POST-KEYNESIAN ESSAYS FROM DOWN UNDER

VOLUME III: ESSAYS ON ETHICS, SOCIAL JUSTICE AND ECONOMICS

Theory and Policy in an Historical Context

Joseph Halevi
G. C. Harcourt
Peter Kriesler
J. W. Nevile

"The neo-liberal experiment has failed. The widespread deregulation of markets has led to financial crisis and mass unemployment. The contributors to this volume are Keynesian economists who for decades have resisted the neo-liberal onslaught. They believe that governments have the ability and duty to ensure full employment and decent pay for all. Their optimism is sorely needed."

—**Emeritus Professor Robert Rowthorn**, *University of Cambridge, UK*

"The socioeconomic and political context has been carefully interwoven through these different essays relating to social justice, a widely debated topic in this day and age. It is impressive how the authors have developed Christian thought and the Christian call for social-welfare, prompting the reader to social-awareness and social-consciousness."

—**The Most Reverend Dr Philip L Freier**, *Primate of Australia*

"This collection of essays makes an outstanding contribution to the discussion of ethics and economics. It moves economics beyond the limits of the "scientific" enquiry and the cramped options of dualism to embrace its moral responsibilities. Halevi, Harcourt, Kriesler and Nevile share a sense of humanity, sometimes characteristic of post-Keynesian economists, and identify those human rights which must form part of the objectives of any economic decision. The essays incorporate into their analyses ethical implications of economic goals, their priorities and the policies which serve these; they show that introducing ethical work practices (eg) tends to raise productivity rather than costs. Their approaches are empirical and analytical. The authors are especially well qualified, individually and in combinations, to comment on Australian institutions, within a global economy, and on mainstream as well as post-Keynesian analytical approaches. This invaluable project confirms their presence as significant leaders in developing the ethical ambitions of economics and its policies through a post-Keynesian oeuvre and Australian example."

—**Prue Kerr**, *Visitor in School of Economics, University of Adelaide, South Australia*

"The authors of this volume studied, taught and did research to make the world a better place for ordinary people. If their work was often extraordinary, their motivation was typical of the generation that entered economics in the wake of the Great Depression and Keynes's *General Theory*. Alas, their sense of economics as a moral endeavor, and of the work of an economist as a calling, has long since ceased to be a major drawing card, and economics is the worse for the absence of debate and discussion of its moral foundations. Both for students just entering the field and for mature scholars who either never encountered or have forgotten the moral dimension, this volume is a timely corrective to the idea that economics can or should exist in an ethical vacuum."

—**Stephen A. Marglin**, *Walter S. Barker Professor of Economics, Harvard University, USA*

"Searching for gold, you must look down under. Here are riches for the questioning economist, perplexed by unjust policy outcomes of seemingly neutral analysis. Enjoy finding many nuggets of wisdom on the undervalued but inescapable impact of ethics and of historical-institutional context, with tributes to some true pioneers of ideas."

—**J. Gay Meeks**, *Senior Research Associate in the Centre of Development Studies, University of Cambridge, UK*

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Post-Keynesian Essays from Down Under Volume III: Essays on Ethics, Social Justice and Economics

Theory and Policy in an Historical Context

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Preface

Geoff Harcourt intended to put together one more volume of selected essays in order to reach double figures. But then Peter Kriesler reminded him that since he joined the School of Economics at the University of New South Wales in August 2010 as a Visiting Professorial Fellow, they, sometimes with John Nevile, had published several joint papers. Moreover, Peter and John, and Peter and Joseph Halevi, had also been publishing joint papers for many years. All their works, whether as sole author or jointly, had important common themes. The underlying theoretical framework was essentially post-Keynesian.[1] They all stressed the importance of the underlying institutional framework, of the economy as an historical process and, therefore, of path determinacy. Money and finance were an integral part of the economy, with monetary variables affecting real variables and vice versa at all stages of analysis. In addition, all the works saw the ultimate goal of economics as being a tool to suggest policy – even the theoretical works were motivated by the desire to make the world a better place, with better being defined by an overriding concern with social justice.

So arose the proposal we made to Taiba Batool that we put together four volumes of selected essays by "Post-Keynesian Essays from Down Under," subtitled "Theory and Policy in an Historical Context." She enthusiastically accepted the offer, ably assisted by Ania Wronski. We therefore set about putting the selections together. When Taiba left Palgrave Macmillan for pastures new, she passed the project onto Laura Pacey and Rachel Sangster who, just as enthusiastically, oversaw the bringing together and publication of the four volumes. Laura, in particular, has been extremely helpful and patient in our journey from idea to manuscript.

Our grateful thanks go to Joan Harcourt for forgiving Geoff for breaking the promise never again to undertake a major research project, witnessing yet again her love and support of over 60 years; to Teresa, Peter's wife, for her continual love and support; and to Fay, John's wife, who, in the absence of a secretary, typed much of his introductions to chapters (and commented that the names had not changed much since the last time she did this when, as a young wife, she typed drafts of John's PhD thesis).

We would also like to thank Roni Demirbag for his help in getting Joseph's papers in order, and Jason Antony for his gracious and good-natured multidimensional expert help in assembling the volumes.

Note

1. For an overview of what we consider to be post-Keynesian economics see Harcourt, G. C. and Kriesler, P. 2015 "Post-Keynesian Theory and Policy for Modern Capitalism," *Journal of Australian Political Economy,* No. 75, Winter 2015, 27–41.

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About the Authors

Joseph Halevi, alma mater University of Rome La Sapienza, began teaching economics at the New School of Social Research in New York and later at Rutgers University. He has a permanent appointment at the University of Sydney. He was Visiting Professor at the University of Connecticut and regularly in France at the Universities of Grenoble, Nice and Amiens. He has authored many books and contributed to the first edition of *The New Palgrave Dictionary of Economics* in 1987 and co-edited *Beyond the Steady State* with Macmillan in 1992, among others.

G. C. Harcourt is a graduate of the Universities of Melbourne and Cambridge. He has worked mainly at Adelaide (1958 to 1985) and Cambridge (1964 to 1966; 1972 to 1973; 1980; 1982 to 2010). He is now Visiting Professorial Fellow at UNSW Australia. He is Emeritus Reader in the History of Economic Theory at Cambridge University; Emeritus Fellow of Jesus College at Cambridge; and Professor Emeritus at the University of Adelaide. He has authored or edited 29 books and over 380 articles, notes, chapters in books and reviews. His books include *Some Cambridge Controversies in the Theory of Capital* (1972), *The Structure of Post-Keynesian Economics* (2006), (with Prue Kerr) *Joan Robinson* (2009) and (jointly edited with Peter Kriesler) *The Oxford Handbook of Post-Keynesian Economics*, 2 vols (2013).

Peter Kriesler currently teaches in the School of Economics at the University of New South Wales. He organises the Annual Australian Society of Heterodox Economists Conference, which is now in its fourteenth year. Peter's main publications are in the areas of history of economic thought, heterodox economics, the Australian economy, labour economics, and economic perspectives on human rights.

J. W. Nevile is Emeritus Professor at the University of New South Wales in Sydney, Australia. He has published extensively on fiscal policy, macroeconomic policy in general, economics and ethics, and the history of economic thought. He has served on a number of statutory authorities and government enquiries. He was the Recipient of the Economic Society of Australia Distinguished Fellow Award for the year 2000.

Introduction to Ethics and Economics

John Nevile

The first essay in this volume is a very generous and gracious article on the part my Christian faith plays in my work as an economist. It is not my place to comment on this essay except to provide a little historical background. From the first year in which I studied economics, in 1950 at the University of Western Australia, I had no doubt that a person's faith, or ideology, or world view should provide an underpinning for one's work as an economist. This was both appropriate and inevitable. Equally appropriate and inevitable was that it affected the conclusions to which one came as an economist. In those days of a brave new world of Keynesian economics it was easy to see a relationship between a faith that firmly believed in God's concern for all human beings and an economics which would save Australian society from the horrors of the depression of the 1930s, of which I had some personal memories. Incidentally, the parochialism revealed in the last sentence was clearly there in practice, but would have been denied on principle if anyone had challenged me about it.

The growth from that first-year student understanding of the relationships between values and economics is of little interest to anyone but myself. Suffice to say that a graduate course on welfare economics given by William Baumol at the University of California at Berkeley brought me more or less up to date with the controversies in economic journals of the time, which ranged from Lionel Robbin's position on the essential nature of economics to D. H. Robertson's arguments with Paul Samuelson over the measurement of utility, which in my view Robertson won easily.

Be that as it may, my understanding that the Pareto concept was devoid of any moral content was now matched by the realization that it was equally useless in the context of measuring economic efficiency. It is true that Hicks's synthesis of earlier work by Hotelling and Kaldor produced a criterion which was for a short time influential. This criterion stated that if the winners could compensate the losers this indicated that national income had increased whether or not compensation was paid. This proposition is discussed in Chapter 3 of this volume. It was soon discredited in the economic literature when Scitovsky pointed out that if compensation was not actually paid income distribution could change and with the new preferences in play a change back to the original position might again indicate an increase in income. Since Hicks was using revealed preference analysis this criticism was fatal.

The next stage in my understanding of the relationship between values and economics was when I was able to contribute as well as learn. Fast forward about 25 years to the last quarter of the twentieth century when my intuitive feeling that policy makers should have advisors who shared their values was formalized.[1] Moreover, this was done in a way I had not seen set out in the literature. In this volume I have included, as Chapter 6, a late version, in which the argument is set out fully and clearly.

In one sense the argument in Chapter 6 goes further than rejecting the widespread view that it is possible to separate positive and normative economics. Although, at least with hindsight, facts may appear to be unambiguous, historical records, one's understanding of what happened may differ according to one's values; "facts and values are not mutually exclusive categories". This quotation, used in Chapter 10 of this volume, refers to what Walsh and Putman have called "the entanglement of fact, theory and value".

Thus, my ideas about values and economics can be summed up as a progression over time of three different types. The first, for very roughly 15 years starting in 1950, were those of a student absorbing, with increasing understanding, the economic literature of the time. This was followed by a period of making my own contribution, at first only with intuitive ideas, but developing into formal economic analysis in the last 15 years of the twentieth century. Then, in the first four or five years of the twentieth-first century, I learnt from others the concept of "entanglement of fact, theory and value" which put beautifully a very vague idea lurking at the back of my mind.

The first piece of my own work in this volume, Chapter 2, is an extract from a slim volume written in response to concerns about the ethical nature of an economy in which the main motivation is the love of money, or, more accurately, the love of things that money can buy. I have put it "up front" because the extracts emphasize that the benefits of a market-driven capitalist economy that flow from decentralized decision making, must, if the economy is to work, be restrained by a moral code. P. N. Junankar drew my attention to a quote from George Bernard Shaw which makes this point very effectively.

> That any sane nation, having observed that you could provide for the supply of bread by giving bakers a pecuniary interest in baking for you,

should go on to give a surgeon a pecuniary interest in cutting off your leg, is enough to make one despair of humanity. [George Bernard Shaw, *The Doctor's Dilemma*, 1911]

In fact, with the resurgence of market liberalism, or economic rationalism as it is usually known in Australia, there is a choice between two codes. One is upholding the welfare state including the premise that a healthy welfare state depends on keeping unemployment to a minimum. The other, based on Hayek's book, *The Road to Serfdom*, and even more on the influence of his follower, Milton Friedman, puts the cost of inflation centre stage in formulating economic policy and advocates using monetary policy as the major policy weapon to combat inflation. Not surprisingly, I favour the first option for reasons set out in Chapter 3.[2]

Chapter 3 distinguishes two ways in which macroeconomic policies may be just or unjust. The first is the obvious one, the effects of the policies on individuals and groups in the community. But one has to look beyond this. The nature of the policy instruments used may help or harm individuals quite apart from the effects of the goals of policy or to the extent to which they are achieved. There is also a third way injustice may occur; that is, due to the actions of the bureaucrats administering the policies. I have written little on this but it is briefly discussed in Chapter 5 drawing on the 2003 review of Work for the Dole carried out by my daughter Ann and myself.[3]

While Chapter 3 argues strongly in favour of the first of the two codes, it does not examine in detail the costs of unemployment. The importance of these costs must be discussed as part of a complete case for the first code. This is done in Chapters 4 and 5. Chapter 4 concentrates more on hard costs that can be measured to some extent using statistical data. Chapter 5 looks more at soft data and indicates how unemployment can sap people's self-confidence and even their sense of identity. Chapters 3 to 5 provide the necessary background to the discussion of economic rationalism in the next four chapters.

Chapter 6 serves two distinct functions. As noted above, it is a late version of my formal argument that policy makers should have advisors who shared their values in which the argument is set out more fully and clearly than in earlier versions. In this context it also outlines the basic tenets of economic rationalism and emphasizes that economists writing about economic rationalism were trying to encourage a political movement rather than establish a new school of economics. This latter point was even more true of overseas English-speaking economists who generally called their discussion "market-liberalism" or sometimes just "neo-liberalism". In the following three chapters, as originally published, both the discussion of the tenets of economic rationalism and its nature as a political crusade were summaries of material in Chapter 6. They have been omitted in the versions included in this volume as readers have the fuller version to hand.

Chapter 7 is about the effects of deregulation on the welfare of the less well off. While it is mostly descriptive, it ends with a question which provides a good link between the preceding and subsequent chapters.

> Labour market deregulation has not proceeded anywhere near as far as many would wish in Australia. Yet it may have already proceeded far enough to undermine a viable incomes policy.

Chapter 8 does praise some valuable results of economic rationalism but these are not enough to offset the increased unemployment caused by giving priority to reducing inflation rather than reducing unemployment. These, set out in Chapters 3 to 5, are also discussed in the section on human rights. Chapter 8 includes material from a study I had published three years before, which is described in full in Chapter 9. In this volume Chapter 9 is in effect an appendix to Chapter 8.

Most of my publications in the section on "Human rights and social justice" are jointly authored with Peter Kriesler who has commented on them but I am the sole author of Chapter 16. This chapter was written at the request of Peter Kriesler and it is included mainly because what it says is very relevant to the material in Chapter 8, even more so now than when it was first published. However, I am also glad to include it as it marked the start of my very fruitful collaboration with Peter on human rights and social justice.

In the comments by Peter Kriesler that follow mine in this introduction Peter sets out the basis of his position on ethics before discussing his contributions in this volume on social justice. In my case Chapter 1 does that. However, I would like to conclude my introductory remarks, with a brief piece of "potted theology"[4] which is an elaboration of one sentence in that chapter. Many Christians think of their faith as a personal thing that is of no concern to anyone but themselves and God. Despite this, both historically and today, the vast majority of Christians see, as central to being a Christian, being part of a local community that together assesses what it is doing and how its performance can be improved. However, God's concern reaches far beyond Christian communities, notably to nations and ethnic groups. Hence, what local churches, both corporately and through members acting on their behalf, do to change Australian policies, such as our treatment of refugees, is an important part of their performance. It also provides an underlying rationale for all advocacy of social and economic policies by Christians.

Peter Kriesler

The first essay in this volume is a joint essay with John Langmore that pays tribute to John Nevile and looks at the ethical dimension that underlies his work, and which Geoff discusses below. This ethical dimension and the associated concern with social justice is an important part of our collaborations on employment and labour rights which are reproduced in the second part of this volume. John's emphasis on these issues was an important motivating factor for these collaborations.

My own views as to the importance of human rights in general, and as standards by which to evaluate economic policy in particular, emerged from my relativist view of ethics. I have always believed that there is a strong cultural and materialistic base for the determination of social and individual ethics – a position that developed further with my understanding of Marx's materialism. According to this view, ethical judgements vary between cultures and are determined by the material base of the economy – which is always evolving. However, this clashed with my belief that there are some eternal invariant ethical truths – certain things were simply wrong, regardless of the social or material base. For me, some obvious examples are the holocaust, genocide, racism and sexism. This suggests that there must be some ethical values which are independent of society and the material base. I discussed these issues with Joseph, an intellectual undogmatic Marxist, at great length when I was a graduate student. In the end, I realized that these invariant ethical truths were the result of our humanity, and reflected the rights that we owe other people – in other words, they are fundamental human rights. Reading the *Universal Declaration of Human Rights,* I realized that this embodied those universal truths which were independent of social and cultural norms. It is these rights which form the basis of my views on social justice. Through my collaboration and discussions with John, I realized the importance of the right to employment, to a decent job. As we argue in the essays reproduced in this volume, employment is about much more than merely providing income. A person's job helps define their role in society, and has important implications for their status and well-being. Unemployment is associated with a number of serious social and medical problems, from the breakup of families, loss of self-esteem, physical and mental health problems and increased crime.

