

**GROWING OUR WAY TO FULL EMPLOYMENT ?**

**JOHN QUIGGIN**

**Centre for Economic Policy Research,  
Australian National University  
and  
Department of Economics  
James Cook University**

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## **GROWING OUR WAY TO FULL EMPLOYMENT ?**

At the end of 1993, nearly one million Australians were unemployed and actively looking for work. Another million were available to start work within four weeks, although they had not actively searched in the previous week. As Professor Fred Gruen has observed “There can be little disagreement that the relative unemployment performance of the Australian economy .. over the last quarter of a century can only be described as appalling.” Yet, on the strength of minor upward revisions to current growth rates and some optimistic projections for the future, the prevailing mood in government circles has become one of complacency.

It is widely assumed that a continuation of existing policies will lead, in due course, to the restoration of full employment. In particular, it has been claimed that the microeconomic reforms of the eighties have laid the groundwork for a sustained expansion in output and employment.

Is this complacency justified? To answer this question it is necessary to consider the prospects for growth, the relationship between growth and employment and the likely impact of microeconomic reform.

In this paper, it is argued that current policies will not yield a return to full employment, and that a policy program for full employment must include both a commitment to active labour market policies and an expansion of the community services sector.

### **Redefining full employment**

One method of guaranteeing that existing policies will restore full employment is to redefine full employment as the employment level generated by existing policies.

This strategy of ‘moving the goalposts’ has been employed using the concepts of the ‘natural rate of unemployment’, "one of the most vicious euphemisms ever coined" as William Vickrey president of the American Economic Association, wrote recently. The idea of a natural rate of unemployment gained popularity in the seventies after the failure of attempts to exploit the short-run trade-off between unemployment and inflation embodied in the Phillips curve. The basic notion of the natural rate is that the workings of labour markets determine that, in equilibrium, a certain proportion of workers will be unemployed. For a given labour market structure this rate of unemployment is socially optimal. A social loss will be incurred whenever unemployment rises above, or falls below, the natural rate. Attempts to hold unemployment below the natural rate are unsustainable since if unemployment falls below this level for a sustained period, inflation will rise and accelerate.

A less ideologically loaded version of the natural rate analysis is phrased in terms of the non-accelerating inflation rate of unemployment (NAIRU). Analysis based on the NAIRU concept accepts the empirical claim of the natural rate theory — that when unemployment falls below some given rate, inflation starts to accelerate — without the implication that this rate of unemployment is in any sense natural or desirable.

The natural rate theory first appeared in the early seventies, when the natural rate was estimated at about 2 per cent. This estimate was well above the average rate of unemployment experienced up to that time, so that the natural rate model, then as now, justified restrictionist fiscal and monetary policies. However, the model's claim that rates of unemployment above 2 per cent would be sufficient to generate a drop in the rate of inflation proved hopelessly overoptimistic. In the late seventies, estimates of the natural rate rose to around 4 per cent, and in the mid-eighties to 6 per cent. Current estimates (eg Murphy model), are between 7 and 8 per cent.

The usual estimates of the current natural rate are well above the maximum level

of unemployment experienced between 1945 and 1980, despite the fact that this period included numerous episodes of decelerating inflation, most notably in the late seventies. If the natural rate model is taken seriously, this suggests that the functioning of labour markets has deteriorated substantially over the past twenty-five years, and that the deterioration is continuing.

This interpretation does not sit very well with claims for the success of microeconomic reform. If the tightly regulated and highly unionised labour market of the pre-1980 period performed systematically better than present labour market institutions, how likely is it that the 'deregulation' now proposed will represent an improvement ?

Another possible explanation is a decline in labour force quality. This seems implausible in the Australian context given the massive withdrawal of teenagers from the labour market and the associated rise in education levels. The Australian workforce is now better educated and more heavily concentrated in the prime age group (25-54) than at any time in the past. This should produce a decline in the natural rate rather than an increase.

