly for the low paid. The view was widely shared that the job creation solution lay on the demand side of the labour market and that micro reforms would be effective.

To review the history of wage changes, and to comment on the results of deregulating the labour market, we focus on the distribution of average weekly earnings from full-time employment. Each annual cross section of individual earnings has been ranked from high to low and real earnings at the 10th, 50th and 80th-percentiles presented in Figure 4. A number of points are immediately evident.

First, real full-time weekly earnings at the median have increased only 15 per cent over the last twenty-three years, and all of that increase has occurred since 1996. This history suggests a number of unpleasant thoughts. One is that it is remarkable that the full-time employment-population ratio has continued to fall so dramatically in the face of no increase in median real wages between 1976 and 1996. For those who believe in a link between average real wages and employment growth it is disturbing that employment outcomes have not been better. What sort of average wage outcome would have produced enough jobs? The inevitable conclusion has to be that a very large wage fall was needed, one of a magnitude that does not seem possible.

The pessimism deepens when we realise that over the period as a whole there have been substantial falls in low wages, especially relative to the median. Over the two and half decades full-time earnings at the 10th percentile have fallen 15 per cent, relative to the median, and not increased in real terms. This suggests that a policy based on a moderate wage reduction, say a 5 per cent wage reduction for those at the bottom of the wage distribution, would be relatively ineffective³. The labour market has already experienced real wage reductions of this order and the full-time employment situation has continued to deteriorate.

Finally, at the end of the 1990s, real wages of all workers began to increase. Although these increases have gone disproportionately to those on high wages, those on low wages have also begun to achieve real wage increases. For policy advisers

³ Something of this order has been advocated by Dawkins and Freebairn (1998). The pattern of real wage outcomes here for the low paid are so different from those of the US where real wages over a similar period have fallen by as much as 25 per cent for those on low wages.

who have argued that a deregulated labour market would moderate real wage growth, produce real wage reductions at the bottom of the wage distribution and create full-time jobs, these are disturbing outcomes. The new deregulated labour market appears to be less successful at delivering real wage moderation than the Accord process.

It is also noticeable that there have been real wage increases at the 10th percentile dating from 1996 onwards, when the unemployment rate was 8.5 per cent. Each reduction in the unemployment rate since then has been accompanied by further real wage increases. The nexus between real wage and unemployment changes seem such that it is difficult to see the current environment consistently producing the large number of full-time jobs that are needed. Already, our policy stance has begun to produce interest rate increases to slow job growth.

The results to date suggest that deregulating the labour market has failed to meet the initial objectives of full-time job creation and moderation of real wage growth. If the deregulated labour market is said to have succeeded then it has to be credited with the labour productivity increase and the large real wage increases to those at the upper end of the wage distribution. The experience of the 1990s suggests that neither of these results has created a faster growth of full-time employment.

Given the failure of a deregulated labour market to produce sufficient full-time jobs it is to be expected that the policy emphasis will increasingly shift to the supply side of the labour market. This was clearly stated by Mr Abbott, Minister for Employment Relations, in his recent address to the Centre for Independent Studies,

“Why might a generous safety net designed to help people on the dole, coupled with wage restraint to boost jobs, only make unemployment worse? Because for many people working has become more trouble than it is worth. Wage restraint might indeed produce a glut of jobs as economists claim but not of willing workers to fill them...The role of the welfare system in creating and sustaining unemployment has been one of the great unmentionables of the Australian public policy debate (Abbot, 2000).”

In the Minister’s view inadequate labour supply has played an important part in the inadequate growth of full-time jobs and unemployment cannot fall further because the unemployed are not truly seeking work. He appears to be arguing that policies are needed to reduce the level of income support of those on benefits and pensions - “working has become more trouble than it is worth”. He is also seeking to increase the

pressure - “or the trouble” - on the unemployed by requiring them to fulfil mutual obligations such as applying to five hundred employers for jobs each year and accepting work for the dole. Given the failure of the 1990s it is inevitable that welfare and labour supply issues will be at the centre of the employment policy debate over the next decade. I offer the following comments.