Chapters 11–15 are concerned with the different aspects of these rights. In 2007 the Australian Institute of Employment Rights published *The Australian Charter of Employment Rights*. The purpose of the book was to develop a blueprint to define the rights of workers and employers. John and I contributed two chapters to the book. Chapter 12 argues that there should be a societal obligation to provide a right to work. Chapter 11 offers an "economic perspective on workers' rights", by considering the argument that providing workers with employment rights imposes a cost on the economy in terms of lost output or increased unemployment. The mainstream arguments against rights is that they, either directly or indirectly, increase the cost of employing labour, which will reduce employment. On the other hand, improved rights may lead to increased demand and also, by improving workers motivation, increased productivity. The actual evidence shows that employment rights do not have any detrimental impact on either employment or output, but, rather, lead to improvements in equity and to fairer outcomes.

The global financial crisis had a severe impact on employment throughout the world. Chapter 13 reiterates the importance of the right to a decent job, and outlines policies to restore full employment as soon as possible.

Chapter 14 looks at how labour market deregulation erodes workers' rights, in particular, to a fair and decent wage. Minimum wages reduce inequality; whereas the increase in inequality consequent on labour market deregulation has adverse effects on the economy in the short run and disturbing longer-run effects on society.

Chapter 15 re-examines the right to full employment, showing that many other rights, such as those to adequate health and well-being, are contingent on it. We argue that the existence of significant levels of unemployment is an abdication of that right. Since governments can always reduce unemployment by fiscal policy, the chapter considers why the situation is tolerated. It argues that there are two reasons for this. First, the benefits of reducing unemployment are underestimated because the costs of unemployment to the individual and to the community are often neglected. Secondly, the costs of reducing unemployment are significantly overestimated due to the widespread use of an inappropriate economic model to estimate these costs. A more plausible alternative model is used to evaluate the impacts of reducing unemployment – which we argue confers benefits rather than costs. A feasible policy package is then suggested as a way to restore full employment.

My final essay in this volume is on the theme of the biographies of economists. The role of biographies in humanizing the subject, making it more interesting and presenting the stories of the individuals who are responsible for major developments is important. Biographies can also throw light on why ideas develop, and put those ideas and economists into context. The other papers in this final section of the book are excellent examples of precisely this point. The last chapter by Joseph on Sylos-Labini highlights his intellectual and ethical role, demonstrating how he was able to unify the historical with a theoretical approach.

Geoff Harcourt

In October 2012, the School of Economics at UNSW celebrated John Nevile's 80th birthday (and getting on for 50 years at UNSW) with a conference at the School. At the conference a number of John's admirers presented papers which subsequently were published in a special issue of the *Economic and Labour Relations Review* with which John has been associated since its inception. In our paper, the first essay in the volume, John Langmore, Peter Kriesler and I traced the influence of John's deep Christian faith and values on his many important contributions to economic theory and policy.

In 2010 Philip Arestis kindly organized a session about my contributions at the Annual Conference of post-Keynesians in Bilbao. The carrots were wonderful papers given by Stephanie Blankenburg, Claudio Sardoni, John McCombie, Philip Arestis and Malcolm Sawyer, and Lilia Costabile, all published in a special issue of *Intervention*. The stick was that I had to give a paper too! I wrote an autobiographical memoir in which I described how I became politically radicalized as a result of Australia's involvement in the Vietnam War and the impact this had on how I saw and did economics.

Since the 1970s I have been writing intellectual biographies and tributes. As I am now in my 84th year, it is not surprising that these are more and more obituary tributes. The four essays reprinted here illustrate this. Two are tributes to Phyllis Deane and Frank Hahn, former Cambridge friends and colleagues; both were published in the Cambridge Faculty's Alumni *Newsletter*. Phyllis and I were friends from the 1960s on when she supervised my Part I Trinity Hall pupils in Economic History and I supervised her Part II Newnham pupils in theory and policy. Subsequently I read most of her books in manuscript, we shared a room in the Faculty in the 1980s until the overflow of my surplus papers on to her desk led to her gracious withdrawal to work at the University Library and at home. Joan and I often enjoyed the wonderful hospitality that Phyllis and her life-long friend Joan Porter extended to us whenever our mutual friend, the late Mark Perlman, visited Cambridge. The traditional British fare cooked by Joan Porter was an ideal complement to the innumerable and extraordinary anecdotes about our trade with which Mark regaled us, holding forth in his three piece tailored suit and sporting the inevitable bow tie: such happy occasions to treasure.

Phyllis was one of the finest, balanced and honest persons I have been privileged to know. She was a pioneering outstanding scholar, modest about her achievements and a stout defender of the essential merits of economic history and the history of economic theory.

The essay on Frank Hahn is a longer version of the published version which Willy Brown's careful editing brought within the word limit imposed for space reasons. As I point out, Frank and I had many clashes but I regarded him as a major intellectual presence in the profession and the Faculty, one that has never been replaced since his death in 2013. In the Tribute I concentrate on his deep understanding of the economics of Keynes and Frank's courageous fight against the forces of darkness associated with Milton Friedman, Robert Lucas and their surrogates.

In July 2010 the *Cambridge Journal of Economics* through Stephanie Blankenburg organized a conference to celebrate 50 years on from the publication in 1960 of Piero Sraffa's classic, *Production of Commodities by Means of Commodities*. The object was to look to the future and to explore how Sraffa's great contributions would help the formation of relevant theory and policy. I opened the conference with a short tribute to Piero and to his, and my, great friend, the late Krishna Bharadwaj. I reprint the tribute here as Essay 18.

The other two tributes are to Australian friends. Peter Kenyon was my Master's student at Adelaide in the 1970s after completing his Honours Degree at Monash. He worked on post-Keynesian themes and our joint article, "Pricing and the investment decision", Harcourt and Kenyon 1976, is the core chapter of his thesis. The article was described by Peter Groenwegen, never one to hand out compliments lightly, as his favourite theoretical paper of mine.

The story of the genesis of the article/chapter is perhaps worth telling. In 1966, before leaving Cambridge, where I was a University Lecturer in Economics and Politics and a Fellow of Trinity Hall, to return to Adelaide, I wrote the first draft of a paper with the same title and submitted it to the *Oxford Bulletin of Economics and Statistics*. It was rejected for a good reason. I deduced from the initials pencilled in on the copy that was returned to me that one referee had been George Richardson (G.B. Richardson), a really great but relatively unsung hero of British economics. He liked the idea of the paper but pointed out a serious logical flaw in the argument. (I subsequently lost the file in which I kept all the go to whoa correspondence and drafts so I cannot now remember exactly what the flaw was, something to do with inconsistent time periods in decision processes.)

In 1974 I spent three weeks in the Royal Adelaide Hospital for an operation on my large intestine, the blockage of which had nearly killed me. I took a monkey mask with me intending to put it on and then hide under a sheet before I was taken to the operating theatre. Unfortunately, a prior injection made me so drowsy I could not get to the mask. Not to worry: on the day I was discharged Peter was giving a progress report on his research. I took in his seminar on the way home, wearing the mask.

As I listened to Peter, the solution to the logical slip flashed into my mind. In a euphoric state, as soon as I was home, I sketched the theoretical argument of the paper and asked Peter to put the scholarship around it. I tell the story of how it came to be published in *Kyklos* in 1976, after rejection from the *Economic Journal*, in George Shepherd's 1995 volume *Rejected*, reprinted in Harcourt 2012.

Peter did not submit his Master's until after he returned from the University of Virginia as PhD, ABD (All But Dissertation) and started his distinguished career as scholar, wonderful teacher, good citizen and chef extraordinaire, ending up with a Chair at Curtin University in Perth. There his life was cruelly cut short by cancer, he was only 60 when he died. His partner, Jan Wright, and his huge host of friends and colleagues miss a fine, unique, human being and an insightful, down-to-earth, humane economist.

The other tribute is to Allan Barton. Allan and I started Commerce degrees together at Melbourne University in 1950, we were PhD students together at Cambridge in the 1950s, and colleagues for some years at Adelaide, and saw one another when Allan was on study leave in Cambridge or I was in

Canberra. His PhD dissertation was supervised by Austin Robinson; it was on multi-product firms. It was never published because Allan was such a selfless person, he put his own interests last on the lists of *n* things he had to do. He had told me that it contained the essence of Oliver Williamson's contributions, for which Williamson received the Nobel Prize. I often pestered Allan to publish the dissertation but to no avail. When he was dying of cancer, on my last visit to see him in Canberra, I conspired with his brother Graham to pinch (temporarily) Allan's copy of the dissertation. After he died in 2012, Selwyn Cornish, Richard Holden and I prepared a tribute to Allan for the *Economic Record*. Richard understands deeply the areas on which Allan wrote and he confirmed what Allan had told me. In the tribute there are incisive paragraphs by Richard documenting the case.

This was but one of Allan's many claims to have been an important and influential applied economist as well as the best Treasurer the ANU has ever had. *The Economic Record* has a rule of thumb that the "greats" get 1000 word obituaries and the "also ran rest", 500 words. The Philistines who now constitute its editorial board relegated Allan to the "also ran rest", writing him off as only an accountant. Jeff Sheen, to his credit, kindly interpreted 500 words very loosely. Nevertheless, I reprint here the longer version of our tribute, both to honour Allan and to show what a splendid and substantial person he was.

Towards the end of 2010, now back in my native land at the School of Economics at UNSW, I was handed an email by Viet Ha Nguyen (I don't "do" email so I employed Ha, then a PhD student at UNSW, to do email for me); the email told me I had been nominated for the 2010 Veblen-Commons Award of the Association for Evolutionary Economics in the USA. (I subsequently found out that it was awarded jointly with Jan Kregel, whom I regard as one of the greatest living all round economists.) I involuntarily exclaimed "Good heavens" and showed the email to John Nevile who kindly lets me share Room 411 with him. I was flabbergasted but delighted; I knew Philip Arestis had nominated me but I never in my wildest dreams thought I would be so honoured.

The conditions of the Award include attending a lunch at the annual AEA meetings (they were held in Denver in January 2011) and delivering a paper at a lunch given by the Association. The paper was then to be published, sight unseen, in the *Journal of Economic Issues* as one of the outstanding papers given at the Meetings. I chose as my subject, topical themes in the writings of Veblen and Commons, and illustrated their bearings on theoretical and policy issues.

Notes

1. Or, if this was not the case in the days when senior public servants were not changed when governments changed, such public servants should be able to put themselves in the shoes of those they advised and give briefings which covered

both the wisdom of the public servants and the inclination of those the public servants advised.

2. Chapter 3 is an unpublished manuscript of an address given in 1999. It was revised very slightly in the light of the discussion following the address and then set aside, awaiting the necessary revisions and additions before it could be submitted to an academic journal. This never happened, partly because some major sections put in different words, material that had already been published. I welcome this opportunity to see it in print in the more informal language appropriate to an address.
3. The report on this is Nevile A and Nevile J,W. *Work for the Dole: Opportunity or Obligation*, Centre for Applied Economic Research, University of New South Wales, Sydney, 2003.
4. I say potted to make clear that the theology, and to a large extent the implications I draw from it, are second hand. If anyone wants to read a fuller discussion I recommend a small (84 pages) book, *Being Christian,* published in 2007 by Rowan Williams, the former Archbishop of Canterbury.

Part I
Social Justice

1
Faith, Works and Talents Entwined: Driving Forces Behind John Nevile's Contributions

G. C. Harcourt, Peter Kriesler and John Langmore

In this article, we consider the mainsprings of John Nevile's many contributions to economics. John has repeatedly argued that because 'economic actions, institutions and policies affect people', they have an ethical dimension (Hawtrey and Nevile, 1986: 1), and he has stressed the importance of understanding the value judgements on which economics rests. His policy suggestions are aimed at improving social justice and the well-being of the most vulnerable. Apart from his deep knowledge of economic theory, his Christian faith provides an important foundation for his analysis, particularly of policy.

1.1 Introduction

> *Human rights are important for religious reasons. The God that I believe in is a God who cares profoundly for the vulnerable in society*
>
> (John Nevile in Conversation, 27 September 2012)

This article's theme of faith, works and talents entwined is derived from a reflection on parallels between John Nevile and Austin Robinson (the distinguished Cambridge economist). At Austin's 1993 memorial service at Sidney Sussex College, Cambridge, one of the readings was the parable of the talents. Some thought it a peculiar choice, but a close friend who knew Austin intimately said it was peculiarly appropriate because Austin could not abide those who did not use their talents to the full. Austin's Christian upbringing (as the son and grandson of Anglican clergymen) emphasised works even more than faith, and this emphasis was exemplified in his long life of service to his profession, his country and to humanity generally (Harcourt,

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2001). The parallels with John Nevile's many years of service to economics, the School of Economics at the University of New South Wales (UNSW), the university, his church, the wider community, Australia and also to humanity generally immediately come to mind (though, thankfully, this article honours John Nevile's 80th birthday and not a Memorial Service). This article seeks to relate John's contributions to the fundamental base of his life and to incorporate this personal understanding into a reflection on an appropriate ethical basis for economics.

John is an unassuming, not-in-your-face person, so that even those who know him personally may be unaware of his deep Christian faith. A clue is a short monograph entitled *The Root of All Evil*, which begins by quoting Jesus' statement that one cannot serve both God and mammon (i.e. wealth) and these words of Epistle writer Paul to Timothy:

> If we have food and clothing, with these we shall be content. Those who desire to be rich fall into temptation, into a snare, into many senseless and hurtful desires that plunge men into ruin and destruction. The love of money is the root of all evil. (I Timothy 5:8–10)

John goes on to quote the theologian Reinhold Niebuhr, who once remarked that the role of Christianity is 'to afflict the comfortable', as well as to 'comfort the afflicted' and to write that he hopes his writing will 'give pause to those who are complacent about the way our economic system operates' and to explain to the radicals his judgement that 'capitalism should be modified, not destroyed' (Nevile, 1979).

John is not the sort of Christian who is obsessed with attaining and maintaining personal perfection, either his or others'. He has written that 'religion is concerned with the ordering of society as well as with the way individuals conduct their lives' (Nevile, 1979: vii). A central theme of much of his writing is that 'if capitalism is to work in morally acceptable ways, the majority of people in the economy must let altruistic motives moderate the naked self-interest of the acquisitive motive' (Nevile, 1979: 8). Unlike Wittgenstein, John realised early on that achieving perfection was an impossibility and that tolerance, compassion, kindliness and, when required, quietly expressed righteous anger at injustice were much more relevant and important. Therefore, John's faith has led him always to be involved in communities, small and large, and to work with people of all beliefs, or none, in institutions, the aims of which have been to move towards the creation of just and equitable societies.

Like others who follow similar paths, he is a realist (though not a critical realist). John knows that even though a cause is just, there is no guarantee in our imperfect world that it will prevail. This has never stopped John from keeping on trying. He has led and still leads a very busy life and works very hard.[1] Over the years, he has served on and contributed to many public enquiries and committees as well as being Head of School and Faculty Dean for periods of time no one would countenance these days. Not that all work and no play characterise his existence. A devoted family man, he is an avid theatregoer and is very well read in Australian and English classics, ancient and modern. He was a better than average rugby player in his youth, and he enjoys gossip and telling jokes.

1.2 Theoretical Development

John Nevile's approach to economics and how he developed it provide fine role models. While he is not what would now be regarded as an orthodox economist, he was for much of his career a highly respected and prominent member of the Australian economics profession, a leading macroeconomist. His work was mainstream Keynesian with a few twists, and he can be seen as Australia's first empirical Keynesian in the sense that his judgments were explicitly guided by a macroeconometric model of the economy. He was very much in the thick of the battle against Monetarism. Later, as money and finance and rational expectations and neoclassical ideas penetrated the mainstream, he became less and less enamoured of modern macroeconomics (as were others like Solow) and focused his attention on broader societal issues.

Not all strands of John's analysis evolved simultaneously (though he would rightly stress the importance of the process of mutual determination; see Kriesler and Nevile, 2002). Rather, his intellectual progress has been sequential and recursive. His earliest graduate work gave him a firm grip on the general nature and details of the dynamics of modern advanced economies. Few economists understand Roy Harrod's (1939, 1948) seminal and now classic contributions more deeply and thoroughly than John Nevile. Over the years, he has continued to write on Harrod and Harrod-like issues, as indicated by his most recent article in the *Cambridge Journal of Economics* (Nevile and Kriesler, 2011).