The characteristic feature of natural rate estimates is that they rise relentlessly over time and that they always deny the possibility of any reduction in unemployment beyond that generated by normal cyclical recovery from recession. Hence the natural rate framework justifies governments in doing little or nothing about unemployment.

Over the last ten years, discussions of the rising rate of unemployment have focused on the concept of hysteresis. Hysteresis originally referred to the lagged effects of exposure to magnetic fields, by which a metal that has previously been exposed to a field is more susceptible to subsequent magnetisation.

The implicit assumption associated with the term 'hysteresis' is that episodes of high unemployment engender a greater likelihood of unemployment in the future. Once the level of unemployment has risen, the level of unemployment appears to rise perma-

nently.

There are various explanations of hysteresis. The most plausible is the skill atrophy model, which stresses the loss of skills and demoralisation associated with unemployment. Therefore, the longer people are unemployed the less likely they are to regain employment at any given wage. The probability of finding a job is lower for the long term unemployed than for those who have been unemployed only a short time<sup>1</sup>.

As well as losing work skills, people who are unemployed tend to lose contact with the informal networks through which many (perhaps most) jobs are filled. People who are in work, or who have been unemployed for only a short time, often have friends, business contacts and former colleagues who know of job vacancies and are able to make recommendations on their behalf. The longer a person is unemployed the greater the loss of contact with the labour market.

Some users of the concept of hysteresis have referred to it in terms of an endogenous increase in the NAIRU. However, the existence of hysteresis undermines the concept of the NAIRU. It implies that there is no fixed level of unemployment consistent with stable inflation - rather the point in a business cycle at which inflation begins to accelerate will be related in a very complex fashion to the level of unemployment.

### **Prospects for the nineties**

What will happen to unemployment for the remainder of this century. No one knows for sure. However, if current policies are continued it is unlikely that the rate of unemployment will fall much below 8 per cent.

One way of looking at the future is to make projections of the main variables

<sup>1</sup> An alternative explanation of this fact is that those with relatively attractive characteristics tend to be hired first, so that the long-term unemployed, as a group, are less employable than the short-term unemployed. However, empirical work such as that of Richard Layard suggests that skill atrophy is also important.

that affect unemployment — population growth, economic growth, labour productivity and labour force participation rates, and derive their implications for rates of employment and unemployment. These variables are related by some very simple equations<sup>2</sup>

% Employment growth rate = % Economic growth rate — % labour productivity growth rate

% Labour force growth rate = % Population growth rate + % Change in participation rate

% Change in unemployment = % Labour force growth rate - % Employment growth rate

From these equations, it is possible to show that the rate of unemployment is determined by economic growth, population growth, productivity growth, and the participation rate.

Of these variables, only economic growth and productivity growth really matter. Short and medium-term changes in the participation rate primarily reflect shifts between hidden and overt unemployment. The most noteworthy example is the well-known tendency of participation rates to rise in the early stages of economic recovery.

Rates of population growth are also relatively unimportant. The main source of short-term variation here is the rate of immigration. Population changes generated by changes in migration rates appear to be matched fairly closely by changes in GDP, leaving per capita GDP largely unaffected. Working through the equations above, it is apparent that changes in migration will have only marginal effects on unemployment.

No fundamental difficulties arise, therefore, if we predict the labour force growth rate assuming a continuation of a current (historically fairly low) levels of immigration and continuation of long-term trends in labor force participation. On this basis, the

<sup>2</sup> These equations aren't quite exact when unemployment is high and participation rates are less than 1, but the necessary corrections can be made fairly easily

potential labour force may be projected to grow at a rate of about 1.2 per cent a year.

The participation rate is rising gradually over the long term, although it has declined in the current recession. The increased labour force participation of adult women more than offsets longer periods of schooling and earlier retirement. The increasing participation rate contributes long term growth in the labour force of about 0.3 per cent a year. Hence, the average rate of growth in the labour force is likely to be around 1.5 per cent a year.

