Prospects for the Australian Economy in the First Decade of the New Century

1. J Bradford DeLong

What Are Australia's Economic Prospects?

Australia's present

Over the past decade or so the country of Australia has been an effective poster child for neo-liberalism. No matter what the political party in power, governments have pursued privatisation of government enterprises and general microeconomic reform – reductions in regulatory barriers to entry and attempts to eliminate blockages to competition in labour and product markets – in an attempt to accelerate Australian productivity growth.

These policies have been broadly successful, at least as far as their effect on real economic growth has been concerned. Australian measured economic growth in the 1990s, at 2.3 per cent per year per capita, has been more than half a percentage point faster than in the 1980s. Labour productivity in the market sector has grown at 2.9 per cent per year during the business cycle expansion of the 1990s, compared to 1.4 per cent per year during the business cycle expansion of the 1980s. Moreover, this acceleration of labour productivity growth is not the result of a high-pressure macroeconomy in the 1990s: Australian unemployment at the end of the 1990s was unusually high, more than 7 per cent.

However, the burst of productivity growth in Australia in the 1990s has been accompanied by a widening of inequality in income and wealth. (However, Australia remains one of the most egalitarian countries in the OECD.) This should not have been unexpected: if you reduce regulatory barriers to entry and eliminate blockages to competition, factors of production that are in low demand will lose (relatively speaking, at least). The factor of production that was in low demand in Australia in the 1990s was labour: hence a rise in inequality.

Thus even though the macroeconomic and microeconomic news from Australia's program of neo-liberal economic reform has broadly been good, it is not clear whether the political coalition to sustain and enhance this program can be built. Policies that are not perceived as *inclusive* have little long-run chance of persisting.

Australia's future

Looking forward, it is difficult to see how Australia's future economic growth prospects over the next decade or so can avoid being brighter than the present. The United States experienced a surprising burst of productivity growth in the 1990s. The consensus view is that this burst of productivity growth – a full extra 1 percentage point per year of increase in average incomes and in productivity – was the result of computers and communications technologies finally reaching critical mass, and the benefits from exploiting these new technologies finally became large in macroeconomic terms.

There is every reason to think that the same path of productivity-enhancing computer investment could be followed by Australia if the flow of savings to finance high investment were present. But Australia's domestic savings rate is low. There is little prospect for large government surpluses to indirectly finance private investment, and little prospect for large amounts of direct government investment. In part, at least, because of the perceived uneven benefits from liberalisation and reform, the next decade seems likely to see all available tax revenues earmarked for the social insurance state.

Thus a high-investment Australia in the next decade needs to be financed, in large part, by a capital inflow: a large persistent current account deficit.

Dare a small open economy run a large persistent current account deficit? Remember Britain and Sweden in 1992, Mexico in 1994–95 and East Asia in 1997–98. The 1990s saw a stunning wave of largely unexpected financial crises driven in large part not by deteriorating economic fundamentals but by herd panic on the part of domestic and foreign investors. Growing foreign debt increases the likelihood and severity of such crises. To date, no country with a floating exchange rate has suffered one. But there is no compelling theoretical reason for this immunity – especially if the foreign debt is denominated in foreign currencies. Yet the potential productivity gains from a high level of foreign-financed investment are so large as to be irresistible. It looks as if the risks are worth running – although steps should surely be taken to minimise them.

In essence, therefore, Australia's future looks much like its past. In the late 19th century, Australia was a rapidly growing economy relying on imported capital and vulnerable to the whims of global finance. In the early 21st century Australia may well become the same.

2. Rob Ferguson

The Future – The Adelaide Effect?

We've spent the last days talking about how well Australia has done in the 1990s – now for the future.

What are the prospects for the Australian economy in the next decade?

For those who deal in numbers like us there is an easy tendency to think the future just rolls on from the past, a bit the way compound interest does.