With this background, John used his comparative advantage as an outstanding applied economist and econometrician to provide the first econometric model of the workings of the Australian economy (Nevile, 1962).[2] He went on to tackle many issues, especially those associated with the impact of fiscal measures and with their optimum coordination in an Australian setting.[3] His modelling exercises always served the purpose of devising practical and humane policies that could bring about and sustain full employment, tackle inflationary pressures, sustain growth and be combined with measures aimed at achieving distributions of income and wealth, which would not have occurred unaided from the workings of the Australian economy, even had these other economic goals been attained.

Thus, John Nevile is known for his combining of policy objectives with a close examination of ways to achieve and protect human rights. Many of his most important articles are concerned with the workings of labour markets and policies to make them work better for individuals and in aggregate. He recognised early on that sustained full employment could only come about if combined with permanent incomes policies reflecting the history, sociology and institutions of each society. Thus, he was a great supporter of the Commonwealth Conciliation and Arbitration Commission (now Fair Work Australia) and the centralised incomes policies associated with it, especially in the early years of the Australian Prices and Incomes Accord – an agreement between the Labor Government and the peak union movement during the 1980s whereby money wage moderation was compensated by 'social wage' measures such as guaranteed superannuation access. The deliberate dismantling of central labour relations institutions and policies since the mid-1990s has not met with John's approval.

1.3 Ethical Underpinning of Nevilian Economics

Early in his career, John abandoned the false claim that the economist's trade is a value-free objective social science – a canard that is still taught to most undergraduates and accepted by the well-trained, technically able, but uncritical cogs of capitalism which modern graduate schools tend to produce. John argues that because 'economic actions, institutions and policies affect people' they have an ethical dimension (Hawtrey and Nevile, 1986: 1). He profoundly regrets that the ethical foundations of economics, described by Adam Smith, for example, in *The Theory of Moral Sentiments*, are now tacitly embedded and at best implicit in economic analysis, rather than being made explicit. He emphasises, with Max Weber, that entrepreneurs will not retain the confidence of their customers and employees unless they have 'highly developed ethical qualities' (Hawtrey and Nevile, 1986: 2).

A clear expression of ethical values was his 1998 critique of the nature of so-called 'economic rationalism', as 'social philosophy masquerading as economic science' (Nevile, 1998: 170). He claimed that worldwide there had been 'a deliberate political campaign to change the prevailing political ideology to that held by the economic rationalists' (p. 170). He argued that 'one of [economic rationalists'] many tricks is to present their policy recommendations as no more than the logical consequences of orthodox economics', despite the dependence of these policies more on 'values than on the theorems of economics [perhaps, in their case, lemmas]'. He emphasised that the principal change resulting from the implementation of economic rationalist policies had been the displacement of full employment as a goal of public policy and the elevation in its place of inflation control as the pre-eminent goal – a reversal of ideological priorities (p. 170).

The fact that controlling inflation should oust the goal of full employment reflects both odious human values and perhaps also the possibly unconscious realisation that capitalism needs unemployment if it is to continue to 'work', to survive. Why? The argument is that it will not work unless unemployment is maintained at levels which make the 'sack' an effective weapon with which to control the working class. Kalecki's argument about the need for unemployment in a capitalist society is one answer which is well known and which is accepted by John, who also accepts that there are always basic contradictions present in capitalism. He emphasises an underlying structural flaw in modern capitalism, namely, that when the very well off engage in personal gratification, or conspicuous consumption, and their increases in income are highlighted by the media, this harms the work ethic on which capitalism depends.

For those who support John Nevile's strong commitment to the idea that economics is not value free, the question arises of how to determine appropriate values and ethics that might underlie economics. Economics started as part of Moral Philosophy, and it is important that its moral aspect not be forgotten. Economic analysis informs important policy decisions, which influence the lives of most of the population. This, as already argued, is why John saw ethical judgments, explicit or implicit, as unavoidably lying at the heart of economic analysis.

The attempt to divorce economic analysis from its ethical impacts has been formalised in mainstream economics in the normative versus positivist science debate. John's rejection of the idea, taught by 'most economic departments that positive economics is value free' (Nevile, 1998: 175) is based on the argument that

> ... positive economics rests on value judgements in at least two respects. ... in general positive economics is not just a matter of deductive reasoning. It also requires an appeal to empirical studies. Moreover, the facts that an economist studies are not facts produced in carefully controlled conditions in a laboratory. They are facts thrown up by real-world situations and some judgement is required in interpreting them. This judgement is heavily influenced by the values of the person making them. ... The second reason why positive economics is not value-free is the human tendency to give more weight to empirical observations that tend to support one's preconceived ideas than to those that tend to disprove them. (Nevile, 1998: 175–176)

The basic ethical judgement in economics is the Pareto one. However, we know that this is extremely problematic. Pareto efficiency implies the power of veto of any policy by any one member of society. Sen (1970), in particular, has been extremely critical of Pareto optimality, arguing that 'a society or economy can be Pareto optimal and still be perfectly disgusting' (p. 22). In addition, Sen has argued that the Pareto optimality criterion clashes with the basic concepts of liberalism. The fundamental problem with the Pareto criterion is that almost any imaginable change, no matter how much it improves the welfare of the general population, is likely to make at least one person worse off. As a result, the change will not satisfy the Pareto criterion.

The alternative to the Pareto criterion is the use of interpersonal utility comparisons, but these have remained theoretically problematic despite the best efforts of neoclassical theory.[4] Thus, the Pareto criterion, despite its flaws, remains the tacit policy guide to 'value-free' economists. John saw the impotence of this criterion as lying in the reality that all policy has winners and losers:

> The gains of the winners may be greater than the losses of the losers, but this, in itself, does not mean that economic analysis supports the implementation of policy change. (Nevile, 1998: 175)

Some economists have suggested that if winners could compensate losers, then it would be acceptable to implement the policy. There was much debate in the 1930s and 1940s about the Compensation Principle, as it was called, and it clearly provides the rational for cost/benefit analysis (for an overview of the Compensation Principle and this debate, see Chipman, 1987). Clearly, if winners actually did compensate losers, then the policy would lead to a Pareto improvement. Much economic policy has been predicated on these principles. However, according to John, whether winners actually compensate losers is a political and a moral issue, and economists opt out and forget to tell people (Nevile, 1994, 1998).

With characteristic balance, John acknowledges that the so-called 'economic rationalists' have made a contribution to Australia by turning it from 'an inward looking country emphasising protection to an export oriented country' (Nevile, 1994: 42). But he goes on to emphasise 'that the great bias of economic rationalists against acknowledging market failure leads to flawed policy advice' and to note the

> ... even more important ... widespread tendency of economic rationalists to ignore, or at least downplay the distributional consequences of their policy recommendations. (Nevile, 1994: 42)

An alternative to the utility approach, which some economists have advocated as a good foundation for ethical economic analysis, is Rawls' analysis of justice as fairness. Rawls derives his analysis of fairness from what he calls the 'original position' where all citizens of a society get together under a veil of ignorance as to their actual social, racial, gender or economic position, in a society whose political, social and economic parameters are unknown. These citizens then agree to the basic principles of justice, which will be incorporated into their actual society. From this analysis emerges a 'difference principle', which is the cornerstone of Rawls' ethical criteria and requires any change to be in the interest of the 'worse off in society'.

Included in this is the idea that it is acceptable for inequality to increase, as long as the worse off are in a better absolute position.

Given that one of John Nevile's main interests is in employment and work, a more telling criticism of Rawls is that his analysis focuses on distribution and exchange, with agents not caring about how things are produced or about labour processes, only how final commodities are distributed. As a result, it ignores production and, in particular, the work process. In addition, it disregards important questions relating to the ownership of the means of production such as those concerned with issues of class and power in society. This means that it would be very difficult to use Rawlsian analysis to meaningfully discuss the right to full employment or the right to a decent job, both of which feature prominently in John's writings.

In his 1979 book *The Root of All Evil*, John had the foresight to advocate the introduction of a prices and incomes policy as a way of directly addressing the underlying cause of inflation – the competition for income. He recognised that this would require union and corporate restraint but argued that this might be acceptable if it was demonstrated that it would prevent most of the costs of anti-inflationary measures being born by those forced into unemployment. In his ethical evaluation of the Accord when it subsequently became operational after 1983, he argued that access to work is essential to self-fulfilment and in order to enable men and women to serve one another and to help the needy. Furthermore,

> the over-riding principle is the emphasis in the Bible on the necessity for justice in community economic relationships. ... it is unjust for the weak to be penalised for the benefit of the powerful. (Hawtrey and Nevile, 1986: 14)

Yet that is exactly what happens when contractionary fiscal and monetary policies are used to constrain economic activity so as to reduce the rate of inflation. 'The Bible is very scathing about those who secure their own economic well-being at the expense of others' (Hawtrey and Nevile, 1986: 20). In contrast, the Accord attempted through a cooperative framework of voluntary wage restraints to provide a basis for expansion of the social wage, which would lead to simultaneous reduction of unemployment and inflation. This worked for about six years from 1983 to 1989 during which time unemployment fell from over 10% to under 6% and inflation also steadily declined. John saw the Accord as promoting cooperation rather than confrontation, which was also of value from a Christian ethical standpoint. He saw the Accord as 'an attempt to break the yoke of unemployment imposed through tight monetary and fiscal policy' and quoted Isaiah 58: 6 as one of many supportive biblical passages:

> Is not this what I require of you as a fast;
> To loose the fetters of injustice,
> To untie the knots of the yoke.[5]

John also supported the Accord because he saw it as enabling the economy to run at a higher level of economic activity and at an agreeable rate of growth. He argued that this economic progress was vital if the needs of the vulnerable are to be adequately met, which he saw as the main purpose of wealth creation. There was a lovely example of John's integration of the biblical emphasis on justice with his policy recommendations when, in an interview on his retirement, he was asked if he still believed in a guaranteed minimum income for all. He replied that he did,

> ... or, even better, a guarantee to all that they will be able to earn a minimum income by acceptable means. When I read the Old Testament prophets I am struck by the emphasis, in their visions of an ideal society, on everyone owning their own plot of land. In the agrarian society of ancient Israel that was another way of saying that everyone should be guaranteed the means to obtain a reasonable minimum standard of living. (Lodewijks, 1994: 27)

These values are entrenched in the Universal Declaration of Human Rights, and the International Covenant on Economic, Social and Cultural Rights. In essence, these provide the basic requirements for a decent life and something which we are all, as humans, entitled to.

According to the Universal Declaration of Human Rights – Article 23:

1. Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment.
2. Everyone, without any discrimination, has the right to equal pay for equal work.
3. Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity and supplemented, if necessary, by other means of social protection.
4. Everyone has the right to form and to join trade unions for the protection of his interests.[6]

The recognition of these fundamental rights underlies much of John Nevile's work. In a series of articles for well over a decade, John has been examining the implications of policies and their consequences for the advancement of these rights. Importantly, he sees economic rights as nested in other individual and social rights, as a synergistic entity, rather than purely in their own terms.

1.4 Conclusion

It is through an acknowledgement of and concern with fundamental human rights that the most vulnerable in society can be cared for. John's work has indicated an extremely important way in which to evaluate economic policy, by ensuring that policies always respect the rights of those affected. This means trying to ensure full employment of the labour force, with decent jobs and equitable pay so as to enable people to be included as full members of society.

John is an Australian prophet, advocating the primacy of social justice in national policy through the centrality of equity and opportunities of work for all and feasible strategies, which would contribute to those goals. In a cynical age, he is a quiet, brave and good man who leads by example and through the intellectual strength of his writing, teaching and speaking. Australia is a more inclusive and less damaged society because of the influence of his life and work.

Acknowledgements

This closing article in the symposium is unashamedly a personal as well as a professional tribute. John has long been a mentor, role model, colleague and friend, someone whom we greatly admire, whose company we much enjoy and for whose steadfast support, we are profoundly grateful. It is based on the premise that honesty in the 'dismal science' calls for a disclosure of values. The authors thank the participants of the Symposium in honour of Emeritus Professor John Nevile, Raja Junankar, Wylie Bradford and the anonymous referees for their comments.

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Notes

1. It is my (G.C.H.) great fortune to share an office with John at the School of Economics, so I am able to observe his great powers of concentration as well as to enjoy well-deserved breaks for chin-wags.
2. We now know that Trevor Swan had made a Keynes-style model of the Australian economy in the 1940s. It is in a brilliant article that was only published after his death (Swan, 1989). However, the applied work in it is not econometric in the modern sense. This is not a criticism, just a statement about a different approach.
3. Books and articles on fiscal policy listed in his curriculum vitae (CV) easily outnumber entries under any other heading. They include Nevile (1970, 1975, 1983, 1999, 2000, 2003) and Nevile and Kriesler (2012).
4. The originators of neoclassical economics thought that the problem of making interpersonal utility comparisons would be solved sometime in the future. However, we now know that this is not the case.
5. The authorised King James version has the phrase 'and to let the oppressed go free', which, as one of our referees commented, 'seems appropriate'.
6. These views are reaffirmed and expanded in the International Covenant on Economic, Social and Cultural Rights: Article 7. The States Parties to the present

Covenant recognise the right of everyone to the enjoyment of just and favourable conditions of work that ensure, in particular, the following:

1. Remuneration that provides all workers, as a minimum, with the following:
   (a) Fair wages and equal remuneration for work of equal value without distinction of any kind, in particular women being guaranteed conditions of work not inferior to those enjoyed by men, with equal pay for equal work.
   (b) A decent living for themselves and their families in accordance with the provisions of the present Covenant.
2. Safe and healthy working conditions.
3. Equal opportunity for everyone to be promoted in his employment to an appropriate higher level, subject to no considerations other than those of seniority and competence.
4. Rest, leisure and reasonable limitation of working hours and periodic holidays with pay, as well as remuneration for public holidays.

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2
The Root of All Evil

J. W. Nevile

2.1 Greed or Self Motivation?

Many idealistic people feel that there is a basic moral flaw in capitalism in that it is based on the love of money, which if not the root of all evil is at best a sordid, ignoble motive to use as the mainspring of an economic system. Christians tend to feel uneasy about the contrast between the "profit motive" underlying capitalism, and the gospel statement that one cannot serve God and mammon. Opponents of capitalism have a field day contrasting the selfish motives which motivate people in a capitalist society with Marx's dictum "From each according to his ability, to each according to his need". Even capitalism's most ardent supporters are often uneasy about the role of the "profit motive" in modern western societies. For example, the American commentator Irving Kristol maintains that capitalism was originally based not on the naked profit motive but on the "bourgeois virtues of probity, diligence, thrift, self-reliance, self-respect, candor, fair dealing and so on", and then laments that

> "What the 20th century has witnessed is the degradation of the bourgeois-capitalist ethic into a parody of itself – indeed into something resembling what the critics of liberal capitalism had always accused it of being ..... The trouble is that capitalism outgrew its bourgeois origins and became a system for the impersonal liberation and satisfaction of appetites ..... a system governed by purely materialistic conceptions and infused with a purely acquisitive ethos."[1]

Whether Kristol is right or wrong about the 19th century or the 20th century nature of capitalism,[2] there is no doubt that in both centuries the

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acquisitive motive, however hedged by rules and moral prohibitions, was, and is, an essential motivating agent in capitalist societies.

The phrase, "acquisitive motive" is more accurate than the better known term "profit motive". It is important to realize that capitalism does not just depend on businessmen seeking profits. It also depends on the fact that if a person is indifferent between two jobs, he or she will choose the one that pays the highest wage, or the fact that a farmer will normally plant the crop that promises to bring him the greatest income, that people will buy at the shop whose prices are the lowest, and so on. The "love of money" is widespread in countries like Australia: farmers, trade unionists, professional people, are just as anxious to increase their incomes as are businessmen, and this is a part of the functioning of the economy. There is no escaping the fact that the sort of economy we have in Australia today is based on selfish motives, or the love of the things that money can buy.[3]

2.2 Strengths and Weaknesses of the Market System

The self-seeking motives underlying our economy do of course serve an important purpose. They act to ensure that the things people want, and have money to purchase, are produced; they give flexibility to the economy and encourage economic growth. The traditional defense of the acquisitive motive is that the "private vices" of selfishness and greed result in "public benefits" of ensuring that the economy produces the things consumers want and produces them in increasing quantities. Any system of economic organisation has to determine three basic questions:

(i) what is to be produced and in what quantities;
(ii) how shall goods and services be produced and by whom, using what resources and what methods of production; and
(iii) for whom shall goods and services be produced – who is to get the benefits, and in what proportions, of production, or how are incomes determined.