The main difficulty relates to forecasting the rate of growth of employment demand, derived by taking the difference of the rate of growth of GDP and the rate of growth of labour productivity.

The Green Paper uses a base projection of 3.5 per cent growth with 1 per cent labour productivity growth. If these growth rates were maintained from 1992-93 to 2000-01, they would yield an unemployment rate of 7 per cent.

Fred Argy, former director of the Economic Planning Advisory Council (EPAC) presents an even more pessimistic extrapolation of current trends. Argy shows that if the trends of the last two decades were to continue, the labour force would grow at 2.1 per cent a year, while employment would grow at 1.8 per cent a year. This would imply that the unemployment rate would rise by about 0.3 percentage points each year, leading to a rate of nearly 13 per cent by the turn of the century.

The implications for long term unemployment are even grimmer. Increases in long term unemployment tend to trail increases in unemployment. People who lose their jobs do not become long term unemployed (by the current official definition) until a year later. Work done by Chapman, Junankar and Kapuscinski provides a basis for modelling the relationship between the general unemployment rate and the rate of long term unemployment. On the basis of this work, the unemployment patterns projected above would imply that around 50 per cent of the unemployed, that is 300 000 to

400 000 will be long term unemployed and that this pattern will persist for most of the remainder of this decade.

Both Argy and the Green Paper task force make the point that more rapid economic growth would, *ceteris paribus*, lower unemployment. The Green Paper gives estimate that an average growth rate of 4.75 per cent over the period 1992/93 to 2000-01, with labour productivity growth of 1.75 per cent would generate a reduction in the rate of (overt) unemployment to 5 per cent. Hidden unemployment would also be lower, as reflected in a 2 per cent difference in the projected participation rates.

The problem then is to assess whether, and under what circumstances, such growth rates are achievable.

### **Macroeconomic obstacles to rapid growth**

A full employment strategy based solely on attempts to boost the rate of economic growth faces significant difficulties. Even with macroeconomic management greatly superior to that of the past twenty-five years, it will be very difficult to avoid at least some years of slow growth (say two years of 1 per cent growth out of the next eight years). To achieve an average economic growth rate of 4.75 per cent, it would be necessary to maintain growth rates over 6 per cent in normal years. Australia has not achieved such rapid growth for more than a few quarters in succession since the sixties, and neither has any other OECD country.

Although Japan and many other Asian countries enjoyed unbroken expansion over the period 1984 to 1992, Japan averaged only 4 per cent economic growth and Asia as a whole 6 per cent. Most of the successful NICs in Asia are now averaging rates of growth around 6 or 7 per cent. The task of achieving high growth in these countries is considerably easier because of the opportunities for catching up to the developed world in terms of technology, education levels and capital-labour ratios. The growth

rates aimed at by the Green Paper taskforce would therefore imply a level of economic performance superior to that of the NICs and of all other OECD countries over the past twenty years.

A critical precondition for the achievement of these goals is that there should be no serious recession for the next eight years. As has already been argued, even the occurrence of slowdowns such as that experienced in 1986 will render the achievement of an average growth rate of 4.75 per cent very difficult.

The most obvious potential source of macroeconomic difficulties leading to a recession is the current account deficit. To the extent that domestic economic growth leads either to increased consumer demand or to increased physical investment, there will result an increase in import demand and *ceteris paribus*, an increase in the current account deficit. In the absence of a change in the conduct of macroeconomic policy, this will be regarded as necessitating the adoption of contractionary monetary and fiscal policies and will ensure that rapid growth cannot be sustained.

It has been argued (most forcefully by Pitchford) that the current account deficit should not be a target of policy. Pitchford's argument is that a current account deficit can only persist if it is financed by loans freely agreed between individuals in Australia and overseas. Any failure to repay particular loans will, he argues, reflect on the individual borrower rather than on all Australians. Against this, it may be observed that the majority of foreign borrowings are intermediated through Australian banks and these in turn are effectively guaranteed against default by the Reserve Bank.