But away from the world of numbers, to quote JM Coetzee:

> ...the future is merely a structure of hopes and expectations, it resides in the mind, it has no reality.[1]

1. JM Coetzee, South African novelist, address to Sydney Writers Festival recorded on ABC Radio National Arts Today Program, 19 May 2000.

Well, what resides in my mind?

I have a view on why Australia has done so well in the 1990s that is influenced by comparing Australia with the old countries in the Northern Hemisphere, England in particular.

I was in London a few weeks ago at a dinner party and a lady from Milan who lives her life in Milan and London asked, 'How often do you come to London?' I said, 'Twice this year but I don't think I'll be coming back so often because I'm finding it so overcrowded and dirty'.

Of course, she'd never been to Australia to know what I was comparing London with.

Why do we keep going back to England? There was a long article in the *Sydney Morning Herald* on Saturday by Peter Conrad,[2] a Tasmanian who returned to Australia after 30 years finding himself 'in a confident country selling dreams to the world'.

Thirty years ago it was different. He left, like lots of the very bright, to study at Oxford.

He wonders why he went away. He attributes part of the blame to the seditious book in the tea chest he took on the boat trip to England. He had a colonial childhood but it was English literature that alienated him from Australia.

He asks, 'How could I love the place I grew up in when the books from which I derived my mental maps denied its existence?'

Our generation was brought up on a steady diet of Biggles, Enid Blyton and Beatrix Potter.

So it's no surprise that it takes a long time to get over the thatched cottages, cute hedgehogs and Cotswold stone wall hang-ups.

I was in the Cotswolds two weeks ago. It was quaint and very green, so it's little wonder that it takes so long to shake the England that's engraved in our sub-conscious minds. But you realise you've shaken it when after you're back home and, ex the jet lag, you see the blue sky and the birds and realise there's nothing about England you miss any more.

Thirty years ago people left for conversation at places like Oxford. Now you can get it here. Conversation, music, food, art. We have developed lots of culture.

So as our Tasmanian says:

> No young Australian will ever feel as isolated, needy and inadequate as I did. Australia's self-confidence has expanded to fill the continent: instead of harrying its restive dreamers into exile, it awards them grants to write novels or direct films.

What about the other world's view of us? Thirty years ago we were still obsessed by our beginnings where Australia began as 'an imperial amenity, a tip for Britain's human refuse'.

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2. Peter Conrad in Spectrum, *Sydney Morning Herald*, 22 July 2000.

At the end of David Copperfield, Dickens sent the improvident Micawber to Australia where he immediately made good!

It's little wonder Australians grew up with a low opinion of themselves.

But now, 30 years later in England, Australia is seen as exotic.

The English TV ads herald the new brand 'Australia' and the punchline is 'Discover the other side of yourself'.

We are no longer down under in Paul Keating's arse end of the world. Down Under, as Peter Conrad says, is no longer derogatory and referring to topsy-turvydom, Down Under is not the unsightly monkey's bum that Keating imagined. It's a place of excitement, potential and excellence, if we want it to be.

But here in the Reserve Bank there's a line that goes, 'What about the Adelaide effect?'

The Adelaide effect reflects the fear that globalisation will suck out all of our head offices and talented people to New York, London or Harvard and leave us just like Adelaide or Auckland. A provincial place where all the kids have to leave town to make good.

Is that what globalisation offers Australia? I believe not.

The Adelaide effect is off-course – another version of the 'winner-take-all society' described by Robert Frank and Philip Cook in their book.[3]

They talk about trade barriers, travel costs and internal markets being reduced or eliminated all over the world, producing a single unified global market in many industries and professions.

Sure, this is one tendency of globalisation. But how come, given the amount of globalisation that Australia's gone through since the 1980s, we are up amongst the top six OECD countries in the world in terms of productivity growth: Finland, US, Netherlands, Sweden, Ireland and Australia? How come our technology take-up is also right up there? Does this fit the picture of a society hollowed out by globalisation?

Now you may argue that it's early days. The worst is to come.