Unless a society is completely traditional and unchanging, answering these questions requires a myriad of decisions every day or at least every week. The acquisitive motive supplies a decentralized way of making decisions which does not rely on a gigantic bureaucracy, and indeed without most people needing to know how the economic system works and the decisions are made.

The acquisitive motive underlies the market system which is the mechanism by which these questions are mainly answered in Australia. In a market system everything has a price, all goods and services have their market prices as do all kinds of labour in the form of wages and salaries. If the pattern of demand changes and less is wanted of anything, say skateboards, sellers will be left with unsold stocks at the existing price and will tend to cut back orders and reduce prices. This will discourage the production of skateboards and some people will drop out of skateboard production. Similarly, if the demand for skateboards increases, sellers of skateboards will place more orders, the price will tend to rise, both at the retail and wholesale level, making it more profitable to produce skateboards and drawing resources into producing them.

A similar mechanism works to determine what occupations people choose, as well as what industries they work in. For example, if there is a shortage of truck drivers, the incomes of truck drivers will rise and more people will be attracted into that occupation. The methods of production used will generally be the least costly at any point in time since these will give the greatest profits. Who gets what is produced is determined by peoples' incomes, which in turn are determined by what resources they own (including their own labour) and how the market values those resources.

Of course in an economy such as that in Australia, the market system is not allowed to work unfettered. Trade unions restrict entry into some occupations. Businesses are not content just to produce what consumers show they want through their purchases, but try to manufacture wants through advertising. Most important of all, the government intervenes in many ways, from laying down minimum safety and other conditions of work to ensuring that, in principle at least, all people have some minimum income and are not left destitute if they happen not to own any resources that the market values. Nevertheless, despite all these modifications, while the Australian economy is a mixed economy, it is still basically a capitalist economy in which the market system, under-girded by the acquisitive motive is the mechanism which determines what is produced, how it is produced, and who gets the fruits of production. We do appear to have the situation where the "private vice", embodied in everyone pursuing their own self-interest without considering others, results in the "public benefit" of ensuring that the right things are produced in the most efficient manner.

This sounds almost too good to be true; and indeed it is! First, if the system is to work, there are very strict limits on the extent to which the majority can pursue private gain without considering others. For example, pursuing private gain through dishonesty and theft makes the system work worse, not better, and if too many people espouse such methods the economy will break down in chaos. "Private vices" do not work for the public good unless carefully hedged by a code of rules and conventions, as well as laws, which the vast majority of participants in the economy observe. At least some of the bourgeois values are as important as the acquisitive motive, if capitalism is to work.

Secondly, even if everyone adheres rigidly to the values of honesty, probity, etc. the system may work in the sense of producing the goods and services wanted by those who can afford them, but it will not produce "good" for all, unless everyone has an adequate supply of resources or human skills that the market values. An economy like that of Australia determines the answers to the questions what shall be produced and who shall get the fruits of production on the basis of one dollar one vote. Men and women are not equal in the resources they own, and hence in the number of dollars they have. If one person chooses to work more and harder than another it may be ethical for him or her to have a bigger income, but people have unequal inheritances both of this world's goods and of genetic resources. There is no ethical support for the proposition that an intelligent (or better educated) man should live in luxury, while a less gifted person lives in poverty. There is even less for the proposition that those born of rich parents should live in luxury while those born in humble circumstances have difficulty making ends meet. In short while some pursuit of self-interest does help the economy to function, it only does so if that pursuit of self-interest is hedged by rules and codes of behaviour which are widely observed. Even then the resulting economic system can only be considered to have any moral validity if the extremes of income resulting from the often arbitrary, largely inherited, distribution of resources (including personal skills) are offset, at least to the extent that everyone has sufficient income to enable them to live in what society recognizes as reasonable comfort.

It is not the case that in Australia everyone has enough income to live in reasonable comfort. The Henderson report on poverty[4] finally exploded the comfortable myth that, apart from drunkards and those who are congenitally lazy and improvident, there are no Australians living in poverty. Many Australians have incomes below the poverty line through no fault of their own. Yet in the majority of countries in the world, a far greater proportion of the people live in poverty than is the case in Australia. Even within Australia it is difficult to defend the acquisitive motive on the grounds that "private vices" promote the "public good". When one considers conditions in poorer countries and the way economic relationships between rich and poor countries help to perpetuate these conditions it is impossible. Can then the acquisitive motive be defended. I think so, but only for want of anything better, given the present state of mankind.

2.3 Alternative Ways of Organizing Society

In this context it is useful to consider the classification, put forward by the great Quaker economist, Boulding, of the main ways in which a society can be motivated, or "organized" as he puts it:

> "A social system consists essentially of relationships among persons ..... There are, of course, a great many relationships which are possible between persons and among rules. However, most of these can be classified into three major categories. The first of these is the threat system

> in which one says to another, "You do something nice to me or I will do something nasty to you." ..... Exchange is the relationship whereby one says to another, "You do something nice to me and I will do something nice to you." ..... In addition to the threat system and the exchange system, there is another set of relationships among persons and rules which may be called generally the integrative system. This is a rather heterogeneous category which includes persuasion, teaching and love: "What you want I want."[5]

It will be noticed that Boulding has listed the three major motivating forces in what most people would regard as an ascending order of ethical desirability. The most typical, and the most long lasting historically, the threat system, is embodied in slavery or serfdom where serfs are little better off than slaves except that they cannot be sold separately from, and separated from, their land. Of course civilizations based on slavery, or virtual slavery, also have elements of the exchange system and the integrative system. Indeed all social organizations have all three types of motivation to some degree. But in a slave based economy the primary motivation is that of the threat just as it is the acquisitive motive in a modern capitalist economy despite the role of the state and many actions prompted by altruistic motives.

Renaming an economy based on the acquisitive motive, the exchange system, makes it sound much better ethically, especially when comparing it with the threat system which it superseded. The exchange system is based on promises. These promises are usually carried out, and have to be usually carried out if the system is to be viable. A system based on people carrying out promises freely entered into sounds quite attractive from an ethical point of view. However, the points about the exchange system which make it sound attractive ethically only hold if there is a reasonable degree of equality between the partners in the exchange. The very word partners implies this. If one participant is much more powerful than the other the exchange system slides imperceptibly into the threat system. In some countries for many people the employment exchange is not so much "if you do something nice for me (work) I will do something nice for you (pay you a reasonable wage)", as much as "if you do not work for me at the wage I determine you will be unemployed and starve".

If the exchange system is to have moral validity and the acquisitive motive is to be sanctified under that umbrella, then it is necessary that all people in the economy enter into exchanges with a certain amount of freedom, and are not forced into them through desperation. While the exchange system is a remarkably efficient mechanism for deciding what is to be produced, since it decides this on the basis of one dollar one vote, everyone must have enough dollars to cover their basic needs before the system can be defended at all on moral grounds.

This is the basic argument for a welfare state, in which everyone has a guaranteed minimum income when they are unemployed, sick or retired as well as when they are working. It is also the argument for a medical benefits scheme which covers the cost of expensive medical and hospital needs – at least for all but the very rich. It underlies the ethical arguments for income redistribution – for the state taxing the rich more heavily than the poor and subsidizing, or providing free, necessities required by the poor or giving them cash grants.

If the exchange system needs so many props to make it both efficient and ethically acceptable – codes of conduct for individual participants plus most of the paraphenalia of the modern welfare state – why bother with it at all? Why not aim for an integrative system which seems more attractive than either the threat system or the exchange system? The answer is to be found in the present characteristics and nature of mankind. Unfortunately integrative systems just do not seem to work in communities much larger than the (extended) family. The history of Utopian societies is a sad commentary on this, as is that of communist states like Russia, which are based on a desire to move as quickly as possible to the integrative system, but which seem to rely heavily on the threat system. This does not mean that one should not work for a steady replacement of the exchange system by the integrative system. Just as over the last five hundred years the exchange system has replaced the threat system as the dominant one in western European economies, so one can hope that in the future the integrative system will replace the exchange system. To a very small extent this is already happening. But lasting changes of this sort seem to occur very slowly. In our lives it seems that viable economies will be based predominantly on either the threat system or the exchange system. Most people would prefer the exchange system.

2.4 Altruism within the Market System

However, this does not mean that here and now ethically sensitive people need to be slaves to the acquisitive motive or feel that they are traitors to the system if they let other things determine economic decisions. It will not disrupt the system if either institutions or individuals are concerned with more than money and the things money can buy. This point is true of corporations. I do not mean that corporations should necessarily give away more (in goods or money) to charities and other good causes. As someone remarked with acerbity, charity is giving away your own money, not other people's. But corporations can (and I believe should) put things like the welfare of their workers as high in their priorities as the dividends that they pay shareholders. Indeed, in the longer run because of resulting better industrial relations, this might increase rather than reduce profits, but that is not the point. One way forward (at least in industries where a very large scale of operation is not necessary for economic production methods) may be for companies to transform themselves into organizations more like co-operatives, in which workers and management "jointly" own the company and work together to produce goods and services wanted by the community and thus provide themselves with a livelihood.

One example of this is the Scott Bader Commonwealth in England which developed from a family business manufacturing polyester resins and employing 160 people. The owner, Mr. Ernest Bader, vested the ownership of his firm in a Commonwealth whose members were the former employees now called partners and with a constitution which not only sets out how the powers of ownership are to be exercised, but which also imposes several restrictions, e.g. a rule limiting the ratio of remuneration between the highest and the lowest paid in the Commonwealth.[6] Under its new form of organization the firm was a resounding commercial success showing that this form of organization is perfectly feasible in a society which is basically organized on an exchange system.

Similarly, there is no need for individuals to make the acquisitive motive underly all their economic activities. Altruistic motives will not wreck an exchange system any more than do the already widespread motive of obtaining a secure rather than a large income – or the desire for an interesting job or leisure rather than more money. Society as a whole can benefit and the economy can function more efficiently if the exchange motive is reduced and integrative motives increased. The following chapter describes in some detail one example where this is the case. It shows that the socially harmful and economically inefficient method of controlling inflation through high levels of unemployment is widely adopted throughout the western world, because the alternative method of an incomes policy requires a willingness to subordinate self-interest to the common good which does not yet seem to exist in most countries.

2.5 The Love of Money and the Welfare State

More fundamental than the example in the previous section is the fact that, if capitalism is to work in morally acceptable way, the majority of people in the economy must let altruistic motives moderate the naked self-interest of the acquisitive motive. Capitalism, with its associated market system, is the most efficient method so far devised to run an economy. But the resulting division of the cake can be extremely inequitable. If capitalism is to have any moral validity it must have superimposed on it the principles of a welfare state.

To say this is not to prejudge the question of what sort of welfare state, or even to say much about the size of the government sector, relative to that of the rest of the economy. In fact, all countries in moving towards a welfare state have adopted increasingly complex regulations and arrangements to look after the different categories of disadvantaged people: the old, the sick, the unemployed, and others in need. This has been accompanied by an expansion of government employment as civil servants are needed to administer the various programmes and to see that the people helped do indeed meet the regulations and fulfil the legal requirements to qualify for assistance. However, the basic requirement of a welfare state is that nobody should be allowed to fall below a certain level of income. In principle, at least, this could be achieved by a simple negative income tax scheme such as that proposed by the conservative economist, Milton Friedman. In this type of scheme there is a certain level of income (significantly above that considered the rock bottom level below which no one should fall) at which one pays no income tax. Above this level people pay income tax in the normal fashion. Below this level of income the government pays people negative income tax. The amount a person receives from the government increases as his or her income falls, until a person who has no income of their own at all receives the amount which society has decided is the appropriate rock bottom level of income. Since the condition for receiving payments from the government is not that a person is sick or elderly or unemployed or anything else, merely that their own income is at a certain low level, the scheme requires little more administrative manpower than the present income tax arrangements, and can be consistent with either a relatively small or a relatively large government sector.

However, if the rock bottom level of income, below which no one is allowed to fall, is sufficiently high to ensure that everyone can live in at least frugal comfort, a welfare state is likely to require high levels of taxation on the incomes of the well-off. The resources provided by the welfare state to the less fortunate must be paid for by taxing the more fortunate. Any worthwhile welfare state will almost inevitably necessitate relatively high levels of taxation, not just on the very rich, but also on the moderately well-off, who comprise the bulk of the population in a country like Australia. If people put altruistic or integrative motives first and want their society to be a “caring” society they will accept this high level of taxation. If they put the acquisitive motive, and the love of things that money can buy first, they may effectively refuse to pay a high proportion of their incomes in taxes.

There are various ways of doing this. Some methods minimize the amount of tax paid and these range from the tradesman doing jobs for cash with no questions asked, to the more legal, if no more moral, tax avoidance schemes engaged in by those rich enough to hire expensive lawyers and accountants. Or people may be able to pass the tax on by putting up the fees they charge, increasing the profits they make or forcing up the wages they receive so that their after-tax income is still at a high level. The first method directly reduces tax receipts. The second causes inflation, which in addition to the other evils of inflation reduces the real value of many of the taxes paid. A third way which is now becoming prominent in some countries is through direct political processes, the so-called taxpayers’ revolt.

A taxpayers' revolt may be a revolt against large wasteful bureaucratic government, or it may be a reflection of a basic unwillingness to share one's income, through taxation, with those less fortunate than oneself. Either way the result is likely to be the same, a reduction in direct grants to the needy or in those services which particularly help the disadvantaged. The major groups in California to vote against the proposition limiting property taxes were the underprivileged minority groups of especially Black and Mexican Americans.

In short, if capitalism and the market system are to be morally acceptable, they must have some form of welfare state superimposed on them. But a welfare state which really does prevent any citizens from sinking to unacceptably low income levels and ensures that all citizens have the basic necessities of food, shelter, medical care, etc. will require relatively high levels of taxation. There is nothing in the ethos of capitalism itself to lead people to accept these high levels of taxation. Unless they do a welfare state is not viable. The capitalist ethos must have added to it another ideology which makes people want the welfare state to be successful and makes them willing to pay relatively high taxes.

A welfare state may be a second best, but it has an advantage over more idealistic forms of organization, which dispense with the acquisitive motive altogether, in that it has worked and worked without loss of individual liberty. There are countries where the welfare state has been successful both socially and economically and in which democracy has been retained in substance as well as in form.

Notes

1. Irving Kristol, *Two Cheers for Capitalism,* Basic Books, 1978, pp. 87 and 88.
2. Personally I think that he is right that in the 19th century society was more approving of the ethic that it perceived as underlying capitalism than is the case today, and that he is wrong in believing that a return to the 19th century ethic is the way forward or that the so-called "bourgeois values" taken as a whole are an attractive list of virtues to emphasise.
3. The use of the word "selfish" is not meant to deny that for many people "selfish" motives include concern for the welfare of their families and friends as well as for themselves. A more fundamental objection to the statement that our economy is based on selfish motives is that it ignores the role played by giant corporations, whose actions are no longer dominated by the profit motive. It is true that the actions of such corporations can often no longer be explained by the profit motive. The goals of modern corporations must be defined as the goals of those managing them. These are mixed and the strength of the different elements in the mixture varies from corporation to corporation. Nevertheless they can be summarized as follows:

   a. Avoiding bankruptcy – this is probably the first goal of the managements of most public companies. While some managers may have the type of temperament that leads them to gamble on risky courses of action which, if successful, will make the corporation bigger and/or more profitable and increase the manager's status and income, most managers put a high premium on risk avoidance. After all the fruits of success are shared with the shareholders, whereas the costs of bankruptcy may fall much more heavily on managers, whose fortunes are bound up with the particular firm than on shareholders who have probably spread their shareholdings over a number of companies. Thus it is natural for managers to be more cautious than shareholders, and to place a high value on avoiding bankruptcy.

b. Achieving a minimum level of profits – which is necessary to avoid shareholder revolts or, perhaps more importantly, to avoid takeovers by other businesses which believe that they can use the assets of the company more profitably.
c. Achieving the growth of the company which often is reflected in the growth of the power, prestige and salaries of those managing the company.

