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Reducing Unemployment: A Conference Report
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Reducing Unemployment:
A Conference Report

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Executive Summary

This Current Issues Brief reports on a recent major conference organised by the Australian National University's Centre for Economic Policy Research and the consulting firm, Access Economics. The conference addressed prospects and policies for reducing unemployment. It surveyed the international context of world economic growth and proceeded on to a discussion of topics such as the unemployment outlook in Australia, monetary and fiscal policy settings, real wages and wage restraint, the issues surrounding long term unemployment, and the roles of both labour market deregulation and jobs levy / wage subsidy schemes in encouraging employment growth.

The causes of, and cures for, unemployment have always been controversial and disputed subjects and this certainly held true for this conference. However, some arguments and positions did achieve widespread support. These key, broadly-supported conclusions of the conference might be summarised as follows:

- Rapid output growth in Australia will be vital to increasing employment and reducing unemployment. Australia's proximity to rapid Asian economic growth augurs well for Australian economic growth, particularly in relation to our exports.

- Macroeconomic policy settings can influence the magnitude and pattern of economic growth and its balance with the current account deficit.

- Wage restraint can contribute to growth in output and employment.

- However, special additional policy measures may be needed to deal with long term unemployment.

In contrast, some key issues continued to be controversial, in particular:

- The effect of labour market deregulation and microeconomic reform on unemployment: This was a matter of some dispute because of the counteracting forces involved, at least in the short term.

- The relative importance of aggregate demand growth in stimulating employment growth: Many still argue that current
account deficits impose a constraint on sustainable aggregate demand growth.

- **The value of jobs levy / wage subsidy schemes for reducing unemployment:** Proponents saw these as an effective alternative to wage cuts for the unemployed while opponents argued that they would not be effective and that wage cuts were unavoidable.

The last section of this paper sets out some of the writer's own reflections on the conference proceedings and on policies to reduce unemployment. In short, these are that:

- Robust growth in aggregate demand, which might be oriented to increasing exports and import replacement, is an essential condition for encouraging sustainable employment growth.

- Reducing real unit labour costs will also be important. To achieve this wage restraint, the most feasible policy path is one of boosting productivity growth and allowing real labour costs to increase by a lesser amount.

- Boosting business investment spending will be vital to this need to raise productivity growth and also to sustaining aggregate demand growth.

- More extensive wage subsidies for the long term unemployed will be needed to deal equitably and fairly with this problem.

- Labour market deregulation and general microeconomic reform do not seem to hold much promise for increasing employment in the short term because their boost to productivity is substantially counteracted by firms' extensive labour shedding which is often part of this very process of change.
1. Introduction

Unemployment is now one of the greatest problems and challenges facing Australian policymakers; putting people back to work will be a major preoccupation of policymaking for the next few years and probably for far longer. The Prime Minister's Committee on Employment Opportunities has issued a Discussion Paper on 'Restoring Full Employment' while the commissioned report by Bruce Chapman of the Australian National University on long term unemployment (LTU) has also been presented. The Government will soon announce its policy response to these analyses. In this climate of concern it was most timely that a recent conference, organised by Access Economics and the Centre for Economic Policy Research at the Australian National University, focused upon the problem of 'Reducing Unemployment'. This paper surveys the presentations made and discussions which took place at this gathering. The last section presents my own reflections on policies and prospects for reducing unemployment.

2. The World Economy and OECD Unemployment

John Hawkins (Reserve Bank of Australia) began by stressing that growth in the world economy (growth in real world GDP), and in our trading partners especially, is of fundamental importance in determining Australian economic growth (growth in Australian real GDP). Specifically, he asserted that world economic growth could statistically 'explain' perhaps three quarters of Australian economic growth. For the remainder of the 1990s he foresaw 1) strong economic growth continuing in the developing countries of Asia, especially in China, 2) modest but respectable growth (3 per cent p.a.) in Japan and Canada which may not recommence until next year in the former case, 3) similar moderate growth (2.5 per cent p.a.) in the United States, 4) higher economic growth in Latin America than seen in recent decades there, 5) slow and uncertain economic recovery and comparatively low growth in Europe, and 6) continuing structural problems and inadequate growth in the former Soviet bloc and in Africa. Overall, this world outlook augured reasonably well for Australia, especially because of our expanding links with Asia, a region which looks like being the locomotive of world growth in the next several years.