First, it is clear from Figure 3 that the large falls in full-time employment and the increase in the numbers on government benefits and pensions are primarily generated by recessions. Demand side management failure is the initial source of the problem. Supply side policies alone will not be completely effective unless we can avoid deep recessions and to a large extent that is not within our control. Having said that, however, the economy does seem better placed to moderate recessions than it has been for some time.

Second, an important part of the welfare debate, largely ignored by economists, is the relative role of financial incentives (such as the level of benefit and pensions) compared to administrative rules and regulations (conditions of access to benefits, the use of threats, the creation of a less friendly welfare environment, mutual obligations and so on). The current emphasis of government is to stress administrative rules and regulations and to toughen attitudes towards those receiving government benefits. In policy terms we are embarking on a major policy initiative and social experiment to see whether supply side reforms can significantly help to create jobs⁴.

Third, in some of the discussion around unemployment and welfare reform the impression is created that the adoption of mutual obligations will bring about a significant fall in the number of pensions and welfare recipients and lead to a fast creation of full-time jobs. Given the past history of wage and employment outcomes it is difficult to see such a policy being effective quickly in terms of full-time job creation. The task is too great for quick short run returns. It seems inevitable that the emphasis will eventually have to be placed on substantial financial incentives as it seems likely that small changes to financial incentives will be relatively ineffective. This suggests that declines in the real level of benefits and pensions are a distinct possibility.

⁴ The government has recently received the report of the Reference Group on Welfare Reform. P McClure (2000). This report stresses more positive intervention to reduce the number of welfare recipients. The government is expected to issue a formal response before the end of the year.

Finally, it is evident from Figure 3 that over the last two and half decades wage inequality has increased considerably with full-time weekly earnings increasing 24 per cent at the 80th percentile but not at all at the 10th percentile. The widening of the wage distribution with the top percentiles achieving such substantial increases suggests two points. First, the faster the rate of growth of real wages among higher income earners the larger the extent to which low wages will have to fall to modify average wage increases. Since 1996 median real wages have increased 15 per cent. Suppose that 10 per cent would have been a better outcome. If, all the adjustment were to be borne by the bottom three deciles of the wage distribution, their wages would need to fall by an additional 15 per cent.

Concluding Remarks

I began by commenting that perhaps the general tone of the discussion over the two days was a little too optimistic. Over the last decade our GDP growth rate was the second highest in the OECD, a cause for optimism, while at the same time the rate of full-time employment growth in the 1990s was the second worst decade since World War II. Furthermore, the growth in welfare recipients, as a proportion of the population increase, was the largest in any decade over the same period.

It is disturbing that we do not seem to have a good grip on what is going wrong and that we are being diverted from the task because other parts of the economy do seem to be doing well. It could be argued perhaps that all the micro reforms will take some time to work and that we will see an employment pay-off soon. However, the fact that so much of the productivity growth seems to have gone into wage increases, especially for those who earn above average wages, does leave us with some pessimism and the feeling that at the end of the day, in the absence of a change in the underlying forces in the economy, we may need more radical policies.