Whatever the merits of the argument, the relevant fact for this paper is that economic policy makers regard the current account deficit as an important target of policy. Any rapid expansion (or 'blowout') in the current account deficit would certainly prompt the adoption of policies aimed at restoring deficits regarded as 'sustainable'.

Within the current policy framework, there are very few policy instruments

which can be used to achieve this goal. The floating of the dollar and, more importantly, the concomitant abolition of exchange controls, removes the option of devaluation. Current policy thinking would not countenance the discretionary use of tariff policy, let alone of quantitative restrictions on imports. Even the very modest 'Buy Australian' campaign is regarded with suspicion.

Hence, the only available response to 'excessive' current account deficits is contraction of domestic economic activity, through tighter fiscal and monetary policy. Measures of this kind do not have any effect on import demand except through their effects on domestic demand in general. Indeed, both high interest rates and cuts in general government expenditure are likely to reduce domestic demand proportionally more than import demand. The only fiscal measures likely to reduce import demand proportionally more than domestic demand are tax increases for upper income earners and cuts in defence equipment expenditure.

The other main macroeconomic concern is the possibility an inflationary upsurge in nominal incomes. The most commonly discussed possibility is that of a wage 'breakout'. In the current high-unemployment situation, it is likely that moves towards labour market 'deregulation' will lead to reductions in real wages and working conditions. However, it is quite possible that a combination of low unemployment and the abandonment of any form of centralised wage fixation could lead to rapid increases in real and nominal wages.

Another, possibly more plausible, route to an inflationary upsurge could work through increases in returns to management and corporate control as in the boom of the late eighties. This could translate into a boom in asset prices and more generalised inflationary pressure. Such a development is unlikely as long as the collective memory of the debacle of 1989 and 1990 remains fresh, but would be quite plausible towards the end of the decade.

As with the current account deficit, changes in the policy framework over the eighties have eliminated many of the policy instruments that might be used to control such developments, leaving only the option of contractionary fiscal and monetary policies. Although the Accord remains nominally in place, the general trend of labour market policy is towards a decentralised enterprise-based contract model, with the main issue of debate being the role of unions. This model leaves no scope for wages policy as a part of macroeconomic policy. Similarly, by abandoning all qualitative controls over bank lending policy (and even any serious attempt at moral suasion) the Reserve Bank has tied its own hands. The set of policy instruments available to curb a future asset price boom is the same as that available in 1989. It contains only one option — raising interest rates sharply and keeping them high until the boom collapses.

The main policy option to improve the functioning of labour markets is the program proposed by the Green Paper Committee. This is based on the provision of a guaranteed place in a labour market program for all long term unemployed workers. The central idea is to reactivate the long term unemployed and thereby offset the effects of hysteresis. However, the scale of the program proposed by the Committee is inadequate (without a further tightening of the definition of ‘long term unemployed’) and appears unlikely to be adopted in full.

In summary, under current policy settings, the prospects for rapid growth depend on strong export growth and domestic stability, particularly in the labour market. The government has greatly restricted the set of policy instruments available to promote domestic stability. The demand prospects for Australian exports will depend far more on economic growth overseas than on the effects of Australian economic policy.

### **Microeconomic reform and the prospects for employment growth**

The Green Paper does not propose any changes in macroeconomic policy, trade

policy or regulation of the financial system. Apart from the labour market policies to be discussed below, the strategy to achieve rapid growth is based on a continuation of the process of microeconomic reform.

The main policies associated with the term ‘microeconomic reform’ have been focused on the achievement of productivity gains through labour-saving organizational and technological innovations. Examples include reform of the waterfront and rail transport systems. Policies of privatisation and corporatisation have also involved large-scale reductions in employment.

One way of analysing the likely effects of microeconomic reform is to treat the pre-reform situation as one in which employment is subsidised, but the subsidy is paid in an inefficient fashion, through ‘featherbedding’. A net social gain can be realised if the subsidy is withdrawn and replaced by a more efficient form of employment incentive such as the labour market programs proposed by the Green Paper Committee or a reduction in disincentives to employment such as payroll tax. The net employment gain from such a switch will depend on the labour market characteristics of the workers who lose employment through microeconomic reform and of those who gain employment through alternative measures. Nevertheless, there are no strong reasons for supposing that the net employment gain will be great.