He then turned to a more specific discussion of recent unemployment in the advanced countries. He argued that the main influence on employment is production and that very weak economic growth largely explained why there had been no growth in employment in the OECD
countries between 1990 and 1993. The pattern in most countries has been for unemployment to rise rapidly in recessions but fall only slowly in recoveries - 'up by the lift and down by the stairs' - with a large percentage of extra jobs created by economic recovery going to new entrants to the workforce rather than to the already unemployed. As a result, the rate of LTU (defined as continuously unemployed for more than a year) has increased markedly in many countries. Unemployment is often a vicious circle with lower self esteem and motivation further reducing the chances of finding a job. Perhaps a third of employers refuse to even interview the LTU for positions.

He noted in passing that the evidence suggests that unemployment benefits are not at all a major cause of the growth in LTU. On the other hand, there is some evidence that 'active' labour market programs (direct job creation, subsidised employment, labour market matching and training schemes) can reduce LTU.

Regarding cross-national differences in recent unemployment rates, he noted that while European and Commonwealth countries almost all have unemployment rates around 10 per cent, rates were somewhat lower in the United States and markedly lower in Japan and, until recently, in the Nordic countries. Although the depth of recession had varied between countries there were other factors operating. He explained the U.S. outcome in terms of 1) labour market flexibility and substantial real wage cuts amongst blue collar workers, and 2) the reinforcing factor of the cessation of unemployment benefits which drove the unemployed either into accepting lower paying jobs or out of the workforce and mainstream society completely and into conditions such as social isolation, homelessness or criminal activity. He explained the Japanese outcome largely in terms of the traditional practice of labour hoarding by Japanese companies during recessions in which many 'window gazers' were kept on the payroll. He explained the Nordic outcome in terms of the success of active labour market programs in those countries.

He concluded with some policy recommendations for reducing unemployment. **Active labour market programs** can be very useful, especially in re-engaging the LTU with the workforce. Continued restraint on real wages and **real unit labour costs** (the real value of wage and non-wage labour costs when adjusted for productivity growth) can provide a major encouragement to increased employment. Hawkins particularly stressed the need to scale back the costs and inconvenience of firing workers (such as notice to be given and levels of severance pay) since evidence suggests that such costs can discourage the hiring of workers in the first place. His only specific suggestion offered for raising world economic growth was that of further trade liberalisation in the context of the GATT negotiations.
Discussion of the paper was led by Graham Hodges (ANZ Bank). He was more pessimistic about the short term outlook than Hawkins, especially for Europe and Japan, although he was confident that a strong world economic recovery would be in place by 1996. He expected that higher OECD productivity growth would dampen employment growth in the short term but accelerate such growth in the medium and longer term.

3. The Outlook for Australian Unemployment

Ed Shann (Access Economics) presented the current AEM (Murphy) model forecasts for the Australian economy and discussed their implications for unemployment. AEM forecasts for real GDP showed growth of 2.3 per cent in 1993-94, rising to 3.3 per cent in 1994-95 and settling into the range between 2.5 per cent and 3.0 per cent for the rest of the decade. The unemployment rate is forecast to fall only gradually to 7.5 per cent by the end of the decade. The Australian unemployment rate is now substantially above the OECD average and this gap is forecast to fall only gradually over the next few years.