In fact these goals are not necessarily inconsistent with the maximization of profits in the long run, and some economists have countered the claim that the profit motive cannot explain the behaviour of large corporations with the statement that the goals of managers that we have listed above are a good set of rules to achieve long-run profit maximization, particularly if one places a high premium on risk avoidance. However, this argument need not detain us. It is clear that the goals of management we listed do reflect the acquisitive instinct of managers. Managers of corporations are no more, and generally no less, selfless than the community at large. Our economy is still based on selfishness and the moral question remains.

4. Australian Government Commission of Inquiry into Poverty, First Main Report, Ronald F. Henderson, Chairman, *Poverty in Australia,* (A. G. P. S. Canberra, 1975).
5. K. Boulding, *Beyond Economies,* University of Michigan Press,1965, pp. 231–232.
6. see E. F. Schumacher, *Small is Beautiful,* Abacus, Lond, 1974, p. 232.

3
Just and Unjust Macro-economic Policy

J. W. Nevile

3.1 Introduction: The Need to Bring Morality Back into Economics

Let me start by congratulating you on the existence of this group. Anything remotely connected to morality seems to be notably absent from neo-classical economics, as used by most academics and public servants, today. If one denies the possibility of intercomparisons of utility it is difficult to go past discussing the probable consequences of actions, to a consideration of whether those consequences are moral or even fair. In any case most neo-classical economists seem to be seized with a desire to make economics a positive science like physics. So instead of considering whether the consequences of economic policy actions are desirable from some moral point of view they concentrate on whether they are efficient and hide behind the concept of Pareto-optimum. A situation is said to be Pareto-optimum if no one can be made better off without making at least one person worse off.

There are two immense problems with this approach, and ignoring them has led economics into disrepute, making the term economist a pejorative one among large sections of the Australian population.

First, and most fundamental, there is no reason to believe that a Pareto-optimum situation has any moral value or any fairness attached to it. A situation in which all the national income accrue to one person and all the others are slaves is a Pareto-optimum situation, but no one I know considers it moral or fair.

Secondly, at a practical level, it is virtually impossible to make any policy recommendations at all in real life situations, if one's criterion for a policy change is that it will bring a move from a sub-Pareto-optimum situation to a

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Pareto-optimum one. Can anyone here think of any practical economic policy change in Australia which would not make at least one person worse off?

Because of this second problem most neo-classical economists tend to fudge the Pareto-optimum criterion and use instead the criterion for recommending a policy change that it is desirable if the winners could fully compensate the losers and still be better off. The winners do not actually have to compensate the losers. Whether they do or not is a political question, not an economic one, at least according to those economists who use this criterion.

This way of judging policy change completely ignores the question of who are the winners and who are the losers, whether compensation is at all likely, and indeed whether it is even feasible. Inevitably economists who adopt this philosophy urge policy changes which will benefit the rich at the expense of the poor. Not all the policies they advocate do this, but enough do to give economists a reputation as people who believe that gaining material wealth should have priority over any other social values, people who want to cut costs at the expense of throwing thousands out of work, who will allow pollution if discouraging it also discourages mineral production and exports and so on.

It may not matter much to anyone except economists if we have a bad name or not; but it does matter to millions of Australians when policies are implemented that reduce the standard of living, and the more intangible quality of life, of the bottom 40 per cent (in income terms) of our population. It also matters if economists constantly urge that such policies be adopted without giving any consideration to their effects on income distribution since this tends to bring everything economists say into disrepute.

The amoral approach of the dominant school in economics since around 1980 has not served the discipline well and has not served society well. Economics desperately needs to be reunited with the concerns of moral philosophy, so again I congratulate you on your existence.

3.2 The Meaning of the Word Just

My title is just and unjust macro-economic policy. I chose the word just rather than moral to tie in with some quotations that I will give you in a minute, but there are other advantages. The adjective just has a range of meanings all of which are appropriate to the subject matter of my paper. At one end of the range is the meaning upright, as in the old ditty:

> The rain it raineth every day
> Upon the just and unjust fellow.
> But more upon the just because
> The unjust hath the just's umbrella

At the other end of the range are concepts with little moral overtone. Just can mean suitable or appropriate, so that the essayist Evelyn spoke of "things to be done in their just season" and Mills and Boon heroines sigh "he is just the man for me".

I believe that macroeconomic policy should be appropriate and suitable. One aspect of some macroeconomic policies that I consider unjust are that they are not appropriate in the sense that they will not achieve the end desired, but the main meaning of the word 'just', as I am using it, is closer to upright. It is the meaning given by the Oxford English Dictionary when it defines just as "consonant with the principles of moral right, equitable, fair". (I hasten to say that moral right means moral rightness and is not a contraction of moral majority and new right.) Principles of moral right is the meaning of just that I emphasise in this address, but the concept of equitable or fair will also cover what I want to say fairly well.

The next step is to say, of course, what are the principles of moral right to be applied. I start with a quotation from a Jewish prophet who lived about 2,500 years ago. In ancient Israel fasting was a central religious observance, as it still is among Muslims today, as well as many orthodox Jews. Isaiah was concerned that the leaders in his society were happy to observe the outward signs of religion like fasting but not to act in conformity with the divine law. The rich and powerful people themselves noticed that their fasting did not have much effect. God did not seem to take much notice when they fasted. "Why do we fast but you do not see?" they asked. Isaiah responded why do you expect God to take notice of your fasts when you oppress all your workers. Then speaking on behalf of God he says

> Is this not what I require of you as a fast,
> To loose the fetters of injustice
> To untie the knots of the yoke
> To snap every yoke and set free those who have been crushed?
> Is a fast not sharing your food with the hungry
> Taking the homeless poor into your house
> Clothing the naked when you meet them
> And never evading a duty to your kinsfolk?

What is just, what is morally right, says Isaiah is to be concerned about the welfare of the less well off in our society, the lowly paid workers, the hungry and the homeless and all those oppressed by the structure and working of society. Of course Isaiah was not the only Hebrew prophet to say this. He just said it so well. Amos, for example, equated levying taxes on the poor as equivalent to kidnapping people and holding them to ransom and said that to levy such taxes was to turn justice upside down. When Amos accused the leaders of his society of turning justice upside down (or turning it into poison) (5:7, 6:12) he was not just talking about social justice and economic justice. The legal justice itself was corrupted into poison because it served the interests of the rich and powerful not those of the weak and poor. This was an exact reversal of the proper role for any justice system which should be particularly concerned with the welfare of the vulnerable.[1]

Similarly, I could have quoted passages from the New Testament to make the point that concern for the less well off is at the heart of moral rightness or justice, but I chose the Isaiah and Amos references because they have authority among Jews as well as Christians and are also respected, I think, by Muslims. One can also find purely secular writers who make the same or a similar point, notably Rawles' principle that one should judge policies by their effect on the welfare of the least well off in our society. However, I do not want to labour the point, but only to set out that for me, and many others, just policies are those which show a particular concern for the welfare of the less well off and unjust policies are those which benefit the better off at the expense of the less well off.

3.3 Just and Unjust Goals of Policy

There are three fundamental goals of macroeconomic policy: low inflation, low unemployment and an appropriate rate of growth of output. Other things like increasing the national savings rate or reducing the current account deficit may look like goals, but they are subsidiary goals, significant because achieving them helps to achieve the fundamental goals, but of no significance in themselves.

There is some controversy in the community about what is the appropriate rate if growth of output, or even whether output should be growing at all. Although I have strong views on this question for the moment let me concentrate on inflation and unemployment, except to note in passing that more rapid growth of output is usually associated with lower unemployment everyone is in favour of low unemployment and low inflation.[2] There is nothing unjust about selecting these two as important goals. The justice issue arises when we consider the relative weight or the priority to be given to each of those two goals.

The problem is that many measures to reduce unemployment tend to increase inflation and the most common measures to reduce inflation increase unemployment. To some extent one has to make a choice about how much one endeavours to reduce inflation compared to reducing unemployment. Moreover, to a large extent different groups in the community benefit from low inflation and low unemployment. For reasons noted later in this chapter, the less well off suffer the most when unemployment is high and it is the well off who are hard by inflation.

In saying this I am not talking about the extremes of inflation or unemployment. Hyperinflation hurts almost everyone in society and very high levels of unemployment, 1930's depression levels, can tear society apart. We should never forget that the Weimar republic in Germany survived unbelievably high inflation in the 1920s but great depression levels of unemployment led to Hitler being democratically elected. In this address I am not considering depression levels of unemployment or higher inflation. I am not even considering moderately high levels of inflation like 20 per cent, but low to moderate inflation, such as we have experienced over the last 15 years, when inflation never got beyond a single digit figure when measured on an annual basis. Similarly, I am talking about levels of unemployment within the range we have experienced over the last 15 years, not great depression levels.

It is not surprising that increases in unemployment hit low income earners the hardest, at least in material terms. On the other hand low and moderate inflation, even low double digit inflation, has little effect on low income earners, one way or the other. This was pointed out by Nevile and Warren (1985) and has been confirmed by other studies. The group who benefit from low inflation, and especially by falls in the inflation rate, are those who own substantial amounts of bonds and notably financial institutions. Financial markets have a vested interest in low inflation and put much more weight on keeping the rate of inflation low than on reducing the high level of unemployment in Australia.

Lest you think that this is just the prejudice of a mildly leftwing academic, let me quote from a former governor of the Reserve Bank of Australia. In a speech to the national press club just before his retirement Bernie Fraser said that "monetary policy was becoming the hostage of influential financial markets with a vested interest in making the Reserve Bank give greater weight to inflation than employment". "The markets" he said "had a financial interest in supporting low inflation and low economic growth while frowning on evidence of strong growth" (those quotes are from the report in the *Sydney Morning Herald* 16/8/96). The *Herald* report also gave a direct quote from Bernie Fraser's speech.

> "Most financial market participants rate low inflation ahead of the Reserve Bank's other objectives. This reflects a number of factors but the financial harm that is done to the holders of bonds when inflation and interest rates rise is the main one. We see their [understandable] priorities in market reactions to different economic indicators: weak economic activity and employment numbers, for example are generally welcomed because they imply lower inflation and higher bond prices, while strong numbers are generally frowned upon because of concerns that they will be followed by higher inflation and interest rates."

Mr Fraser concluded that it would be "ironic" if the Reserve Bank's freedom from political influence were to be the vehicle of allowing it to be dominated by another interest: "If the short-termism of politicians were to be replaced by the short-termism of the financial markets". His successor as Governor of the Reserve Bank quickly reverted to the position that had become traditional in the 1980s saying on several occasions that he sees keeping employment high has a very low the priority in the list of factors that should drive Reserve Bank actions. For example on 8th May he told the House of Representatives standing Committee on Financial Institutions and public administration that there was no chance of another interest rate cut to reduce the chronically high unemployment rate (*S.M.H.* 9/5/97) and that the Bank "will have to tighten monetary policy if wages pick up further". This at a time when unemployment was stuck at 8.7 per cent and inflation was at the lowest rate it has been for 30 years.

If, given my age, I may be allowed to reminisce I would like to contrast this with a little history about a similar situation which arose when I was an undergraduate. In 1951 the Australian economy still rode on the sheep's back. Because of the Korean the price of wool in 1950–51 was double the price in 1949–50 but in the next year, with the cessation of fighting, the value of wool exports fell by 314 million pounds, precipitating a major slump. There are no official quarterly national income and expenditure accounts for this period but (lagged) changes in unemployment and other data with a cyclical pattern indicate that the fall in economic activity started around the middle of 1951 and continued until at least the end of 1952. On an annual basis current value gross national product deflated by the Consumer Price Index fell by 14 percent in 1951/52 and was virtually unchanged in 1952/53. The unemployment rate started to rise slowly in the first half of 1952 then rose rapidly to peak at the end of that year and started to decline in 1953. The Conservative Federal Government acted promptly as soon as there was a significant rise in unemployment, mainly through fiscal policy but also through aggressive relaxation of monetary policy which changed even before that of fiscal policy. One further point should be made about the use of monetary policy. The boom in 1950–51 was accompanied by a very high rate of inflation. When the stance of monetary policy started to be relaxed, inflation was still over 20 per cent (as measured by the CPI) yet the CPI was only 3.9 per cent (or 0.54 percentage points higher in June 1953 than it's value in June 1952. The aggressive fiscal and monetary policy kept the rise in the unemployment rate small and remarkably brief. Over the 20 year period as a whole the unemployment rate averaged about 2 per cent. At its peak at the end of 1952 it was probably barely 1 percentage point above that and then fell rapidly, so that in 1953–54 it was below its average value. Entrepreneurs did reduce expenditure on fixed capital equipment a little, but not by much. A belief that departures from full employment would be brief was a self-fulfilling prophecy, as one would expect from standard Keynesian theory. Those who would like a more detailed description of events can find one in Nevile and Kriesler (2011).

The current emphasis on keeping inflation low, even at the cost of high unemployment is not just the result of lobbying and public statements by those in the finance sector. It is also a result of the influence of what in

Australia we call economic rationalism and which is more widely known as market liberalism.

Market liberalism downplays the existence of market failure and tends to be less concerned about involuntary unemployment, which is traditionally associated with market failure, than with inflation which, if one wishes, can be blamed on government failure. One school of economists, the new classical school, even argues that involuntary unemployment does not exist and that it is possible through tight monetary policy to reduce inflation without affecting the level of unemployment; though to be fair I can only think of one economist, responsible for giving advice to those determining economic policy, who ever believed in the new classical school of economics.

In any case, the conventional wisdom now is that it is impossible to avoid a short-run trade off between unemployment and inflation when monetary policy is used as the principal anti-inflationary instrument, though there are ways of minimising the trade-off. This point will be discussed in the next section, and the point made that not only do anti-inflationary policies increase unemployment in the short run, but they may also do so in the longer run, especially when monetary policy alone is relied on to control inflation. It is no longer possible to take the easy way out and maintain that tight monetary policy to reduce inflation will not also increase unemployment.

Economists employed in the financial sector and financial journalists do not necessarily argue that reducing inflation is costless. Sometimes they argue that interest rates should rise to reduce the rate of growth of employment because falling unemployment is producing unacceptable inflationary consequences. Perhaps more often financial journalists and some spokespersons for the private business sector argue that this is not a proper concern for macroeconomic policy at all but should be achieved by microeconomic reform, which in this context is largely a euphemism for cutting wages for the less skilled.

It may be that institutions in the financial sector always placed much more weight on controlling inflation than on reducing unemployment. The point is that financial market institutions now have much more power to impose their views in the government. Financial deregulation has both hastened and heightened the decline in power and influence of governments, and of authorities like the IMF, in global financial markets. Governments have lost control over the exchange rate for their currency – probably the most important single price in the economy. As long ago as 1995 *The Economist* (14/1/95 pp. 48–49) speaks of a government being punished by financial markets and similar language. The language may be extravagant but the underlying point is correct. The exchange rate has a widespread influence on the economy. Hence, governments must be constantly look over their shoulder with concern about the effects of policy actions on financial markets.

I make this point to indicate that I am not arguing that governments should ignore the likely reactions of financial markets, but do emphasise the they should not simply take the line of least resistance and accept the priority of keeping inflation very low, even at the cost of leaving the unemployment rate far too high. To do this is to ensure that macroeconomic policy is inherently unjust. There are ways of achieving a better balance between low inflation and low unemployment without having a disastrous effect on financial markets.

3.4 Just and Unjust Ways of Implementing Macroeconomic Policy

It is not only the priority given to different goals in our current macroeconomic policy that is unjust, the way policy instruments are used to achieve these goals is also unjust. I have already hinted at this in my references to the choice of monetary policy as the principal anti-inflationary weapon and the fact that tightening monetary policy inevitably increases unemployment. There is no disagreement that in today's world tightening monetary policy to reduce inflationary pressure will usually have an immediate effect of increasing unemployment.[3] In other words tightening monetary policy will reduce the rate of output growth and increase unemployment. There is now no argument that it is impossible to avoid a short-run trade-off between unemployment and inflation when monetary policy is used as the principal anti-inflationary instrument. The argument is whether there is also a long-run trade-off. There is increasing evidence for the proposition that not only is the current unemployment level determined in part by the previous year's level, but also that the level of unemployment which is high enough to prevent inflation is determined by past levels. Hence, more economists are coming to the view that there is a long-run trade-off between inflation and unemployment when monetary policy alone is relied on to control inflation. It is no longer possible to take the easy way out and maintain that tight monetary policy to reduce inflation will not also increase unemployment. Nevertheless there is continual pressure from financial markets to use monetary policy to keep inflation very low.