But my point is we are extraordinarily well placed for whatever might come because what we have created down here is a society that works. A society that is no longer part of the arse end of the world, but something that is exotic and attractive to others. Yet we are still maybe in the last stages of shedding the old colonial engravings in our mind and it makes it hard to see this.

Okay, maybe we are well placed today, but let's have a closer look at the Adelaide effect to see what might happen in the future.

To do this I've gone to the horse's mouth. I spoke to some people in Adelaide and Auckland, and even remote Perth, to get their views. Perth's so remote you'd expect them to be shivering in their boots. What do they all say?

3. Frank and Cook (1995).

Auckland first. New Zealand has lost three head offices to Australia or Asia in the last few years. Nufarm to Melbourne, Brierley NZ to Singapore, and Lion Nathan to Sydney.

Nufarm and Brierley were very small head offices. Brierley's had maybe half a dozen people in their Wellington head office.

The interesting one is Lion Nathan, a big NZ brewer. You'd expect it to be a big deal for them to move to Sydney, but in fact there were only 25 jobs displaced from Auckland to Sydney. Of more importance, however, was the retention of 820 jobs in New Zealand.

What stayed in New Zealand were liquor assets of NZ$750 million, NZ$550 million of revenue and taxes of NZ$150m paid to the New Zealand Treasury. So Lion Nathan has gone global but still is a good corporate citizen in New Zealand. All it has done has placed the senior management of its business at the place where the bulk of its revenue is generated. This hardly seems unreasonable.

The reality is New Zealand is composed of lots of small businesses and that's where the jobs are created and that's where the entrepreneurialism is.

In New Zealand, 90 per cent of businesses have five employees or less. So if you're looking for the engine room of economic activity, it doesn't come from large companies.

I think the Adelaide effect focuses too much on the issue of where the head office is. Big business, regardless of where the head office is located, will want to attract and retain good people and give careers in New Zealand, Australia and the rest of the world.

New Zealand is similar to Australia in this regard. Lots of young people go overseas for work experience and work 2, 5, 10 years.

But most yearn to get back. They accumulate capital and experience globally and come back to live very good lives at the local exchange rate.

My correspondent in New Zealand reads the *Wall Street Journal*, the *Financial Times*, the *Economist* and the *Australian Financial Review* on the internet. Technology has made it easy to live anywhere.

But it's not all good news from Auckland. There is a word that used to be used directed to Australia that can still be directed at Auckland. Provincialism.

There was an article in the AFR recently that suggested New Zealand was having difficulty attracting and retaining good quality immigrants.

New Zealand society is nowhere near as diverse as Australian society.

In the post-World War II period over five years, Australia became home for more than a million Greeks and a million Italians.

This didn't happen in New Zealand.

Their blue-collar labour force was provided by Polynesians and this has left New Zealand society lacking in diversity and, some say, accordingly somewhat hostile to Asian migration.

This will be New Zealand's loss.

I heard our Foreign Minister, Alexander Downer, talking at a dinner the other night about how when he was a kid and his father was in the Menzies Cabinet, his Dad would come home and talk about the nation-building that Australia was engaging in during the post-War period by bringing in so many settlers.

What about Adelaide itself? My Adelaide correspondent tells me that the loss of head offices is no big deal. He says, 'Globalisation allows Adelaide to be good at what it does well'.

The Adelaide we know from the past became great because of copper and sheep and wheat, but all that's gone because of commodity prices.

Then there was the Adelaide that was propped up after the war by protection.

They were false props that built an artificial motor vehicle industry and, when the props were removed with tariff reduction, the people who were made redundant saw their house prices collapse so they couldn't move to other jobs.

That sort of artificiality was bad for Adelaide. What's happening now is they are building sound foundations.

So the wine industry is doing well in exports at the current dollar rate and lots of good processing jobs are moving to Adelaide because there's a well-educated workforce and it's not an expensive place to live. Sure, a lot of the kids might leave for Sydney but didn't that always happen to Adelaide?

Then there's Perth, the remotest city on the planet. Next to the Indian Ocean and the closest city 2 000 kilometres away is Adelaide.

