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ON THE DRY SIDE 172 RECOVERY ALONE WAS NOT ENOUGH John Hyde

We have enjoyed three years of economic recovery - of high economic growth - but unemployment, still nearly eight per cent, looks like rising again. We do not know how many of the 580 thousand known unemployed would prefer employment to the dole, how many drawing sickness and single parents' benefits and widows' pensions would prefer to be working and we do not know how many people do not enter the work force because they are sick of trying against the odds. These are important questions, but we do not need to know the answers to know that the situation is unacceptable on economic, social and moral grounds. Twenty years ago even three percent unemployment would have been unacceptable on political grounds as well. How times change!

Even without these answers we can say that unemployment has become a problem for which 'recovery' alone is not a solution.

According to Mr. Keynes and the Neo-Keynesian economists deficit budgeting encourages business activity and employment. We now know that the price of activity now is reduced activity at a later time but experience has supported their contention in the short run. However, if the unemployment in question is not caused by deficient demand, fiscal (or monetary) stimulus will not fix it. Little can be gained, even in the short run, by increasing or even having a deficit.

The purported aim of fiscal policy is to smooth out the business cycle roller-coaster. The plunge down the slopes can be slowed by governments which borrow and spend. If governments redeem their debts on the way up the hills they can borrow again to ease the next plunge but governments do not look that far ahead; they ask the economy to carry the added weight of debt service down the next hill.

Such is the burden of past borrowings that, even if we are about to run out of Mr. Keating's 'recovery', now is still the right time to restrain government expenditure. He and Senator Walsh are correct; the Premiers, the Left and the spending department ministers are wrong.

Present circumstances are like enough to those of 1982 to learn from what happened then. From 1978 to 1981 the economy grew quite strongly but looked like slowing down sharply in 1983. Some say that the 1982 budget was cynically designed to win an early election, but let us give Mr. Fraser the benefit of doubt, and say it was designed to stimulate a slowing economy, albeit one with an inflation rate of 10%. Even if Mr. Keating's estimate of $9.6 billion for the full-year deficit of that budget is overstated, the 1982 budget was, in Keynesian language, 'expansionary'.

During three years of exceptionally high growth the Hawke Government has not reduced the deficit to even 1981 levels, least of all repaid the debt - budgeted a surplus.

The public sector deficits, which have been accumulating since 1973, have driven domestic capital raisings off shore. Because of a crazy antipathy to foreign ownership enforced by the Foreign Investment Review Board we are stuck with servicing fixed interest and capital payments.

The deficit fed demand of the past three and a half years - starting with the last Fraser budget - has reduced unemployment by about one percentage point but beyond this it has puchased imports and fueled inflation rather than employed Australians. The foreign account has run into deficit. The Trade Weighted Index of the value of the Australian dollar has dropped from 85 to 60. To avoid an inflation/devaluation spiral the Government is now choking off the recovery with tight money and real interest rates which are among the highest in the world. Even with eight per cent unemployed the price of forced growth has become too high.

For a substantial proportion of the workforce we are forced to conclude that it does not pay to work because the rewards for working over those of unemployment are insufficiently high; or it does not pay to offer jobs because the combined costs of equipment, wages and on-costs are insufficient to sell at a profit.

We have had recovery but recovery was not enough.

We need a much greater share of GNP allocated to investment which provides on-going employment: not housing, not Americas Cups, not Grands Prix but factories, farms, mines, banks, transport etc.. We also need much greater labour market flexibility to enable and encourage employees to take the available jobs and we need much greater product market flexibility to encourage employers to seek out and find those activities which will sustain the highest living standards for themselves and their employees.

Most commentators now insist that the investment without the flexibility will not do the job.

Emile van Lennep, Secretary General of the OECD: "With roughly similar investment trends in North America and Europe during the past decade [to 1983], employment growth in North America was more than ten times as great. Even when aggregate investment was not particularly high, greater labour mobility, more flexible real and relative wages, and perhaps other factors related to the freedom for entrepreneurial initiative in small or new enterprises led to a rapid creation of new jobs."

Professor Lester Thurow (Sloan School of Management, Massachgusetts Institute of Technology: author of The Zero Sum Society): "While Europeans have generated no new jobs on a net basis since 1970, the US economy has generated 25 million new jobs during the same period. From 1978 to 1983, US productivity growth was a dismal 0.6% per year while European

growth grew by a healthy 3 to 4% annual rate....The reason for this paradox can be found in very different labour markets. Relative to the price of capital, American wages were 37% lower in 1983 than 1972. After correcting for inflation, wages have fallen by 6 percent....Sweden had 13 times as many programmable robots in proportion to the size of its labour force as the United States....firms add employees only if their sales volume exceeds their productivity growth."

In short while Europe employed machines USA employed people.

Van Lennep again: "Some encouraging developments include...greater decentralisation of wage negotiations in some countries; a general weakening of the wage indexation processes....It is unavoidable that social security benefits will have to be reined back...if large government deficits persist they will increasingly put pressure on the available savings needed to finance investment..."

If we really want full employment we must liberate both labour and capital from governments and unions and, although we will not like to remove benefits, we have no option but to pitch them so as to leave adequate incentives. To do the last with precision we need to know much more than we do about the responses of potential employees to wage and benefit levels.