It is not inevitable that monetary policy be used as the principal means of controlling inflation. This was not the case during the 13 years of the Hawke and Keating Labor governments. Yet the rate of inflation was reduced dramatically over this period. Given that unemployment hurts most the less well off and low inflation mainly benefits the well off, the use of monetary policy to keep inflation low is unjust. It not only operates to the benefit of the well off at the expense of the badly off it is also clearly unfair by any straightforward understanding of that term. It works by putting some workers out of a job – making them join the ranks of the unemployed – in the hope that this will frighten those who are still employed so that they substantially reduce their demands for wage increases. It is rather like the mother who took her little son to school for the first time and said to the teacher: Johnny is very sensitive, you must not smack him or even scold him. If he misbehaves just give the boy next to him a good whack. That will be enough to make him good.

3.5 Just Macroeconomic Policies

There are many possible just macroeconomic policies. In the time that is left just let me outline what I would recommend to reduce unemployment without increasing inflation.

First, I would stop using monetary policy as the principal anti-inflationary weapon. That role should be assigned to incomes policy though with some help from monetary policy. The major role of monetary policy should be to influence the exchange rate. It is fiscal policy and labour market policy that play leading roles in reducing unemployment. In general, however, I think it is a mistake to link particular policy instruments with particular goals. This is very frequently done. However, at least since Tinbergen's path-breaking work in 1952 conventional wisdom among economists, correctly, is that instead all should work together in an integrated way to achieve all goals.

The unemployment problem will only be solved (at least in our generation) when the Australian economy grows fast enough to create the necessary jobs. Let me say in passing that this is not an anti-environment statement and has no implications one way or the other on vexed questions such as exports of wood chips. If we, the community, so desire, we can easily take out the fruits of economic growth in cleaner beaches, more national parks, better and more non-polluting public transport and so on. But on whatever we spend the fruits of economic growth, economic growth itself, properly understood, is essential if we are to solve the unemployment problem.

One constraint on growing fast enough to reduce unemployment substantially that is often put forward is the current account deficit of the balance of payments. The current account deficit arises because we import too much compared to our exports. The ultimate reason for imports is consumption. If unemployed people become employed their incomes will go up, they will spend more on consumption and this will increase the demand for imports in Australia. With the increase in imports the current account will get worse. Overall Australians will have to reduce consumption just a little bit so that our demand for imports goes down a little. The sure way to reduce our consumption is to increase taxes; and, after all, Australia is one of the three lightest taxed countries in the OECD. Also, if we want to help the unemployed, especially the long-term unemployed, find jobs, through retraining, through wage subsidies and through job creation schemes, this will have to be financed through additional taxation. The measures introduced by the Government in 1994 have had an effect on long-term unemployment. But we have only begun to reduce substantially the number of long-term unemployed and special programs will be needed for years to come.

Another reason for increasing taxes is to finance the public economic and social infrastructure required to support a growth rate. Much of the investment needed for rapid growth without inflation will occur in the private sector, but an increase in public investment will also be required and should be financed through taxation.[4]

Many, would agree with this but reject the conclusion. They advocate cutting government expenditure to achieve the same effects on imports. Substantially cuts in government expenditure, generally hurt those on low incomes the most – social security recipients, unemployed, those who can't afford private schools for their children and so on. That option is clearly unjust as I am using that term.

So far I've talked about unemployment in general. Long-term unemployment is an even more serious problem. A faster rate of growth of the economy and a fall in unemployment generally is a necessary condition to reduce long-term unemployment, but by itself a faster rate of growth will not do the trick. Most people unemployed for 12 months or longer are no longer effective members of the workforce. Employers are loathe to hire them because, rightly or wrongly, they fear that they have lost work skills and motivation. Bringing these people back into a position where they are effective members of the workforce, with a chance of being hired that is a long way above zero, will not only transform their lives, it will also make the economy more productive, since it now has more productive resources to draw on. Hence, as the economy grows more rapidly it is essential not to cut out specific labour market programs because they appear to be expensive. The most disadvantaged usually do need more costly assistance and are often difficult to place with private employers. There is no short cut to removing deep seated workforce barriers but the long term costs of not doing so are very high.

In any case cost figures generally miss the point. Labour market programs for long term unemployed may not, in most circumstances, immediately increase employment significantly. Their purpose is to maintain or restore contact with the labour market and the skills of long term unemployed people, so that they can have a real chance of getting a job again. Overall policy, especially fiscal policy, must be used to increase overall aggregate demand to generate more jobs and labour market programs should ensure that unemployed, especially long term unemployed, are reintegrated into the productive labour force.

Notes

1. I am indebted to Harris (1995) for drawing the literature on this to my attention.
2. This may not be true of some business executives: See Kalecki 1943.
3. In a symposium in 1997 a thoroughly neoclassical economist, John B Taylor, stated "A third principle is that there is a short-run trade-off between inflation and unemployment" (p. 234).
4. See for example Kriesler and Nevile, 2011, especially p. 16.

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4

Policies to Minimise the Costs of Unemployment

J. W. Nevile

The costs of unemployment depend not only on the number of unemployed but also on the nature of unemployment, whether it is short-term or long-term, and also on who is unemployed. In general, the longer the person is unemployed the greater the costs of each additional period of unemployment, both to the person and to society. Individuals often gradually lose skills, become increasingly depressed or angry at their situation, and suffer more from ill health as the period of unemployment lengthens. Moreover, they miss out on the increase in skill that occurs in many occupations with experience in the job. The loss of skills and potential skills is a loss to society as well as to the individual; the cost of ill health is also a cost to society.

There is another group besides the long-term unemployed whose unemployment is particularly costly. Disadvantaged youth and young adults may be mostly unemployed, but their unemployment may be interrupted from time to time by short spells of casual work so that they are not technically long-term unemployed. If they remain on the fringe of the labour market, their children are also likely to be often unemployed and are the group where unemployment is most likely to lead to criminal activity. As far as reducing the costs of crime are concerned it is important to reduce frequent and long-term unemployment among young poorly educated workers, especially where unemployment is concentrated geographically.

It follows from this that policies to minimise the costs of unemployment are likely to be different, at least in emphasis, from policies whose sole goal is to reduce the rate of unemployment. Unemployed disadvantaged young

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people are a critical group to help to find continuing jobs, if the costs of unemployment are to be minimised. However, they are a group that OECD countries have found very difficult to help in this way (Martin, 2000, p 201). Policies aimed just at reducing the overall number of unemployed would show more success, per dollar spent, if they largely ignored the needs of this group.

Similarly, it is easier, and hence cheaper, to reduce short-term unemployment than long-term unemployment. Policies to reduce the overall numbers of unemployed will be helpful in reducing the amount of long-term unemployment but may not help very much. Special, usually expensive, programs are necessary to help the long-term unemployed. Hence, evaluating policies by the cost per unemployed person who gets and retains a job is inappropriate if one is concerned to minimise the cost of unemployment rather than the number of unemployed.

On the other hand, one cannot focus policy entirely on the long-term unemployed. Preventing the short-term unemployed becoming long-term unemployed is also desirable. As Webber and Weller point out 'the longer a worker has been unemployed the greater the probability that he or she will again be unemployed' (Webber and Weller, 2002). Weller and Webber (1999) discuss at greater length the way employment history affects the probability of unemployment. Moreover, a potential two-way feedback exists between long-term unemployment and social exclusion. This is one of the things that makes indigenous unemployment so intractable.

The costs of unemployment, to the individual and to society, are also affected by the experience of the unemployed. The low levels of social security benefits, the waiting periods, and the disposal of assets before income support is provided all impose severe financial stress on the unemployed, who have great difficulty in affording the minor expenses of seeking employment, let alone the larger expenses incurred in being a normal member of society. In addition the attitudes of society to unemployed people, the private as well as government support services provided for them, and the institutional arrangements for providing these services are all important. They affect the psychological impact of unemployment on the unemployed and their families, and the costs to society of ill health, crime and the loss of skills or human capital. Two things are needed here. One is educational campaigns to change attitudes to the unemployed so that they are generally regarded as valuable, if disadvantaged, members of society. The other is policies targeted directly at the unemployed designed to minimise the costs listed earlier. These should include the changes to social security laws and their implementation.

Some policies to minimise the cost of unemployment do not try to increase the total numbers employed. They may try to overcome directly some of the costs to the unemployed or society, as unemployment benefits do. Alternatively, they may try to distribute employment more evenly, decreasing the numbers working very long hours and also decreasing the number seeking work, as additional workers are employed to offset reductions in the numbers of hours worked by existing workers. Such a policy of redistributing employment has been tried, notably in France, and is discussed below.

However, most Australian economists would argue that it is better to tackle the causes of unemployment rather than accept and redistribute existing levels of unemployment. There is very wide agreement that policy packages to reduce unemployment must operate on two fronts. This was a recurring theme in the OECD (2000) conference on 'Policies Towards Full Employment'. Policies should be introduced that make it more likely that unemployed people will obtain jobs from the existing pool or from any additions to that pool. Such policies are discussed below. However, these policies alone are not enough. It is more important to have policies to increase total employment. If there are no more jobs on offer, making unemployed workers more attractive to employers can lead to unfilled vacancies being filled, reducing unemployment a little. But, in the year 1999/2000 at the height of a strong economic boom, there were still over five unemployed people for every vacancy in Australia. Fitting the unemployed to fill these vacancies is thus not enough.

By and large there is no ideological divide in the economics profession about policies to increase the employability of those unemployed. This is not true about policies to increase total employment. On the one side are neoclassical economists who hold that, if some shock increases unemployment, a capitalist economy will automatically return in a relatively short period of time to the minimum rate of unemployment that is sustainable given current institutions: the so-called 'natural' rate of unemployment. If this 'natural' rate is higher than society can tolerate, the solution is to change institutions. Usually, neoclassical economists advocate deregulating the labour market, which means reducing or abolishing minimum wage rates, other regulations and union power.

On the other side, Keynesian economists maintain that frequently not only will the total demand for goods and services in an economy ('aggregate demand') be insufficient to provide employment for all those seeking jobs, but also that private market sector forces will not remedy this situation. It is necessary for the government to increase aggregate demand through macroeconomic policy, especially monetary and fiscal policy, and perhaps direct job creation in the public sector.

This thumbnail sketch of the two positions grossly simplifies the matter. This is partly because most Keynesians also think wage restraint is important—but usually to moderate inflation, not to reduce unemployment. Similarly, most neoclassical economists think macroeconomic policy is important, but for different reasons to Keynesians, and hence they often advocate a different mix of macroeconomic policies.

The neoclassical view of the causes of unemployment is based on a model in which there is perfect competition throughout the economy. No reputable economist believes that the conditions for perfect competition exist in any actual economy, but the neoclassical economists consider that departures from perfect competition are not important enough to invalidate the use of the model as a tool for analysing aggregate employment and unemployment. Keynesians think that departures from perfect competition are so widespread that the neoclassical model is useless as a basis for policy. Both neoclassical policy proposals and a typical Keynesian policy package are discussed below, and the threads drawn together in the final section.

4.1 Policies to Redistribute Employment

Some time around 1980 there was a reversal in Australia, and in many other OECD countries, of the downward trend in the average number of hours worked per week by full-time employees. As the downward trend was at least 100 years old, this was a major change in the labour market. The average number of hours worked per week is strongly correlated with the level of economic activity. Hence, in making comparisons, it is necessary to pick two points at roughly the same stage of the business cycle. From August 1984 to August 1994, the average number of hours worked by full-time workers in Australia rose by almost 6 per cent. Long working weeks are more prevalent among males than females: over 25 per cent of full-time male workers in Australia work more than 49 hours a week. The corresponding number for females is 8 per cent.

Since unemployment was high and persistent in many OECD countries in the 1980s and the 1990s, it is not surprising that several (for instance France, Germany and Denmark) introduced policies to encourage firms and workers to reduce the number of hours worked per week, or per year, in the hope of redistributing some employment to the unemployed. In Australia the trend to reduce or abolish penalty rates for overtime encourages an *increase*, rather than a decrease, in the number of hours worked.

It is important to distinguish between policies which encourage firms and workers to reduce the number of hours worked by full-time employees, and those in which there is an element of compulsion, or rationing of hours worked. Compulsory reduction in the number of hours worked (and the corresponding weekly wage rate) raises difficult equity issues: Should a person whose spouse cannot work, or cannot find employment, be prevented from working more than (say) 40 hours a week, when in the case of many couples, both partners work full-time? Should a semi-skilled low-income worker be forced to moonlight, at lower than her/his normal hourly wage rate, to maintain modest living standards when many with far higher living standards do not have to change their patterns of work to help the unemployed? There is even the question of whether for many a compulsory reduction in the standard working week, and hence the wage rate, might merely mean a reduction in weekly remuneration but not in hours worked. After all, already 20 per cent of overtime worked in Australia is unpaid. Moreover, some part-time workers may be employed for more hours, but not enough more to offset the cut in wage rates.

The best known example of a mandated reduction in working hours tries to keep the weekly wage unchanged, though the rules for implementation allow considerable fudging of this. In France, the standard working week was reduced from 39 to 35 hours with a year 2000 deadline. Employers were not to reduce the weekly wage rate, at least for existing employees. In return, if firms did increase the number employed, or prevent falls in that number, by the reduction in the working week, the amount of social security contributions they pay per employee was substantially reduced in the first year. The reduction itself is then reduced by a diminishing amount each subsequent year until it is phased out completely in the sixth year. However, firms could—and numbers do—hire new workers at the same hourly rate that existing workers received when they worked 39 hours a week. Also, in many firms changes in work practices which increased productivity, reducing wage costs, were accepted and agreements were reached which effectively froze wage rates for two or three years (Kirman, 1999).

It is still far too early to make well based judgements about the success of the reduction in working week laws in France. However, it is worth noting that the French experience suggests that unless there are very large government subsidies, reducing the number of hours worked per week will reduce real wages below the level they otherwise would be. This can occur directly or indirectly through inflation.

4.2 Active Labour Market Policies

Policies aiming to directly assist the unemployed obtain paid employment are called active labour market policies. (Australian usage often omits the word 'active'.) Policies to increase employment in the whole economy, which are not directly targeted on the unemployed, are not included in active labour market policies, although they may have a large labour market content and will inevitably impact on the labour market, if only indirectly.

The OECD database covers five 'main' categories of active labour market programs (Martin, 2000, p 193) namely:

1. labour market training
2. subsidised employment (including direct job creation for the unemployed in the public sector)
3. public employment services and administration (due to data limitations this also includes the cost of administering unemployment benefits)

4. youth measures
5. measures for the disabled.

The database shows that for the OECD as a whole, the two categories on which there was most expenditure were labour market training and subsidised employment. In 1997, each accounted for about a quarter of all expenditure, including expenditure on administering unemployment benefits (Martin, 2000, p 218). Martin argues that training, both in the classroom and on the job, is particularly helpful in assisting women re-entering the labour market to find jobs, but that it is very ineffective in helping disadvantaged youths.

Martin relies mainly on US research to reach this conclusion. In Australia, there is disagreement among empirical studies about whether labour market training has any effect in increasing the employability of the unemployed. However, there is agreement that even if it has some effect, it has not worked as well as wage subsidies (Webster, 2000, p 243). One reason why labour market training has not worked as well as it might have is that, for political reasons, spending on it tends to be greater when unemployment is high and vacancies are low. It is universally agreed that it is more likely to be effective when vacancies are high (that is at times when unemployment is relatively low). Also, there is empirical evidence that the quality of primary and secondary schooling has lifelong effects on employability (Martin, 2000, p 201). This could explain why labour market training works well for women re-entering the labour market and is largely ineffective for disadvantaged youth.

Subsidies to wages paid by private sector employers can also be regarded as an indirect training program. Since the subsidies are limited in duration the government is, in effect, paying the employer to undertake on-the-job training of the subsidised workers. The period of subsidised employment can prevent the deterioration of both skills and motivation that may accompany long-term unemployment, or may replace lost skills and motivation. It may also give new skills, either general skills or ones specific to the job in question. Richardson (1998) has shown that working in a subsidised job for a limited length of time increased the employability of Australian young people.