But in Perth they have realised that you have to look outside of Perth for additional markets and capital.

There's a technology company called ERG that's sold ticketing systems in Sydney, London, Rome and New York. All done out of Perth.

Once again, Perth's a great city to live in, great services, low cost structures and a good environment.

What about research and development in Australia? Well, in medical research Australia has a competitive edge.

Why?

1. Low wage costs
2. Currency effect
3. Portability of research.

Research doesn't have to be done in the US any more. It can be farmed out. The National Institute of Health in the US funds research globally, including the US, on the basis of excellence, not geography. So Australia has at least two world-class medical research centres – the Walter and Eliza Hall Institute in Melbourne and the Garvan Institute in Sydney – and in Perth at least one major research institute is already the beneficiary of major US research dollars.

So what I'm talking about in Australia and New Zealand is the way we have adjusted to globalisation already. The success of that adjustment is there to see from what we've talked about over the last few days. It seems to me the floating exchange rate has got a lot to do with the way we have adjusted. We sometimes forget how important that event was in 1983 because the adjustment process has become so seamless.

I think globalisation allows Australia to be a sort of Switzerland of the new century. They had snow and mountains and clocks. What we've got is a society that works very well, where distance has been eliminated and so you can live here without isolation doing business around the world.

Sure, there are other places with great attributes, be it Canada or California or New Mexico. There's a cluster of lucky places around the world and we're one of them.

What would the knockers say?

We're provincial and we're a long way away. But that's nonsense.

Others might say that the US will just buy our best people. Is that the essence of the Adelaide effect? Everybody has a price it says. That's true if you measure your life by money, but not everybody does that and we don't particularly want that sort of culture anyway. We can afford to lose those people.

Others may say we don't have the capital markets of Wall Street or Silicon Valley but what is clear today is that it is capital that goes to good ideas rather than the reverse.

So we've got access to capital, we've got access to a big market – the world. The output of the future – software – can be sent anywhere.

So to me that's the future. Our problem is we don't know it enough. We are still suffering from those colonial engravings in our minds. We need to get the buzz that Ireland or Israel has developed. Do they discuss a local version of the Adelaide effect in Dublin or Tel Aviv? I doubt it.

It's not about Adelaide. It's about excellence, about doing well at things at which you excel. That's the challenge.

References

Frank RH and PJ Cook (1995), *The winner-take-all society: Why the Few at the Top Get so Much More Than the Rest of Us*, Free Press, New York.

3. Ross Gittins

Another Decade, Another Set of Issues

In thinking about the prospects for the economy in the coming decade it's always easier to focus on the things that need attention and the things that could go wrong than on the things that could go right. That's the economist's way and, in any case, if you thought everything was going to be fine, there wouldn't be a lot to talk about. But Gruen and Stevens' paper (this volume) reminded us that, had you been engaged in such a future-gazing exercise at the start of the 1990s, you wouldn't have dared to hope that things would go so right on so many fronts as we now know they did. So it behoves us to resist the temptation to become too oppressed by the problems and risks that lie ahead. As well, it gives us a much more promising starting point from which to cope with those problems.

But the 'noughties' will be a decade in which the growing confidence of economists at the end of the 1990s will be tested. Has there been some structural improvement in the way the economy works and in the way the macro managers manage that will allow the economy's improved performance during the 1990s to continue unabated for another 10 years? Or will some Factor X turn up that returns us to our more accustomed state of anxiety and mediocrity? Gruen and Stevens were honest in reminding us that at least part of our success in the 1990s was owed to the significantly more stable external environment in which we operated. Can we expect the rest of the world to be as kind to us in the noughties? There are no guarantees. I was also interested to see in their paper a shift in the rhetoric from stressing the need to 'prolong the expansion' to stressing the need to achieve a 'shallow' recession. We can confidently expect to see a recession some time in this decade – its degree of severity will be, to me, the ultimate test of our much-hailed structural improvement and superior macro-management 'framework'. But, if we can pass that test, the US experience in the 1990s promises us we can expect to make great strides in the noughties. Another question that will be answered in the coming decade is whether the improvement in our rate of productivity growth of the 1990s proves to be a lasting step-up or just a once-only catch-up – whether it was about improved productive efficiency or greater dynamic efficiency.