Shann was keen to highlight the 'unduly neglected' role (in his view) of labour costs in the current recession. He pointed to data that indicated a substantial rise in real unit labour costs in Australia in the years from 1987-88 to 1990-91. He argued that Australia had experienced an 'explosion' in real wages in recent years, especially when seen from the viewpoint of employers, and that this real wage boom in fact was larger than the real wage increase which preceded the recession of the early 1980s. This had not occurred because of any boom in nominal wages growth but largely because the inflation rate had fallen more quickly than expected. This real wage boom was especially evident when measured from the viewpoint of producers (the producer real wage) rather than from the viewpoint of workers (the worker real wage). This wedge between producer and worker real wages was due to changes in the terms of trade and policy changes such as the superannuation and training levies.

The clear conclusion of his argument was that this real wage boom had contributed substantially to the rising unemployment of the last few years and that this mechanism had not been given the attention it deserved. However, he did agree with the conventional wisdom that contractionary aggregate demand policies had also been an important factor in the onset of recession.

The problem of 'underemployment' was also given much attention. This broader measure includes part-time workers wanting to work longer hours and discouraged workers who have withdrawn from the
workforce but who want a job, as well as the unemployed actively seeking work. For Australia, this measure reached just over 20 per cent in early 1993, which was considerably higher than that experienced by other OECD countries in 1991 (the most recent year in which comparable data is available). He concluded that this high incidence of underemployment will make it difficult to rapidly reduce recorded numbers of unemployed. Employers will work existing part-timers harder and people will re-enter the workforce looking for work, so there may be substantial increases in total hours worked without much fall in unemployment. Indeed, the data for Australia was already beginning to show this divergence.

Shann praised Australia's relative lack of restrictions on part-time work compared to European countries and argued that this might well have bolstered total Australian employment in the recent recession as employers transferred full-time workers to part-time work who might otherwise have been retrenched completely. He asserted that Australia had a highly skewed distribution of hours amongst workers when compared to other OECD countries, with relatively large groups of both part-time workers and those working very long hours. Although overtime is increasing, he judged that a substantial percentage of long hours worked were unpaid, with both salaried employees (not eligible for paid overtime) and the self-employed involved.

He also argued that interstate people flows within Australia are working quite effectively to even up unemployment rates amongst the states although substantial discrepancies in underemployment remain, with the southern Rust-Belt states continuing to be hardest hit in this regard. Policy focus should be put on reducing the costs of interstate movement, although moves to increase labour market flexibility and allow greater wage inequality between regions and states would also help.

Mike Keating (Department of Prime Minister and Cabinet) led discussion. He took up Shann's point about real wage growth and argued that this recent boom will be easier to unwind than previous real wage booms of the 1970s and 1980s because, unlike these earlier episodes, it has not been caused by nominal wage growth and thus is not an expression of unreasonable worker and union demands over wages. Both Fred Gruen (Australian National University) and Ross Gittins (Sydney Morning Herald) questioned whether any recent real wage boom had actually occurred. Shann reiterated that it was not due to nominal wage growth generated through renewed union militancy but due to the overestimation of inflation, which is a quite different mechanism of real wage growth compared to the 1970s and 1980s. Judy Sloan (Flinders University) argued that since most long hours worked were unpaid, then any restrictions on maximum hours worked would not save firms very much in financial costs but would
reduce their labour productivity when measured in terms of output per worker.

4. Macroeconomic Policy and Unemployment

Chris Murphy (Access Economics) utilised his AEM model to calculate the best or 'optimal' course of macroeconomic policy for the rest of the decade, according to an explicit weighting of macroeconomic goals. Most weight is placed on achieving sustainably low unemployment. He concluded that optimal macroeconomic policy plans broadly agree with current macroeconomic policy settings but some disagreements seem likely to emerge in future years. In the optimal plan the current relaxed stance of monetary policy is gradually reversed as economic recovery gathers pace. In the optimal plan the current expansionary stance of fiscal policy is rapidly tightened with the recovery in business investment.