Under current policies it is more likely that the employment subsidy associated with ‘featherbedding’ will be withdrawn, but that only a small proportion of any savings will be allocated to any form of employment subsidy or employment creation. In these circumstances it is unlikely that microeconomic reform will lead to a net gain in employment.

The most likely outcome from extensive micro-economic reform, provided it is successful in its own terms, is that the rate of labour productivity growth will increase, total factor productivity growth will increase but more slowly, and output will increase

at a slower rate or perhaps not at all. The result will be a decline in net employment. This has been the aggregate experience of both the UK and New Zealand. The UK recorded large increases in labour productivity in manufacturing in the early eighties. However, despite relatively strong output growth in the middle eighties (this was the period of the ‘Thatcher miracle’), manufacturing output never returned to, let alone surpassed, the previous growth path, and manufacturing employment never recovered the losses of the eighties. Similarly in New Zealand, despite strong labour productivity performance, both employment and per capita GDP fell over the eight years during which the main microeconomic reforms were introduced.

The effects of micro-economic reform, both positive and negative have been masked in large measure by the effects of financial deregulation. While micro-economic reform has led to higher productivity and reduced employment, financial deregulation has had the opposite effect. From the initial steps towards deregulation in 1979 until the onset of the recession in 1990, the financial sector grew from 7.6 per cent of the workforce to 10.7 per cent. Total employment in the sector almost doubled. Moreover this growth was concentrated among skilled professionals. Automation and bank mergers had already curtailed the growth of employment in clerical areas. Thus, the financial sector appeared as the source of a potential replacement for the jobs steadily being lost in primary and secondary production.

It is now clear that the growth of the financial sector was unsustainable. Technological change has greatly increased productivity as measured by transactions per worker. Hence, financial sector employment can continue to grow only if the number of financial transactions rises rapidly relative to real product. This is unlikely at the household level. Indeed, the steady increase in transaction fees gives households an incentive to economise on transactions and this has been reflected in declining employment in the retail end of the banking industry. Transactions by business can only be cost-justified if they increase

the efficiency with which final output is produced. There is no evidence that this has been the case. Indeed, an attempt to estimate the contribution of financial sector capital and labour to private business productivity suggests that employees in the financial sector at best make no contribution to final output and at worst have a negative impact. The prospects are therefore for future contraction in financial sector employment. This contraction will reinforce the general tendencies associated with microeconomic reform.

The ideological basis of microeconomic reform, frequently referred to as ‘economic rationalism’ is closely associated with the view that contractions in public sector activity are desirable. The most important areas of public sector economic activity are in the provision of infrastructure and in the supply of community services such as health and education. The logic of the rationalist argument is primarily directed towards the replacement of private with public provision in these areas. However, the difficulties of private provision have led to restricted progress in these areas. Instead, the energy of economic rationalists has been directed towards cutting back the provision of community services, and combined with considerable hostility to those employed in the community services sector (particularly teachers and social workers).

Since the services sector has been the primary source of job growth for at least the last thirty years, the hostility of economic rationalists to the community services sector represents further grounds for supposing that the package of policies associated with the term ‘microeconomic reform’ will in fact lead to employment losses rather than employment gains.

### **Labour market programs**

Current economic strategy rests on the proposition that economic growth will be sufficient to restore full employment. As has been argued above, the current strategy is not informed by either new policy initiatives to secure sustained growth or by character-

isation of the type of growth most conducive to the restoration of full employment.

One element of a sustainable strategy must be the use of active labour market policies is to mobilise the long term unemployed. Such policies can prevent the upward ratchet effect associated with hysteresis, resulting in a lower rate of unemployment at every point in the economic cycle. Accumulation of evidence from many countries suggests that properly designed active labour market policies can generate significant improvements in the employment chances of those involved, and significant reductions in the long term level of unemployment.