I foresee that fiscal policy will remain an area of pressure and problems in the noughties. On the positive side, governments will reap the benefits of the recent round of tax reform, in the form of buoyant growth in revenue. Over time, the GST will raise far more than the motley collection of indirect taxes it replaces, and I also believe that the Australian Business Number (ABN), the pay-as-you-go (PAYG) system and other 'integrity measures' will do much to restore the revenue-raising power of income tax. The New Tax System is truly a structural improvement from a fiscal-policy perspective. But I doubt if it will end the annual struggle to balance the Budget. The problem I see is that we've gone through a 20-year period of using fairly crude methods to restrain government spending in various areas, but we're not going to be able to keep the lid on for another 10 years.

One area is defence spending, with its allegedly looming problem of 'block obsolescence'. Another is general capital works, with the rural revolt contributing to pressures for increased spending on rural telecommunications, roads and highly expensive new railways (notwithstanding the assurances that these visionary projects can be fully financed without government contribution). As well, we have a lot of bills outstanding in the area of repairing the environmental damage done by 200 years of inappropriate farming practices.

But the two really big areas of government spending where crude cost-capping measures can't hold out much longer are the financing of health care and the financing of higher education. Peter Forsyth (this volume) said a bit about education, so I'll mention health. The pressure is coming not so much from the ageing population as from the cost of technological advances. The challenge is to find a better trade-off between equity (universal coverage) and efficiency, so the savings from greater efficiency can be used to afford more of the benefits from advances in medical science. The answer is some form of 'managed care', and the stumbling block is the desire of the medical profession to protect its income.

Reform of health and education financing can be seen either as challenges for fiscal policy or, following Forsyth, as major outstanding items on the agenda of microeconomic reform. There are two other major issues for the decade. We'll have to decide whether or not we need to achieve a higher rate of national saving, and what part measures to encourage or compel increased private saving may play in that. We will also have to make up our minds about population growth - what we're doing about immigration and the declining birth rate.

Now for some political economy. We hear much these days about 'reform fatigue' – and it's real enough – but my positive observation is that there's a countervailing force: these days, federal governments aren't allowed to merely preside. We've come to expect them to have one or two major projects on the go at all times. As you recall, it was big business's complaints about the present Government's lack of activity and vision at the time of the 1997 Budget that prompted John Howard to embark on tax reform. So I remain confident the coming decade will see progress on at least some of the major issues I've mentioned.

One of the lessons of the 1990s was that, though governments that preside over poor macroeconomic performance can expect to be punished by the electorate, it doesn't follow that governments that preside over good performance can expect to be rewarded. The good performance we've been celebrating these past two days wasn't worth many votes to the Howard Government at the 1998 election and it's not likely to be worth many at next year's election. This is part of the dynamic of the pressure on governments to always have some major reform project on the drawing board.

But another part of the phenomenon is a kind of Top 40 effect: when the public, the media and the Opposition don't have unemployment, inflation or interest rates to complain about, they don't hold congratulatory conferences, they find other things to worry about. The obvious current example is distributional issues (which I will leave to Bob Gregory to comment on in detail), but I would argue that concern about the environment is correlated with the business cycle.

And then, of course, there are the discontents of RARA-land – rural and regional Australia. If the rural revolt has a big effect on the outcome of the next election – or is merely perceived by the politicians' conventional wisdom to have had such an effect – it's likely to remain high on the political agenda of both sides for much of the rest of the decade. RARA is an area where, I fear, rational policy advisers have been caught short. They're full of policies for unwinding cross-subsidies between the city and the bush, but short of second-best proposals: politically attractive measures that would be less than utterly wasteful. This is a vacuum the politicians will fill with their ominous 'nation-building projects'.