However, Murphy's best-guess scenario of likely future policy settings over the next several years shows these to be quite different from those recommended by the optimal plan, with actual monetary policy too restrictive compared to the optimal plan and actual fiscal policy too relaxed compared to the optimal plan. Fiscal policy will not have moved far enough away from its current expansionary stance. In Murphy's view, the authorities will probably attempt to compensate for insufficient flexibility in fiscal policy with high flexibility in monetary policy; if this occurs it will hamper progress in reducing unemployment.

In this situation, unemployment will be higher than necessary because the tighter monetary policy will have discouraged some investment, thus inhibiting capital accumulation and sustainable growth in output and employment. Thus, Murphy's policy prescription for maintaining low unemployment is one of quicker movements in fiscal policy (through, for example, tax rate changes) to dampen economic shocks and the use of monetary policy to achieve an inflation target in the broad range of 2-6 per cent.

Jerome Fahrer (Reserve Bank of Australia) argued that the nature and weightings of the macroeconomic goals used in Murphy's calculations are flawed in that they effectively give too little weight to reducing unemployment by specifying a sustainable unemployment goal of 7.4 per cent, whereas a much lower unemployment rate should be the goal of economic policy. He also argued that a national savings target should be included amongst the macroeconomic goals and that public debt was viewed as unrealistically harmful by Murphy. Overall, although he agreed with Murphy that current macroeconomic policy
settings are just about right, he cast great doubt on the usefulness of the future optimal policy plans calculated by Murphy.

5. Wage Restraint and Unemployment

Rob Brooker (Access Economics) utilised the AEM (Murphy) model to study the effects on unemployment of extra wage restraint, as implemented by the reducing the independent ('exogenous') component in the growth of real wages. He found that such wage restraint had substantial benefits for expanding output and employment, with a 1 per cent reduction in this component of real wages growth allowing the creation of 200,000 additional jobs and reduced unemployment of perhaps 90,000 by the end of the decade. The difference is made up of the extra persons attracted into the workforce by the higher job creation.

Peter Dixon (Monash University) led discussion and argued that, in the context of open international capital markets, the Brooker argument implied that just a small degree of real wage restraint will lead to full employment in the long run since it will raise the Australian return to capital relative to the overseas return to capital, thus generating capital inflow into Australia and higher rates of investment here. This boom in investment generates extra growth in output and employment. Judy Sloan argued that these macroeconomic exercises are misleading because they exclude essential institutional details. For example, in widespread internal labour markets (i.e. internal to organisations) she argued that wage restraint would have very little effect on employment, although it might have greater effect in secondary, open labour markets where outsiders have some role.

John Quiggin (Australian National University) surveyed the long debate on the relationship between real wages and unemployment and argued that the experience of the recent recession bolstered the Keynesian view that aggregate demand has powerful effects on unemployment and weakened the classical view that real wage growth substantially determined unemployment. This contrasted with the coincidence of real wage booms and jumps in unemployment found in the 1970s and 1980s. Although he agreed that real labour cost cuts could, other things being equal, reduce unemployment it was important to implement these cuts in ways which do not reduce aggregate demand. Wage subsidies financed by income tax rises and cuts to payroll tax financed by energy taxes or higher company taxes would fit this need.

Bob Gregory (Australian National University) led discussion and argued that Brooker's analysis was not a good approach to analysing the real wage - unemployment link because it could only generate
temporary real wage cuts which were eventually counteracted through extra investment and higher labour productivity. The effects of permanent real wage cuts could only really be studied through more focused partial, econometric studies. He also agreed with Judy Sloan that segmented labour markets cast great doubt upon the simple story depicted by the Murphy model, although he did admit that real wage restraint was a major part of the explanation of the 1980s boom in employment and that it should be a part of any recovery program to reduce unemployment for the rest of the 1990s. Chris Murphy responded that the partial econometric approaches to the question are highly misleading because they neglect the effect of real wage restraint on aggregate demand and output through investment effects and the like. Only an integrated macroeconomic modelling approach can deal fully with these complexities.