Expenditure on active labour market programs was run down in the late eighties and held down through much of the recent recession. It has since grown in a fairly *ad hoc* fashion, as a result of a series of initiatives beginning with the *One Nation* statement. However, expenditure has remained low in relation to the scale of the problem. Furthermore active labour market programs have not been accepted as anything more than a temporary expedient. Forward estimates have consistently indicated that the programs will be phased out as soon as unemployment begins to fall.

The labour market policy proposed in the Green Paper Committee represents a significant move beyond this very grudging acceptance of active programs. Its central element is a 'job compact' based on the idea of reciprocal obligation of all members of society to contribute to society through work and of society to provide work for all.

Under the Job Compact Proposal, both sets of obligations between government and unemployed people would be significantly strengthened. ... Greater assistance would be made available to people who are long-term unemployed, including worthwhile jobs or work experience ... In return for this new commitment from the government, the individual would be required to accept any reasonable offer of employment or assistance. (p124)

The reciprocal obligation approach would help to raise the effective supply of

labour by preventing the loss of skills and motivation associated with long term unemployment. It would thereby permit the achievement of lower levels of unemployment for any given level of job vacancies and labor market tightness. It would also prevent the gradual drift of the long term unemployed into permanent dependence in such forms as the invalid pension (despite general improvements in community health over the past 20 years, the proportion of the population on invalid pensions has doubled) and involuntary early retirement.

The Green Paper proposes an expansion of the wage subsidy scheme JOBSTART. It also proposes direct job creation, through an expansion of the LEAP program and a variety of local community initiatives.

However, the direct job creation proposals are not particularly ambitious, and the overall scope is limited. The result is that the job guarantee is envisaged as applying initially only to those who have been unemployed for a very long time (perhaps as long as three years). Even at the predicted peak of the program, in 1996/97, the job guarantee would only apply after eighteen months of unemployment. The proposed program involves the provision of an extra 170 000 places, with an estimated net additional expenditure of \$1.4 billion. A genuine job compact, embracing all the long term unemployed would require substantially greater expenditure, probably around \$2.5 billion per year

### **Improving the chances of sustainable growth in employment**

By improving the performance of labour markets, active labour market policies could remove one of the obstacles to high levels of sustainable growth. However, such policies will do little to overcome either the labour-saving bias of current organisational and technical changes or the problem that much of the additional demand generated by growth will be met by increased imports. To attack these obstacles it is necessary to go

beyond aggregate measures such as GDP growth and make social decisions on the composition of growth.

The aim of policy should be to promote growth in areas that have high demand for labour and relatively low demand for imported inputs. Such characteristics are most closely associated with the service sector, and particularly with the community services sector and the (considerably smaller) recreational and personal services sector.

Increased spending on services would generate a permanent increase in the demand for labour. The case for such spending is based on a recognition that long-term employment growth can only come from the service sector and that community services such as health, education and R&D are an essential element of this sector. Even when such community services are not publicly provided, they are almost always publicly financed, at least in part. Dogmatic resistance to any expansion of the public sector almost certainly guarantees permanently high levels of unemployment.

In opposition to this approach, it has been argued that it would increase public consumption at the expense of investment. This objection is based on a failure to understand the nature of investment, which is in turn rooted in a belief that goods are 'real' while 'services' are not. Neoclassical economics has long since rejected these primitive ideas, but they remain surprisingly influential. Services such as education, R&D and law and order are not consumption items. They are essential elements of our economic infrastructure, more important in many ways than roads, bridges and harbours.

Related to this objection is the claim that large amounts could be saved by cutting waste in health, education and other services. Efficiency gains could doubtless be made in these as in other industries. Where specific inefficiencies can be identified, they should be eliminated. However, our basic need is for more education and health services, not less. Attempting to achieve efficiency gains through across-the-board cuts, as is being done at present, leads to a misallocation of resources and a reduction in our

long-term economic potential.