Substantial wage subsidies can be effective in increasing employment among targeted groups, but much of this is likely to be at the expense of others, so that the net gain in employment is small. Obviously, careful monitoring of the hiring and firing practices of participating employers can increase the net increase in employment achieved by wage subsidy programs. So too can more intensive targeting of those eligible for wage subsidies. However, there is a trade-off. Both these measures will make employers less keen to participate: the first for obvious reasons; and the second because the more targeted are the eligible groups of unemployed the less desirable workers they are likely to be in the eyes of the employers.

Subsidised wage programs can also act as an educational program for the employers involved, teaching them that workers in the targeted group are not necessarily inefficient workers incapable of benefiting from training. In general it is better to regard wage subsidies as a measure to increase labour market training than to increase the numbers employed, even though they do have some net effect in increasing employment. They are important as one of the few active labour market programs which have been effective in helping the long-term unemployed find continuing jobs (Martin, 2000, p 217).

Public sector jobs of limited duration created for, and targeted at, the unemployed have been a traditional type of labour market policy in many OECD countries. They are roughly equally important, in terms of expenditure, as wage subsidies for private sector jobs, and have similar aims. However, they are not as successful—at least if success is measured by the proportion of participants who are in employment up to a year after ceasing to participate in the program (Webster, 2000, p 243). This could be because there is a greater stigma in taking part in a program involving government employment. It could be because there is no possibility of the employer (the government) being pleasantly surprised by the employee's capabilities and keeping him or her on when participation in the program finishes. Or it could be that the government is left with the least employable workers, and this fact is not taken sufficiently into account when selecting the control group. Even if the first two possibilities suggest it would be better to divert funds from government employment programs to subsidising private sector employment, the third possibility warns of the dangers of doing this before more is known about the reasons for the apparent greater success of private sector wage subsidy programs.

Public employment services, or job search assistance, appear to help a wider range of the unemployed find continuing employment than most active labour market policies (Martin, 2000, p 217). The relative emphasis on this category of programs, both in Labor's *Working Nation* set of policies and in the policies of the Coalition Government, is well placed. Job search assistance ranges from minimal job placement services to intensive counselling and other measures to raise the motivation and skills of unemployed in seeking jobs. In a number of OECD countries, it includes cash bonuses to those unemployed who quickly find re-employment.

Minimal job placement services are cheap, but if one is concerned to minimise the costs of unemployment rather than the number of unemployed, emphasis must be put on expensive measures, including in-depth counselling, both to disadvantaged youth and the long-term unemployed of all ages. One major criticism of active labour market policies in Australia is that not enough is spent on intensive assistance of any sort (see ACOSS, 2000a, pp 43–44).

The other major issue in job search services in Australia is the replacement of the Commonwealth Employment Service with the Job Network.

This network comprises those successful in tendering for contracts to supply employment services to unemployed job seekers. Job seekers are classified according to broad categories of the amount of assistance needed and payment is on the basis of category with separate tenders, on a regional basis, for each category.

It is not possible to review such a radical change because of the limited space that can be given here to the subject. Kelly et al. (1999) provide a generally sympathetic review and ACOSS (2000b) a somewhat more critical one. Both agree that 'the major concern is with ... outcomes for the most disadvantaged job seekers' (Kelly et al., 1999, p 44). Eardley, Abello and Macdonald (2000), in a preliminary report on a major empirical study, also raise concerns about the most disadvantaged. They comment that 'in a period of rising unemployment the Job Network does not seem to have had as much impact on long-term unemployment [as *Working Nation*]' and 'many intensive assistance clients seem to have received rather little in the way of assistance' (p 61).

The remaining OECD categories of active labour market policies are those targeted at particular groups of unemployed people. We have already noted Martin's (2000) summary of the evidence about programs to help disadvantage youth, namely that they have been unsuccessful. He does not recommend despair, but argues that the, admittedly limited, empirical evidence suggests that:

> early childhood interventions of high quality can have lasting effects on the employment and earnings prospects of disadvantaged children, especially if they are sustained over time and not limited to one-shot interventions ... [and that it is] important to target support not only at the youngsters themselves but also at their families and local communities. (Martin, 2000, pp 201–202)

Active labour market programs to help disabled people encompass both employment in sheltered workshop programs and training to help disabled people hold down positions in private industry. More needs to be spent on such programs in Australia. In 1997, we allocated 0.055 of 1 per cent of gross domestic product to such programs, compared with 0.132 of 1 per cent for the European Union as a whole and 0.096 for the OECD as a whole (calculated from Martin, 2000). The other particular groups in Australia which are from time to time put forward to be the focus of active labour market programs are those in rural areas, and indigenous Australians. So far, programs targeted at one or the other of these groups have not been successful in enabling many participants to find continuing employment in the private sector.

Overall, active labour market programs are on the right track in Australia, with the emphasis on job search assistance and intensive counselling. Job subsidies are also important in assisting the long-term unemployed and training programs are valuable, especially for women. Active labour market programs are an essential complement to policies that increase the demand for labour. It will be argued below that Australia should spend more on active labour market policies. In 1997, Australia allocated 0.5 per cent of its gross domestic product to these programs compared to an average of 1.1 per cent in the European Union and 0.8 per cent for the OECD as a whole. The latter average is pulled down by the very low figures for some of the new OECD members. However, in the long run it is probably even more crucial for Australia to increase expenditure on primary and secondary schooling in disadvantaged areas than on active labour market programs.

It is important not to oversell active labour market programs. They fit people for jobs but they do not *create* jobs for people. Their role is two-fold. One part is to ensure that the rising tide of employment does lift all boats. For the reasons outlined in the introduction to this chapter, this is particularly important if one is concerned to minimise the costs of unemployment and not just the numbers of unemployed. The second part of their role is also important. They can increase the supply of effective workers and reduce inflationary pressure as the rate of unemployment drops.

4.3 Removing Poverty Traps

A major feature of the Australian social security arrangements is that payments are tightly targeted to those with little income or assets. The desirability of targeting is a matter of controversy (and Mitchell et al., 1994, review the arguments for and against). However, because of the cost there seems little likelihood that Australia will rapidly, if ever, move away from targeting social security payments. One important consequence of this is the creation of poverty traps. If people on benefits move into paid employment they may in fact receive very little additional income, because of the combination of the effects of income tax on net earnings and the loss of benefits as income rises. Their 'effective marginal tax rate' can be very high, even over 100 per cent in some instances. The extent to which this happens depends both on the level of marginal tax rates and the speed with which benefits are tapered off as income rises. There is no obvious answer to the question of which is the best taper rate, but there is agreement that very high (say 70 per cent or more) effective marginal tax rates discourage those receiving social security rates from taking up part-time employment.

There are three ways of reducing poverty traps without abandoning the overall structure of the Australian social security system. The first is to raise substantially the tax-free threshold and/or cut the rate of tax on income immediately above that threshold. This is expensive, as far as the government budget is concerned, as all taxpayers benefit, and not only those facing very high marginal tax rates. It was done to a small extent as a part of the

New Tax System introduced in July 2000. Low-income tax rebates, as exist in Australia, can effectively increase the threshold for low income earners. However, if such rebates are small and relatively inexpensive, they only affect poverty traps for those working relatively few hours a week. For others, they just shift the poverty trap a little up the income scale.

The second way is to reduce the benefit taper rate. This was done in Labor's *Working Nation* reforms and again as part of the New Tax System. However, more needs to be done in this area. For example, someone receiving an unemployment allowance faces a taper rate of 70 per cent when their employment income is over $70 a week. Those who receive more than one type of social security payment (for instance unemployment *and* child support payments), each with its own taper rate, are likely to face very high effective marginal tax rates. Public housing tenants receiving social security allowances may also be vulnerable, as their rent is usually fixed as a percentage of their income.

The third way of reducing poverty traps is through the introduction of tax credits for earned income. These have been used extensively in the United States and to a lesser extent in the United Kingdom. An earned-income tax credit is usually equal to a proportion of earned income over a certain range, so that in this range it increases with the amount of income earned. It also tapers off when earned income rises above the range, and may be subject to an additional income test based on family income.

Earned-income tax credits are usually proposed by neoclassical economists and are intended not only to reduce poverty traps but also to compensate low-income families when minimum wage rates are kept low in the belief that this will lead to employment growth. (The validity of this belief will be examined in the next section.) Earned-income tax credits are certainly effective in reducing high effective marginal tax rates on social security recipients, though the high effective rates are pushed further up the income scale to where the income tax credits are phased out.

There are three negative impacts of earned-income tax credits to set against the substantial reduction in poverty traps and increases in income of the working poor. The first is that, because they generally produce downward pressure on wage rates at the bottom end, they effectively subsidise the wages of not very productive workers and hence of the firms that employ them. Many of these firms are low-productivity firms and, in any case, any increase in employment of low-wage workers will lower the overall level of productivity in the economy. It is argued in the next section that the effect of any reduction in wage rates in expanding low-wage employment will be small, and that the negative impact on productivity will also be small. However, in principle, it is better to use the money spent subsidising low wage rates in increasing the productivity of low-wage workers. In the United States, the group that have benefited most from earned-income tax credits are single mothers. In Australia at least, this is a group for which labour market programs centred on training are effective.

The second negative impact is one of equity. Any expansion of the scope of the distinction between 'deserving' and 'undeserving poor' could lead to greater levels of support to the less needy than to the more needy. For example, it could lead to children of those who are unemployed receiving a lower level of support from the state than children whose parents are low-wage earners. If receiving the tax credit is subject to a family means test, this can also lead to equity problems. Not all low-wage workers will receive them. Given that earned-income tax credits will put pressure on wage rates at the lower end, those in families with incomes just above the means test may, after a few years, have lower incomes than they would have received if earned-income tax credits had not been introduced.

Thirdly, if earned-income tax credits are added to a system with family allowances and various other categories of support, overall complexity will increase, adding to administrative costs, particularly in preventing fraud. Over-payments have proven to be a serious problem in the United States, although it has a much simpler social security system than Australia (Ingles and Oliver, 2000, p 86). Many of the benefits of earned-income tax credits can be achieved by changing aspects of the present social security system, especially family allowances, as has been done as part of recent tax reforms.

4.4 Deregulating the Labour Market

Neoclassical economists believe that unemployment in the economy tends fairly quickly to settle at a 'natural' rate of unemployment. However, this 'natural' rate is not immutably fixed but reflects institutions in the economy. Therefore, they argue that the only way to achieve a permanent reduction in unemployment is to change institutions and, in particular, to deregulate the labour market in order to lower the natural rate of unemployment.

The present Australian Government has pushed hard for two forms of labour market deregulation: relaxing employment protection through unfair dismissal laws; and abolishing, or reducing the scope of, laws that encourage or help union activity, including the traditional Australian system of conciliation and arbitration. The economic literature gives little support to the view that either job protection or union activities have been major factors in adding to the average level of unemployment. For example, after a careful and thorough study across 20 OECD countries Nickell concludes:

> Labor market rigidities that do *not* appear to have serious implications for average levels of unemployment include the following: ... strict employment protection legislation and general legislation on labor market standards; ... high levels of unionization and union coverage, so long as they are offset by high levels of coordination in wage bargaining, particularly among employers. (Nickell, 1997, p 72, emphasis added)

Nickell's analysis shows that employment protection legislation reduces short-term unemployment. It may increase long-term unemployment, which is worrying given a concern for the costs of unemployment. However, the evidence for any increase is very weak. More general labour standards laws have no discernable effect. This is not surprising. In the European Union, the same labour market laws apply equally to all member states, but there are some that have been notably successful in boosting employment and keeping unemployment low, and others that have been very unsuccessful. This suggests that 'employment problems are not caused by excessive labour market regulations' (Larsson, 2000, p 35).

As far as union activity is concerned, Nickell finds that greater union coverage does tend to raise unemployment when there is little co-ordination of wage bargaining activities between unions and employers. Nickell's explanation is that unco-ordinated union-dominated systems create 'an additional source of inflationary pressure that requires more unemployment to quash it' (p 68). Co-ordination can prevent such situations, which generate inflationary pressure, as arise when one union secures a wage rise and this is used by another union as the basis for a larger wage rise.

The conclusions of Nickell's article suggest that, while the reduction in importance of the co-ordinating function of the Australian conciliation and arbitration system may be unfortunate, labour market regulation is not in general a major problem as far as unemployment is concerned. This is supported by work done in Australia. Sloan and Wooden (1998) argue that labour market outcomes have been much the same in Australia, New Zealand and the United Kingdom, yet in the last two mentioned countries the labour market is much more deregulated than it is in Australia. Gregory (2000) points out that, although the United States has the best performance with respect to employment growth over the last 40 years, the United Kingdom and Australian experience was the same until 1980, but 'during and after the Thatcher reforms, the UK employment performance *deteriorates* relative to Australia' (p 115, emphasis in the original). After its reforms, New Zealand did even worse than the United Kingdom.

The other, perhaps more controversial, issue in labour market deregulation concerns the role of minimum wage laws. These may be more important in Australia than most countries because award wage rates set various minimum rates for workers with various categories of skill, not just one universal minimum rate. While there is little support in Australia for proposals to reduce nominal minimum wage rates, there is support for freezing award wage rates in nominal terms, so that real wage rates fall as inflation occurs. For example the proposal to freeze award wage rates, made by the five economists (Dawkins et al., 1998) in an open letter to the prime minister has been taken up by the Business Council of Australia.

It is argued that freezing award wages for four years would reduce the growth in average real wages by about 3 or 4 percentage points (over the four years as a whole) and that this will produce a fall in unemployment between 1.5 and 2 percentage points. The expected increase in employment and fall in unemployment could be due to one or both of two causes. First, employment may increase because, with the price of labour reduced compared to that of capital, labour may be substituted for capital. In addition there may be effects on output: for instance lower real wage rates might encourage, or possibly discourage, investment, they might decrease consumption, or they might change the 'natural' rate of unemployment.

There has been a great deal of controversy over whether reducing wage rates will increase employment or not, disregarding any effects on output. (See Nevile, 1996; 2001, for discussion of this.) However, to a large extent this controversy is not important for present purposes. The large majority on both sides agree that any effect is small, though some argue that it may be important in the case of teenagers. Many neoclassical economists, including Dawkins et al., use a figure estimated by two Reserve Bank economists Debelle and Vickery (1998), which implies that a 1 per cent cut in wage rates would increase overall employment by 0.4 per cent assuming that output does not change. The fall in unemployment will be less than the increase in employment because, with lower unemployment, people outside the labour market will start actively looking for work again. Many of these will obtain jobs before the currently unemployed. Hence, if the fall in unemployment is to be of any noticeable size, wage cuts must lead to significant increases in output. Does any such effect exist, and if so how big is it?

While many rely on the work of Debelle and Vickery to answer this question, those writers actually undertake no empirical work on the size of such effects. Debelle and Vickery explicitly state that they do not know the size of these effects or even if they are positive on balance. They make two assumptions. One is that there is no effect on output; an assumption they think is at the bottom end of the range. The second is one at the other end of the range, that output increases by so much that the final increase in employment is 2.4 times as large as that occurring just through the substitution of labour for capital with no change in output. It is results based on the second of these assumptions that are used by those advocating freezing award wage rates. Thus, the size of the fall in unemployment that is claimed will follow a freeze in award wage rates is largely based on an assumption, not empirical research. What is assumed, in effect, is that a 4 per cent cut in real wage rates will reduce the 'natural' rate of unemployment by 2 percentage points. Some of this comes from the substitution of labour for capital, but more because with lower wage levels, 'the firm (the economy) is able to move to a higher level of production, thereby employing more labour and more capital' (Debelle and Vickery, 1998, p 242). Even if one's model of the economy suggests that this is true, it is not easy to estimate how big the effect will be, as Debelle and Vickery implicitly acknowledge. Yet the size of that effect is an important issue for all proposals to reduce unemployment by cutting wages.

One way to look for an answer is to simulate full-scale econometric models of the whole economy. As is well known, different econometric models give different answers to many questions, even when estimated over the same period with the same definitions and data. This is because such econometric models incorporate not only estimated equations but also assumptions (or judgments) about the structure of the economy and how it works. Often, they also include assumptions about particular parameters which are hard to estimate, or which are dictated by the economic theory held by the model-builders. A full-scale survey of econometric models is well beyond the scope of this chapter, but, even if it were to be carried out, the judgment made on the results of a model's simulations would depend on judgments about the economic theory and assumptions underlying the model. There may be strongly held views but there are no black and white answers on such matters.