6. Dealing with Long Term Unemployment

Bruce Chapman (Australian National University) focused on long term unemployment (LTU) and very long term unemployment (VLTU), with the latter defined as unemployed and continually seeking work for two years or more. Both LTU and VLTU more than doubled in the aftermath of the recessions in the early 1980s and early 1990s, while they fell only very slowly during the recovery period of 1984-90. He concluded that those most adversely affected by recession are also not very much advantaged by recovery. The longer the duration of unemployment then the lower is the worker's 1) search activity for a new job, 2) remaining work skill level, 3) attractiveness to employers, thus substantially reducing the likelihood that such people will ever find work.

The large incidence of LTU and VLTU are obviously worrying on the grounds of equity and fairness. They also represent a substantial waste of resources and loss of production and national income. In macroeconomic terms they increase sustainable the rate of unemployment which the economy needs in order to avoid excess demand pressures and accelerating inflation (called the Non-Accelerating Inflation Rate of Unemployment or NAIRU). Overall, the LTU and VLTU become almost irrelevant to the normal functioning of the economy.

He concluded with some comments on policy responses to the problem. Rapid economic growth is a necessary but not sufficient condition for a significant reduction in LTU and VLTU over the rest of the 1990s. Continued wage restraint will be vital for reducing overall unemployment and it will help with LTU and VLTU. While labour market deregulation and moves to enterprise bargaining might
encourage some employment creation, there is a potential in such a system for inflationary wages outcomes which could undermine efforts at job creation. Some continuing aggregate coordination of wage outcomes, through the preservation of some elements of the centralised arrangements of the 1980s, would be wise. Extra efforts on programs targeted at raising the skill levels and motivation of the LTU and VLTU will also be necessary.

Judy Sloan led discussion and argued that 1) labour on-costs can be important in determining employment patterns (e.g. payroll tax thresholds produce some very strange employment effects), 2) there may be a strong case for wage subsidies to help the LTU and VLTU to get back into the workforce, and 3) Australia might need an unemployment insurance scheme in which the threat of cessation of income support at the end of the designated period encourages strenuous efforts by the unemployed to get back into employment, with the case of the United States a prominent example of this effect.

7. Labour Market Deregulation and Unemployment

Keith Norris (Murdoch University) discussed his collaborative research on the effects of labour market deregulation. This research uses a 'centre-periphery' conceptual framework arising from 'dual labour market' theory. The centre comprises full-time, high-skilled, permanent workers with long job duration while the periphery comprises casual and part-time, low skilled, transitory workers. Labour market deregulation was defined as the full elimination of the conciliation and arbitration system and the substitution of private collective bargaining.

Regarding unemployment, the main conclusion about short term effects was that deregulation would lower wages in the periphery and generate some increase in employment there (although no quantitative estimates were given) but that there would be very little effect on wages and employment in the centre. In the medium to longer term deregulation would increase labour productivity growth in both the centre and the periphery by up to half of a percentage point, which would amount to a 50 per cent increase in the rate of progress. Depending on how wages responded this could have the potential to increase employment and reduce unemployment in both sectors.

Overall, the increased economic inequality flowing from deregulation would need to be dealt with through 1) establishing a sensible minimum wage which did not destroy jobs in the periphery, 2) reforming the tax/transfer system to better help low income earners,
and 3) raising the 'social wage' through higher spending on education and health.

Judy Sloan led discussion and argued that the American and Japanese cases showed that much more flexible industrial relations arrangements could produce much lower rates of unemployment. Industrial relations flexibility encourages higher employment and lower unemployment mainly through changes in patterns of work organisation rather than through lower wages. For example, she pointed to the employment-inhibiting effects of the restrictions and constraints on work activity found in many Australian industrial awards. Although deregulation might increase wage inequality in the short run the consequent increase in employment would substantially reduce poverty and economic inequality in the medium to longer run. She also argued that Norris and his co-authors may have seriously underestimated the jump in productivity growth which would arise from deregulation.