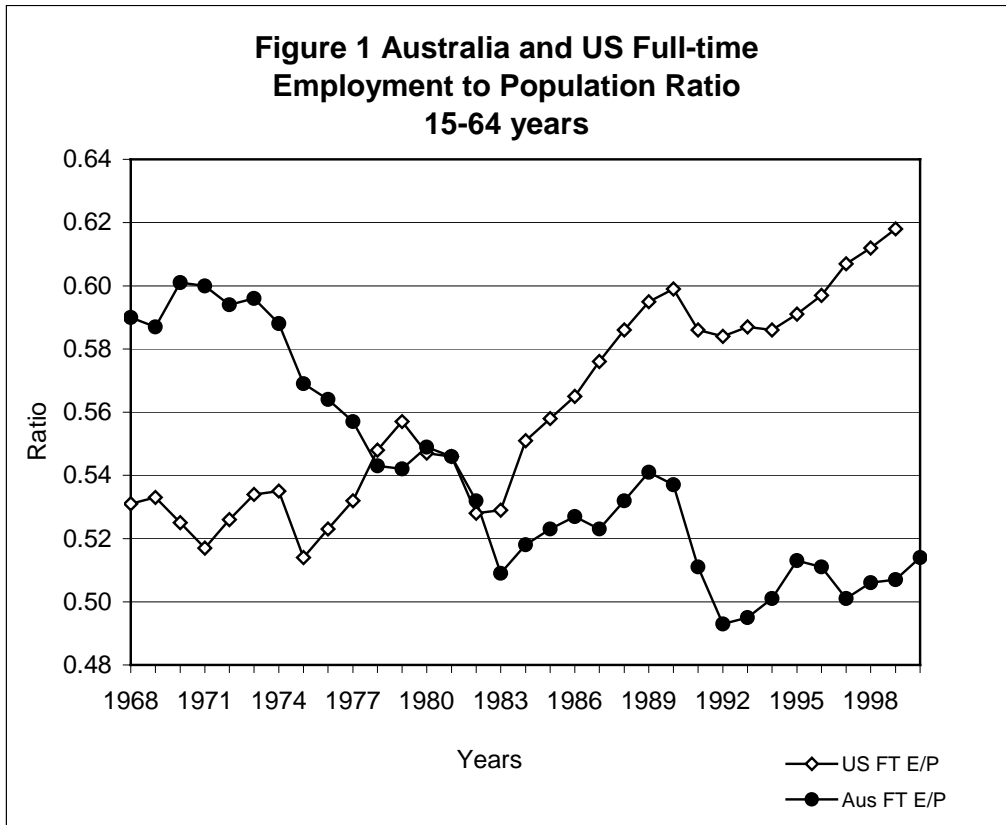
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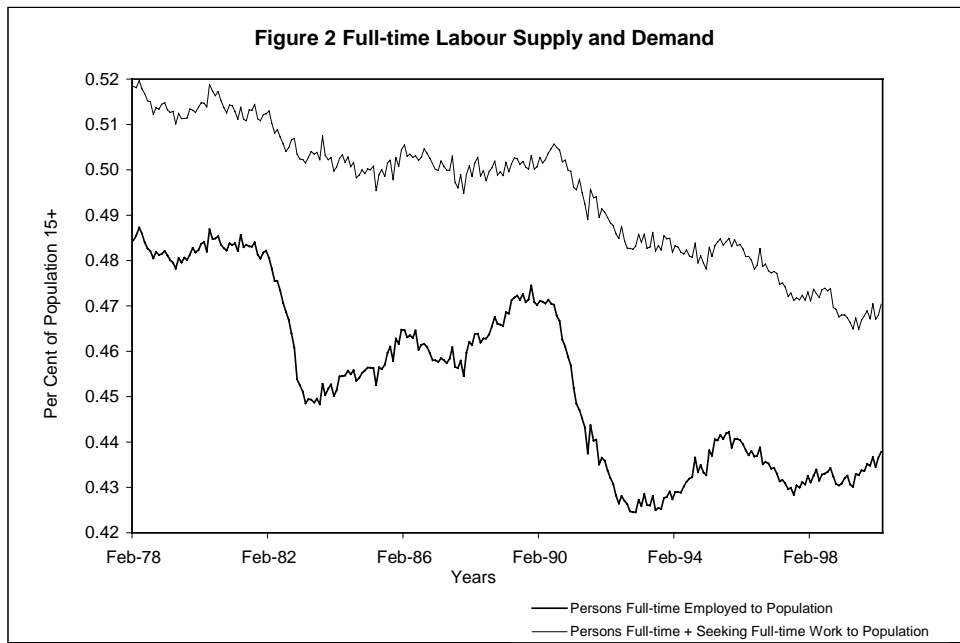
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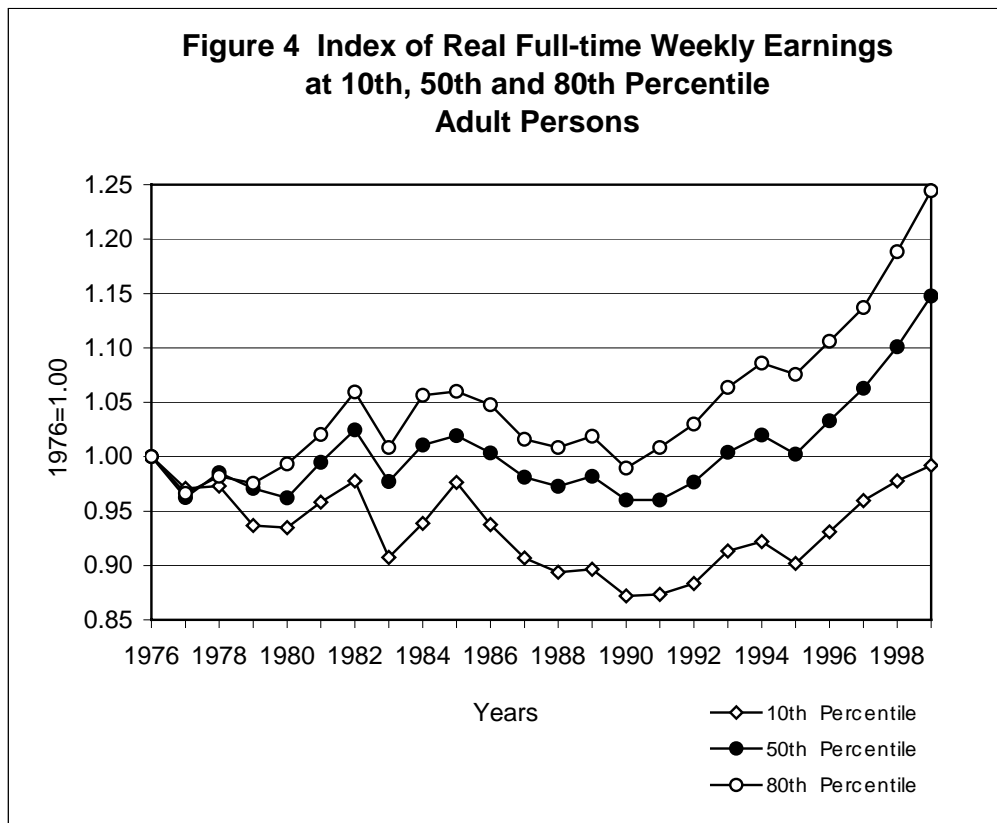
Source:
 Australia: Authors calculations based on Labour Force (August various issues), ABS Catalogue No 6203.0
 US: Current Population Survey, US Department of Labor.