A final objection is that any such expenditure would need to be financed by higher taxes in the long run. It has been argued that the effects of higher taxation on domestic demand and savings would largely offset any benefits. Against this objection it should be noted that, particularly for upper-income earners, there is a high marginal propensity to consume imported items. Thus, a large proportion of the increased tax payments would be met by reducing imports. This would permit a somewhat more expansionary stance for monetary policy, thereby offsetting the effects of higher taxes on domestic demand. In any case, the labour input to services and community programs is significantly higher than for total domestic demand, so that even a pure expenditure switch would yield a net gain in jobs.

## **Projections**

Having discussed the obstacles to growth, and possible policy responses it is now possible to make some projections of feasible reductions in unemployment over the next seven or eight years.

Under a continuation of current policies, the most optimistic feasible projection would yield a gradual return to rates of unemployment of 7-8 per cent, suggesting that the number of unemployed at the turn of the century will still be close to a million.

Successful microeconomic reform would result in labour productivity rising fairly rapidly, perhaps at around 2 per cent a year, as compared to 1.6 per cent over the last 20 years and around 3 per cent in the sixties. However, because of the increased substitution of capital for labour, total factor productivity would grow more slowly. Assuming favorable macroeconomic outcomes, an average growth rate of around 4 per cent might be sustained. Working through the simple model set out above suggests a slow decline in unemployment to rates of 7-8 per cent.

An active labour market policy could potentially raise the sustainable rate of growth, and would also increase somewhat the associated rate of growth of employment. However, the likely long-run reduction in unemployment associated with the Green Paper is unlikely to be more than 1 per cent (indeed under the Green Paper proposal no more than 2 per cent of the workforce would be engaged in labour market programs in any given year). In the absence of changes to the orientation of macro policy the projected average growth rate of 4.75 per cent does not appear attainable.

An expansion of community services employment could significantly raise the level of output and employment consistent with any given balance on the current account. An increase of 3-4 per cent in the proportion of the workforce employed in the community services sector would be required to meet social needs for improved health, education and other services. By switching the mix of output towards more labour-intensive services, this policy would reduce the rate of labour productivity growth, but not the level of total factor productivity.

The combination of growth rates somewhat in excess of 4 per cent and slightly slower aggregate labour productivity growth would imply more rapid employment growth - perhaps an average increase of 0.5 per cent per year. Over eight years, this would permit a reduction of unemployment rates to levels of 3-4 per cent.

This implies a employment growth rate of 2 per cent a year, or more than 1 million new jobs over the next seven years. Although this sounds impressive, and would be hard to achieve under current policies, it would make very little impact on current levels of unemployment. After taking account of the increase in the labour force

associated with population growth, the employment/population ratio would rise by around 0.5 per cent a year, or a total of around 4 per cent over the next eight years.

At least a third of this growth is likely to be absorbed by discouraged workers and other hidden unemployed returning to the labour force after the present recession (this implies a cyclical increase in participation rates of about 0.7 per cent). Hence the net reduction in unemployment is likely to be around 2–2.5 percentage points. In the absence of a policy change, the rate of unemployment is likely to be above 6 per cent for the rest of the century , even assuming very favorable macroeconomic outcomes.

### **Concluding Comments**

The recent increase in rates of economic growth has led some commentators to suggest that there is no need for a change in economic policy to restore full employment. The analysis presented above suggests that this complacency is unwarranted. Even with very favorable macroeconomic outcomes, current policy is unlikely to achieve much more than a slow return to rates of unemployment around 7 per cent.

A policy to achieve sustainable growth in employment must address both the supply of and the demand for labour. Active labour market policies based on the concept of reciprocal obligation could improve the supply of labour by mobilising the long term unemployed. An expansion of publicly funded community services would increase the demand for labour. Together these policy changes could permit higher levels of sustainable economic growth and a reduction of the rate of unemployment to 3 or 4 per cent.