Dick Blandy (University of Melbourne) argued that the substantial employment growth by small business operating in an institutional system of defacto labour market deregulation showed what could be achieved nationally through full-scale deregulation. Raja Janunkar (Australian National University) argued that 1) there was evidence that lower wages could reduce labour productivity through lower worker morale, so that unit wage costs might not change much, and 2) the American evidence showed that minimum wage standards do not cause unemployment, so there seems little rationale for lowering or eliminating these in Australia.

8. Policy Forum

Dick Blandy outlined his program for quickly and sustainably reducing unemployment. This involved 1) maintaining low interest rates, 2) reducing the real foreign exchange rate through nominal devaluations and consequent real wage cuts, 3) further microeconomic reform and 4) an extensive jobs levy / wage subsidy scheme. This scheme involves a 5 per cent levy on wages to be pooled with the scheme's savings on unemployment benefits to be used for wage subsidies paid to private firms to expand employment. These subsidies would drastically reduce the effective real cost of employing extra labour. He argued that the rate of the levy could be varied in a counter-cyclical way to keep the unemployment rate at its target level of say 5 per cent. The levy would need to be applied to all workers in order to raise enough funds for sufficient subsidies to achieve the desired reduction in unemployment. He argued that this scheme is very feasible in economic terms for reducing unemployment but faced large, perhaps
insuperable, political obstacles because workers now in employment did not seem willing to reduce their disposable incomes to the degree required to substantially reduce national unemployment.

Ted Evans (Treasury) argued that a return to full employment required much higher output growth than Australia had recently achieved in order to generate the consequent higher employment. He argued that this in turn required further drastic microeconomic reform, with a particular stress on labour market deregulation.

Geoff Carmody (Access Economics) argued for a variety of policy actions. First, there was need to change the macroeconomic policy mix to reduce budget deficits and relax monetary policy to further lower interest rates; this would lower the real foreign exchange rate and improve the trade balance, thus allowing higher growth without increasing the current account deficit. This would lift the external constraint on growth in Australian output and employment. Second, further labour market deregulation would restrain real wages, raise productivity, reduce the sustainable unemployment rate and increase international competitiveness. Third, there might be a role for a jobs levy / wage subsidy scheme but there was a vital need to design such policy actions to prevent firms merely replacing unsubsidised workers with subsidised ones (this is known as 'job churning'). The problem of LTU could be addressed through training and subsidy schemes and the eventual cessation of income support to encourage them back into the workforce. He agreed with Dick Blandy that the economic solutions to unemployment are clear but political barriers to implementing these solutions are the real problem.

Fred Gruen led the discussion and rejected claims that labour market deregulation could bring any rapid fall in unemployment. The only way to achieve this was through growth in aggregate demand based upon, for example, further fiscal policy stimulation. John Pitchford (Australian National University) again reiterated his well-known view that there was not any genuine external constraint on Australian growth because of the current account deficit and argued for mild demand stimulation and rapid labour market deregulation as the proper policy path back to lower unemployment.

In contrast, John Quiggin argued that there was a need to channel the pattern of growth into lowering or restraining the current account deficit; this could be done, for example, through switching demand away from imported to domestically produced services. He also cautioned that much microeconomic reform and labour deregulation had taken the form of job shedding, thus indicating that this was not a way in which unemployment could be much reduced in the near term.
9. Paths for Reducing Unemployment

In this section I present my own views on ways of reducing unemployment. There is a large, well-established body of economic analysis which shows that a number of reliable policies can be put in place to accelerate growth in employment and reductions in unemployment. On the demand side we know that the demand for labour is highly dependent on the general demand for goods and services in the economy; firms will not employ additional workers, or increase the work hours of their existing workers, unless they expect to be able to sell the additional production at acceptable prices within the time period of their usual planning horizon. Thus, robust growth in aggregate demand over the next several years will be an essential prerequisite for reducing unemployment. Economic policy settings will need to bolster such demand growth.