Source: ABS Time Series Statistics, supplied through Econ Data dX Data Services, March 2000, Monthly, Seasonally Adjusted.



Source: Table 1.



Source: Weekly Earnings of Employees (Distribution), Australia, August 1976-99, ABS Catalogue No. 6310.0

Table 1: Increase in Full-Time Employment, Non-Student Welfare Recipients and Population of Working Age

	<u>1970-1980</u>		<u>1980-1990</u>		<u>1990-1998</u>	
	(000s)	%	(000s)	%	(000s)	%
Increase in						
Population 15-64 yrs	1548	(100)	1867	(100)	1062	(100)
Full-time Jobs	329	(21)	840	(45)	156	(15)
Welfare Recipients	723	(46)	459	(25)	743	(70)
Residual	507	(33)	568	(30)	163	(15)

Source: The Labour Force, Australian Bureau of Statistics, Cat. No. 6203.0 (various issues).
P. Whiteford, The Australian System of Social Protection: An Overview, Department of Family and Community Services, Canberra, 2000.

Footnote: The period August 1998 to June 2000 has seen much stronger growth of full-time employment. Between August 1990 and June 2000, 479,000 full-time jobs have been created, which is still substantially less than the 1980's outcome.

Table 2: Increase in Non-Student Welfare Recipients 15-64 years

<i>Decade Increase</i>	<u>1970-1980</u>	<u>1980-1990</u>	<u>1990-1998</u>
	000's	000's	000's
Disability and Sickness	184	187	150
Poverty and Widows	160	91	319
Unemployed	<u>379</u>	<u>180</u>	<u>274</u>
Total	723	459	743

Source: P. Whiteford, The Australian System of Social Protection: An Overview, Department of Family and Community Services, Canberra, 2000.