This Top 40 effect is one reason it's so hard to sustain large Budget surpluses when times are good. And it's a reminder that, even if we realise our hopes of maintaining the economy's improved performance during the noughties, there'll be plenty of other issues to occupy our attention.

4. Bob Gregory

Miracle Economies Are in the Eye of the Beholder: Our Failure to Create Sufficient Full-time Jobs

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 re-balance 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.

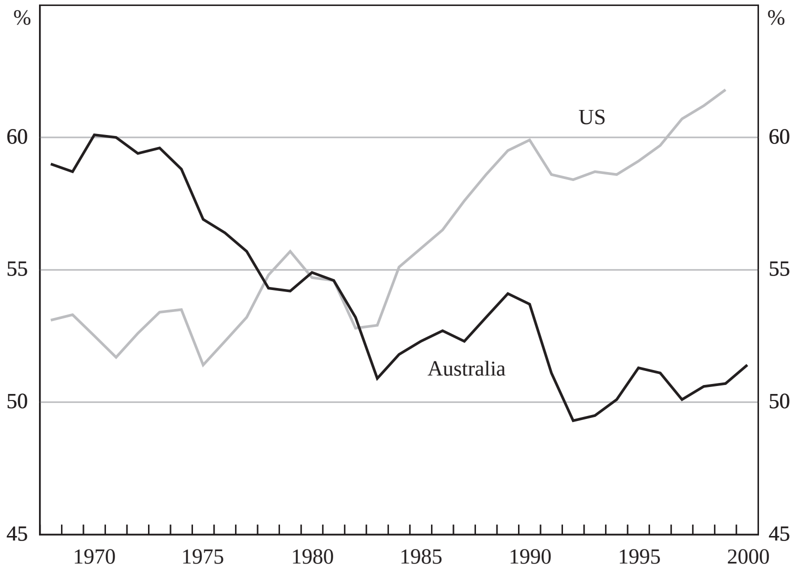
There is no evidence to date that the 'miracle' economy has begun to consistently generate better performance in any of these areas. Maybe it is too early to detect a change. Perhaps, in response to the current upswing in the interest rate cycle, these outcomes may deteriorate further.

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

Figure 1: Australia and US Full-time Employment to Population Ratio

Per cent of population 15–64 years



Sources: Australia – author's calculations based on ABS Cat No 6203.0 (August, various issues); US – US Department of Labor, Current Population Survey

through to the early 1970s, the Australian full-time employment to population ratio was approximately 7 per cent above that of the US. We were a high-employment economy. Then the dramatic slide in the Australian full-time employment to population ratio began. The full-time employment to population ratio fell 9 per cent between 1970 and 1983, by which time it was below that of the US.

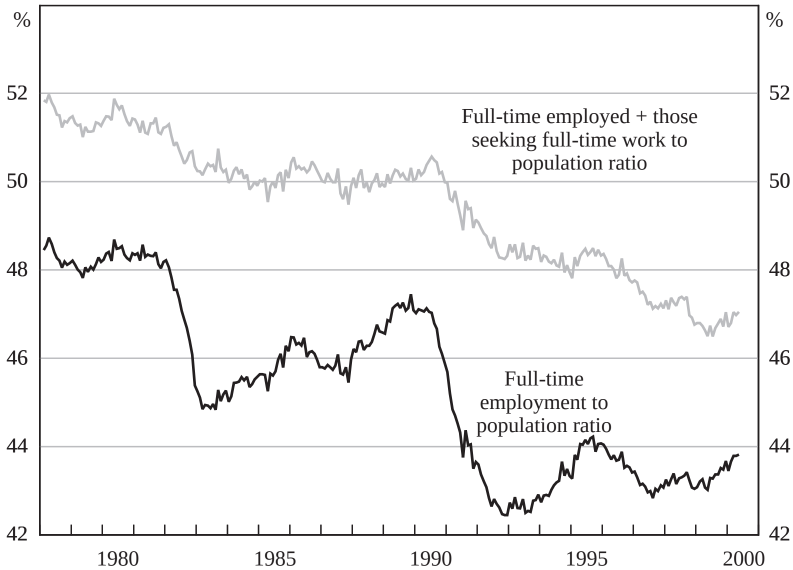
Australian full-time employment began to increase from the depths of the recession in the early 1980s but since 1990 the full-time employment to population ratio has fallen once more – a further 4 per cent – and the full-time employment to population ratio of the US has increased a further 3 per cent.