The two areas of concern regarding demand growth are business investment (which is much affected by other types of demand such as exports and consumption) and the balance of trade (i.e. exports minus imports), which forms a large part of the current account outcome. On the first, the recovery in investment has been much delayed and needs to arrive soon to sustain the broader economic recovery process. Investment represents both a component of demand and an addition to the economy's productive capacity, thus discouraging the eventual re-emergence of inflationary pressures by expanding the supply of goods and services.

On the second, despite the efforts of people such as John Pitchford, many economists and economic policymakers still seem to regard current account deficits as a major concern and a substantial constraint on Australian economic growth. The grim logic of this view seems to be that the need to contain current account deficits means that aggregate demand cannot grow at rates required to reduce unemployment much (since, other things equal, this would increase such deficits) unless demand growth is concentrated in exports and import replacement.

Some argue that active, interventionist trade and industry policies can achieve such demand growth in the external account, but most economic commentators would disagree. Since these nay-saying commentators have very few policy recipes themselves for engineering such a pattern of demand growth, they remain highly reluctant to see aggregate demand grow rapidly; they put their faith in other policy tools for reducing unemployment such as labour market deregulation. However, it should be said in their defence that a macroeconomic policy mix of monetary relaxation (to encourage, compared to other scenarios, a lower exchange rate and increased international
competitiveness), reduced budget deficits (to increase national savings levels) and aggregate wage restraint (to help restrain inflation) might contribute substantially to this desired pattern of externally-oriented demand growth.

We also know that restraint in employer's labour costs, particularly in real unit labour costs, can substantially contribute to increasing employment and reducing unemployment. The debate here is whether such unit wage costs should be reduced through labour market deregulation, accelerated microeconomic reform and reduced access to unemployment benefits, or whether the focus should be upon an expanded program of wage subsidies financed by a jobs levy or some other revenue source.

Certainly, there are very strong equity arguments for substantially expanded wage subsidy programs for the LTU and VLTU categories. Even if substantial job churning takes place (where subsidised workers replace unsubsidised workers) such subsidies will be worthwhile because they help the worst-off people (those unemployed the longest) to re-enter the world of work and jobs. There is also the longer term economic efficiency argument that reducing LTU and VLTU reduces the sustainable rate of unemployment in the economy, thus improving aggregate economic performance. Unsubsidised workers who might be displaced by newly subsidised workers will be able to find work relatively quickly so long as aggregate demand is strong and aggregate wage costs are restrained.

There have been arguments put that wage subsidy / jobs levy schemes would discourage aggregate consumption (because the levy is effectively an increase in tax), thus discouraging aggregate demand and economic recovery. However, even in programs with high levels of job churning, aggregate consumption is unlikely to be much affected by this policy package since the reduced consumption of those paying extra tax will be neutralised by the increased consumption brought about by 1) the small extra total employment in the economy and 2) the higher profits and dividends (brought about by lower wage costs) in those firms employing subsidised workers. On the other hand, it should not be too difficult to design programs which increase aggregate employment and allow only small levels of job churning. This could be done by linking the payment of wage subsidies to overall increases in total employment within business firms as well as to the employment of persons in the LTU and VLTU categories.

For the general labour market, some restraint on the growth in real wages per worker will be vital. For example, real unit labour costs can be reduced if higher productivity growth is achieved and real wages and other labour costs increase by a lesser amount. Labour market deregulation and accelerated microeconomic reform provide some
potential to raise productivity growth through improved resource allocation and better production and work practices but they can lead, and have led, to substantial labour shedding by firms trying to abandon the existing, relatively inefficient, production and work practices. Overall, even with some reduced real wages for workers in the secondary, peripheral labour market, the scope for expanding employment in this way does not seem significant, at least in the short term.

On the other hand, expanding business investment to increase capital equipment per worker will provide a powerful boost to higher productivity and restraint in real unit labour costs; this provides an additional reason to ensure that aggregate demand growth remains robust since this will stimulate investment spending. Low and stable real interest rates will also contribute to higher investment; this will require low world interest rates and the maintenance of low inflation, relatively neutral monetary policy settings and reduced budget deficits in Australia.