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 to 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.

Figure 2: Full-time Labour Supply and Demand to Population Ratio

Per cent of population 15+ years



Source: ABS time series statistics, supplied through EconData DX Data Services, March 2000

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 period.[1]

1. The data on the number of welfare recipients are taken from 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.

Table 1: Increase in Full-time Employment, Non-student Welfare Recipients and Population 15–64 Years

	1970–1980		1980–1990		1990–1998	
	000s	%	000s	%	000s	%
Increase in:						
Population 15 – 64 years	1 548	(100)	1 867	(100)	1 062	(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)

Note: The period August 1988 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 1980s outcome.

Sources: ABS Cat No 6203.0; Whiteford (2000)

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 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 small.[2]

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

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

Table 2: Increase in Non-student Welfare Recipients
15–64 years, 000s

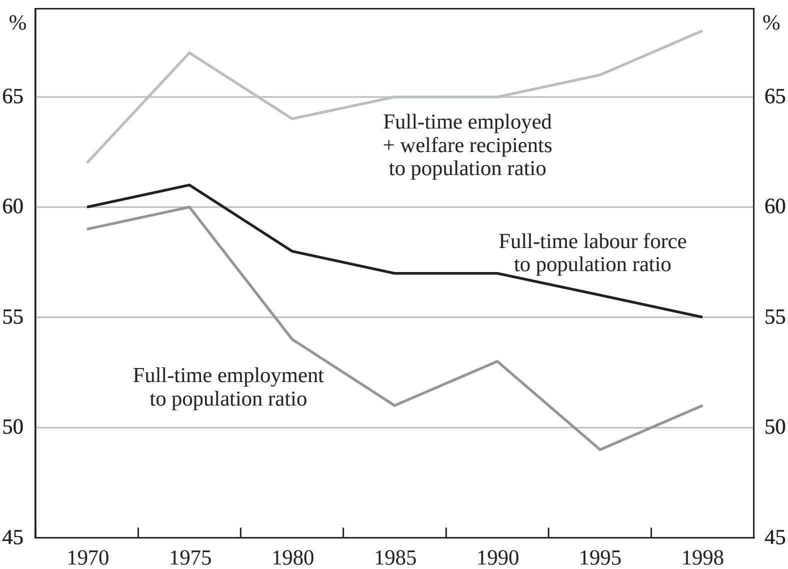
	1970–1980	1980–1990	1990–1998
Increase in:			
Disability and sickness	184	187	150
Parenting and widows	160	91	319
Unemployed	379	180	274
Total	**723**	**459**	**743**

Source: Whiteford (2000)

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

Figure 3: Full-time Employment, Labour Force and Welfare Recipients
Per cent of population 15–64 years



Source: See Table 1.

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. In 1970, one in twenty members of the 'potential full-time labour force' was supported by 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 to 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 to 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 415 000 full-time jobs over and above the demands generated by population growth. Against an annual growth of full-time jobs of 53 000 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 – seem 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.

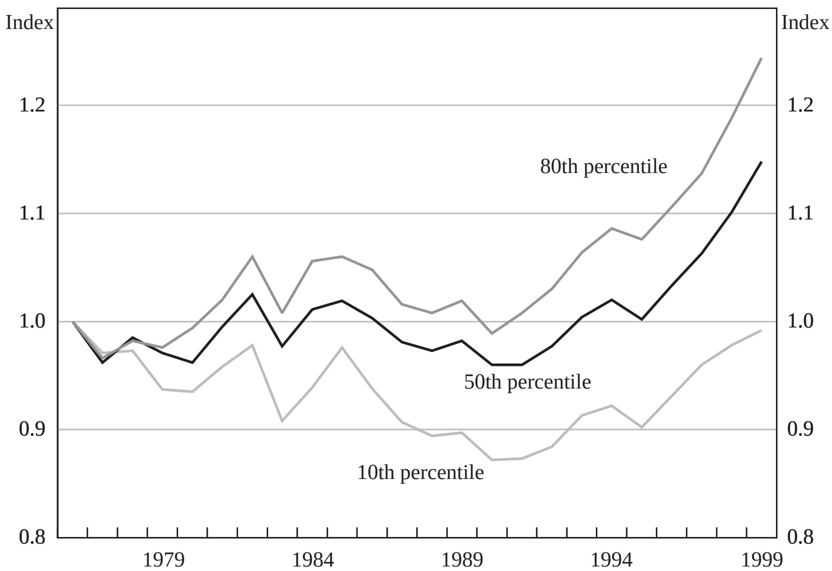
To review the history of wage changes, and to comment on the results of deregulating the labour market, we focus on the distribution of average weekly earnings from full-time employment. Each annual cross section of individual earnings has been ranked from high to low and real earnings at the 10th, 50th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

Figure 4: Index of Real Full-time Weekly Earnings at 10th, 50th and 80th Percentile

Adult persons, 1976 = 1.0



Source: ABS Cat No 6310.0

bottom of the wage distribution, would be relatively ineffective.[3] 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 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 seems 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 Tony 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* (emphasis added), 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. (Abbott 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

3. Something of this order has been advocated by Dawkins and Freebairn (1997). 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.

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 jobs.[4]

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.

Finally, it is evident from Figure 4 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 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.

4. The government has recently received the report of the Reference Group on Welfare Reform (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.

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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5. General Discussion

The discussion of the final panel session provided an opportunity for participants to discuss future prospects for the economy, as well as to return to themes that had been discussed in earlier sessions of the conference, which might have important implications for the future.

The tone of the discussion about future prospects for the Australian economy was one of cautious optimism. Participants agreed that macroeconomic outcomes in the 1990s had been favourable on many fronts, but some argued that continued reforms were needed for these outcomes, particularly the strong productivity growth, to be sustained.

In taking stock of important developments in the 1990s, participants pointed to eight years of solid growth, declining unemployment and low inflation as being very positive outcomes. They attributed these outcomes to structural reforms and prudent macroeconomic management. The significance of a relatively benign external environment over most of the 1990s was also highlighted. As a sign of just how benign this environment had been, one participant remarked that it was perhaps unique that terms-of-trade shocks had been mentioned only once in a conference about a decade of Australian economic experience. The relevance of fiscal reform was also discussed, with some echoing Ross Gittins' view that the new tax system had been an important structural improvement.

Others argued that more should be done to arrest the rise in income inequality, and that a more equitable distribution of earnings may enhance the prospects for continued growth and stability. One participant added that the concerns recently raised by Australia's rural communities need to be addressed, and that these concerns should play a significant role in decisions made for the country as a whole.

A few referred back to the paper by Edey and Gower to consider the future implications of policy-induced disincentives for saving, as well as the implications of demographic change. Indeed, one participant nominated demographic change as one of the key developments that would determine economic outcomes over the decades to come. This participant pointed to the implications of ageing not only for national saving, but also for labour market outcomes and for government expenditure.

The current account debate was also revisited. Several participants acknowledged the trade-off highlighted by DeLong – on the one hand, Australia can continue to benefit from a higher level of investment funded by foreign saving; on the other hand, continued reliance on foreign saving could make the economy more vulnerable to sudden changes in investor sentiment. It was acknowledged, however, that Australia's effective supervisory and regulatory system should significantly reduce its vulnerability to changes in investor sentiment. Furthermore, it was pointed out that much of the foreign investment in Australia had been in the form of long-term and less volatile foreign direct investment.