A second and more promising approach is to examine in a broad-brush way, how (assuming it exists) the 'natural' rate of unemployment has changed following changes in real wage rates, or rather changes in real unit labour costs. (Debelle and Vickery can only focus on changes to real wage rates because of their assumption that productivity growth is both exogenous and constant. It is better to use the theoretically correct variable, real unit labour costs.) The examination can only be broad-brush because estimating the size of the 'natural' rate is very difficult to do with any accuracy. Debelle and Vickery (1998, figure 1) show that following an upward movement in the previous few years, there was a sharp rise in real unit labour costs in 1973. There is no disagreement that this was accompanied, with no lag in most estimates, by a sharp rise in the 'natural' rate of unemployment. However, many more things than a rise in real unit labour costs were occurring in the early 1970s and many of them might be thought to increase the 'natural' rate. In my judgment, the most important reason for the increase was a major change in the formation of inflationary expectations. In the 1950s and 1960s, practical decision-making, with a horizon greater than a year or so, assumed a constant rate of inflation of around 2 to 2.5 per cent a year, but this changed around 1970 (Nevile, 1977). The shattering of these expectations of a stable inflation rate at a time when nominal wage rates were rising very rapidly is enough by itself to explain the increase in the 'natural' rate.

After 1974, real unit labour costs trended downwards for 20 years at a trend rate of decline of over 0.5 per cent a year (Debelle and Vickery, 1998, figure 1). Most estimates show this massive fall in real unit labour costs had virtually no effect on the 'natural' rate of unemployment. The Treasury's estimate of this remained more or less constant from 1974 to 1994. Debelle and Vickery's estimate of the 'natural' rate did fall initially, but then rose again and was higher at the end of the 20-year period than in 1974 (Debelle and Vickery, 1998, p 239). Australian experience since 1974 thus gives no encouragement to accept an assumption that there will be a significant decline in the 'natural' rate of unemployment if real unit labour costs are reduced.

It follows that there is no strong empirical evidence that the effects of freezing award wage rates would be large. Moreover, if low-income earners are to be compensated with earned-income tax credits for falls in real wages, the cost to the government budget will be large. There is no definitive statement about who should be eligible for tax credits. In one proposal, put forward by Keating and Lambert in the *Australian Financial Review* (16 November 1998), full tax credits would be available to wage earners, in low-income families, whose annual earnings are between $23,400 and $28,200. For these workers, the credits are initially equal to 2 per cent of two-thirds of male average weekly ordinary-time earnings. They are reduced proportionally for those with lower earnings. If the credits increase by a further 2 percentage points in each subsequent year, by the fourth year the annual cost of the tax credits would be $4.6 billion. Although this amount depends on the income and asset tests and the taper rate, $5 billion could be taken as a ballpark figure for a typical scheme. One has to ask whether there are other ways of spending $5 billion a year which would do more to reduce unemployment.

One final point about the economics of freezing award wage rates should be made. The evidence suggests strongly that unemployment will *not* decrease much if award wage rates are frozen unless this reduces the 'natural' rate of unemployment significantly. However, in Australia today, award wage rates only determine, or have a large influence on, the wages received by those workers with little industrial muscle. A new incomes policy suitable to our current wage-setting arrangements is highly desirable. An incomes policy which operates entirely on the wages of those least likely to secure inflationary wage increases is unlikely to be effective.

4.5 Keynesian Policies to Expand Employment

Unlike the case of neoclassical policies, Keynesian policies are well supported by empirical evidence suggesting that they can increase output and employment (Nevile, 2000). However, there is also strong evidence that Keynesian policies may have undesirable side-effects on inflation and the current account deficit. In the short to medium term, the rate of inflation rises as the unemployment rate falls, unless policies such as the Accord are put into place to prevent this from happening. This trade-off between inflation and unemployment has been well documented empirically and is widely accepted by Keynesian and neoclassical economists alike. Not quite so uncontroversial, but still widely accepted, is that there is a rate of unemployment (or narrow range of unemployment rates) below which inflation accelerates, or increases, even if the rate of unemployment is constant. When unemployment is above this rate, inflation declines. This rate of unemployment is known as the non-accelerating inflation rate of unemployment (NAIRU). It has a completely different theoretical underpinning to the 'natural' rate of unemployment, but its practical effect is the same.

Like the 'natural' rate of unemployment, the NAIRU is not a number set in stone. It can be changed by policies, especially incomes policies and labour market policies. Between 1982/83 and 1989/90, Australian output grew at an annual rate of 4.3 per cent and the unemployment rate fell from 9.0 per cent to 6.2 per cent. Over the same period inflation fell from 10 per cent to 6 per cent.

In the past 25 years in Australia, whenever output and employment have grown fast enough to significantly reduce unemployment, and this rate of growth is sustained, the leakage of aggregate demand into imports causes uncomfortably high current account deficits on the balance of payments. If consequent market forces, or even government policy, result in a depreciation of the value of the Australian dollar against foreign currencies, imports will become more expensive adding to inflationary pressure. A rising rate of inflation will put further pressure on the foreign exchange rate and it is easy to slip into an inflation-depreciation vicious circle. This can be prevented, but usually only if wages are not allowed to rise to offset the increased cost of living caused by higher import prices.

It is better to prevent an inflation-depreciation vicious circle starting than it is to undergo the pain of stopping one. Thus, it is necessary to have in place policies to reduce inflationary pressure by lowering the NAIRU. Active labour market programs and an incomes policy are the usual contenders. It is also desirable to moderate any increase in the current account deficit. In today's world, it is even more important to avoid policy actions which will unnecessarily alarm foreign exchange markets.

The deregulation and integration of financial markets around the world has given financial markets considerable influence on government policy. These markets now have great power in determining the exchange rate, and the exchange rate has such a widespread influence on the economy that, in many countries, governments must be constantly looking over their shoulder with concern about the effects of policy actions on financial markets (Nevile, 1996, p 323).

The practical effect of this is not necessarily that national sovereignty in policy making must be superseded by tailoring policies to please financial markets. While there have been assertions that this is the case, careful empirical studies suggest that 'governments still have policy choices and fiscal policy may be the most important instrument for choice' (Keohane and Milner, 1996, p 248). This quotation reflects the conclusions of Garrett (1996), who, after a careful study of 15 countries, concludes that monetary policy is constrained by increasing capital mobility, but that the evidence that there are important constraints on fiscal policy is weak. Moreover, Moore (1998) has shown that much of the evidence found to support the loss of national autonomy in policy making is based on the experience of members of the European Community, which have gone much further along the road of integration of their economies than is generally the case.

It is difficult to strike the correct balance between blithely ignoring the financial market reactions to macroeconomic policy changes on the one hand, and giving up independent macroeconomic policy for fear of those reactions on the other. This is particularly the case since the fall in the value of the Australian dollar in 2000, when it was clearly demonstrated that a substantial depreciation can occur despite an economy meeting all the usual criteria for financial market approval. Nevertheless, while governments do not have to make the desires of financial markets their first priority in economic policy making, at least those in countries with a large foreign debt need to convince financial markets that their actual (or potential) policies will not lead to a large depreciation.

Thus, a successful Keynesian policy to reduce unemployment without painful side-effects must be multi-faceted. The following, taken from Nevile (2000) is a typical example. It has five elements:

1. a substantial increase in government expenditure, especially on economic infrastructure, education, training and labour market programs and on labour intensive socially useful community services
2. an equally large increase in taxation revenue
3. an effective incomes policy
4. substantially expanded and better designed labour market programs
5. measures to reduce the current account deficit (by increasing savings in the private sector and increasing net exports).

The increase in government expenditure is necessary to stimulate growth in aggregate demand and private investment. Expenditure on economic infrastructure, education, training and labour market programs should also increase both labour and capital productivity and help offset the fall in the real value of take-home pay caused by the rise in taxation. There is mounting evidence that in many countries increased public investment in economic infrastructure increases the productivity of private sector investment. Dowrick (1994, pp 16–23) provides a good survey of the literature on this issue, while Otto and Voss (1993) document the case for Australia. Making private investment more productive will normally increase the rate of private investment which will also help to increase aggregate demand.

Increasing taxation revenue is at the heart of this package of policies. It will offset some of the stimulus to employment from the increase in expenditure but only some, not all. As the Americans say, with expenditure you get a 'bigger bang for your buck'. The increase in taxation will help increase national savings and hence in the longer run help reduce the current account deficit. More importantly, this proposal will have to ensure that, despite increases in government expenditure, the budget deficit does not become large enough to alarm financial markets. In the short to medium term, it is essential that financial markets do not have undue concern about the Australian dollar. This rules out budget deficits that are large and increasing. There is scope to increase taxes, in that Australia has one of the lowest ratios of taxes to income in the OECD.

Incomes policy and expanded labour market programs are necessary to reduce inflationary pressures and to help prevent any inflation-deprecation vicious circle from developing. The incomes policy will have to be strong enough to withstand the strain put on it by increases in tax rates as well as falling unemployment. Successful incomes policy and labour market programs are needed to reduce the NAIRU, not only to reduce short-run inflationary pressures, but also because while the exact level of the NAIRU in Australia at present is not clear, it certainly is above any socially acceptable long-run goal for the unemployment rate. Labour market programs also help the unemployed directly, by increasing their employability.

It is theoretically possible, though unlikely in practice, that productivity in Australia could increase so rapidly that we have 'jobless growth'. Government expenditure on labour-intensive socially useful community services, including improvement of the environment, is valuable in its own right and more emphasis can be given to it if anything like 'jobless growth' seems likely. In the longer term, solving the problem of the current account deficit will be eased by measures that increase private savings without reducing private sector investment or public sector savings. One possibility is to increase the superannuation levy, but thought should also be given to other measures. Increasing net exports will also ease current account problems. There are numerous examples where Australian governments have not proven good at 'picking winners', nevertheless, policies that encourage export and import-competing industries across the board can be devised.

Keynesian policies to reduce unemployment can be successful, but they do impose costs on some in the community. Even in the short-term, they are likely to increase income per head as the unemployed are drawn back into productive activity. However, at least in the short-term, the increased taxation required will reduce the incomes of those already in steady full-time employment and those with comfortable incomes from rent, interest and dividends or profits. How big is the required rise in tax revenue? It is impossible to be precise. It will depend in part on what is happening in the rest of the world but equally on how rapidly unemployment is to be reduced. Even if policy does no more than make recessions shorter and not so deep, this will reduce the average level of unemployment. However, historical experience over the last 30 years suggests that the big jumps in unemployment that occur during severe recessions increases substantially the numbers of long-term unemployed for many years, increasing the costs of a given level of unemployment and making it harder to reduce the number unemployed (Chapman and Kapuscinski, 2000). An ambitious, but not completely unrealistic, target would be to avoid all but very soft landings and to reduce unemployment by half in five years so that after that five-year period, the average level of unemployment over boom and slump is a little under 5 per cent.

Given this target, and assuming that the world economy is growing only moderately, a ballpark figure for the increase in the ratio of tax revenue to GDP is 10 per cent. Current government revenue, which includes dividends from government business enterprises and fees and fines as well as taxation, would have to rise from a little over 34 per cent of GDP to around 38 per cent of GDP. This rise will be needed if the increase in government expenditure is not to produce continuing substantial budget deficits.

The rise in government expenditure and current revenue should be sustained, as a percentage of GDP, over the whole five years. Obviously, those who move from unemployment, or under-employment, to full employment will have a rise in real income. On average, other Australians will suffer a short-run decline in real income because of the increase in taxation. This will be greatest (between 3 and 4 per cent) at the beginning of the period, but will become progressively smaller because of the more rapid rate of growth of GDP. By the end of five years, the higher rate of growth will have offset the increased tax rates so that the real incomes of these already fully employed will be just as high as they would have been if the policy package had not been implemented. At the end of the five years, goals and policies for the next five years can be determined.

4.6 Conclusion

Policies to minimise the *cost* of unemployment are not synonymous with policies to minimise the *number* of unemployed. The former should include policies to directly help all of the unemployed while they are unemployed and also put more weight on helping the long-term unemployed and disadvantaged youth (and young adults). Job subsidies appear to be the best labour market program to help the long-term unemployed, but intensive counselling is also needed. No labour market program has been very successful in helping disadvantaged youth. Again, intensive counselling is very important, but it is hard for labour market programs to offset the disabilities flowing from poor primary and secondary education. In the longer run, much greater expenditure on education in disadvantaged areas will do more for disadvantaged youth than will labour market programs. Training programs also have a role to play, especially in helping female reentrants to the workforce.

Active labour market programs are important, both in helping the most disadvantaged, and in reducing inflationary pressure as unemployment falls. However, they are only effective if the number of jobs available is increasing and old-fashioned macroeconomic policy to increase the level of economic activity may do more than labour market policies to provide jobs to the most disadvantaged. The eminent US economist, Robert Gordon, has argued that both labour market and macroeconomic policies are desirable, but stressed the importance of macroeconomic policy: 'In the United States, monetary policy makers have been willing to defy risks of overheating, and the resulting tight labour markets have proved effective in creating jobs for many individuals previously considered to be unemployable' (Gordon, 2000, p 17).

This chapter has argued that labour market deregulation and cuts to real wage rates are not likely to greatly increase the demand for labour in Australia; Keynesian policies, involving increased government expenditure are required. To reduce the risk of spooking the financial markets the increased expenditure must be matched or largely matched by increased tax receipts. To avoid inflation the macroeconomic policies must be complemented by active labour market policies that increase and improve the supply of labour. An innovative incomes policy is also desirable as another weapon, other than increasing unemployment, in the fight against inflation. Historical experience over the last 30 years in Australia suggests that the big jumps in unemployment that occur during major recessions increase the number of long-term unemployed for many years thereafter. Preventing major recessions, as far as possible, is an effective way of reducing the costs of unemployment (Chapman and Kapuscinski, 2000). A reconsideration of the relative weight given to controlling inflation and reducing unemployment is needed, as well as a review of the methods used to control inflation.

One final caveat is also required. From the point of view of minimising the costs of unemployment, it is not true that any job is better than no job. Poorly paid temporary jobs may *increase* the cost to the unemployed by removing them from informal support mechanisms in their own communities. This is well known in the case of indigenous people, but the possibility is more widespread. The increased cost to the unemployed may also be an increased cost to the community generally through increased need for future income support and other services (Healy and Darlington, 1999, p 6).

In economics, exercises to maximise or minimise something are usually subject to a constraint. In this case the constraint is obvious: it is the amount Australians as a whole are prepared to spend, through their government, in minimising the costs of unemployment. Due no doubt to the long upswing in economic activity in the 1990s, Australians seem to have become less concerned about the costs of unemployment. Yet over this long upswing the unemployment rate in Australia averaged 8.5 per cent. Over the whole of the twentieth century the unemployment rate roughly averaged 5 per cent and the figure is the same if one removes the years of the two World Wars and the Great Depression. Economists now know much more about the causes of unemployment than we did for much of the twentieth century. It is lack of political will, backed by the belief of politicians that the majority of Australians are unwilling to pay significantly more in taxes, that is preventing us from substantially reducing the costs of unemployment.

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5
Overcoming Social Exclusion

J. W. Nevile

In the large majority of cases, social exclusion is caused by a lack of economic participation and in particular by chronic joblessness. This paper looks at policies and programs to overcome joblessness. Programs that increase individuals' capacities are important, but they cannot be widely effective in increasing participation if there is a shortage of jobs available for people to fill. The first half of the paper surveys policies to increase the demand by employers for workers. At times like the present, when employment is increasing substantially, programs to build capacities can be much more effective in increasing economic and social participation. The second half of the paper is a case study of one such program – a rather controversial one – Work for the Dole. The paper concludes that Work for the Dole helps build capacities, but that changes in the program are necessary if it is to reach its full potential.

5.1 Overcoming Social Exclusion

The theme of this Chapter is "Capacity Building to Participate?" The question mark is apropos. Many people strive hard and probably successfully to help disadvantaged people obtain the capacity to participate in society. But does that mean that their clients are actually able to do so? Social exclusion is the opposite of participation. Building capacities to participate may well be very valuable for the individuals concerned. But the extent of social exclusion does not just depend on the characteristics of those excluded. Unless the root causes of exclusion from society are significantly reduced, capacity building will not have a large effect on the extent of participation. The most important thing this chapter can do is to identify these root causes and discuss how they can be reduced. This is done in the sections 2 to 4 of the chapter.

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In fact the chapter covers two quite different but linked topics. After a brief discussion of the meaning of the term social exclusion, there is a 'big picture' discussion which identifies "involuntary chronic joblessness" as the most important single cause of social exclusion, lists the categories of policies which help reduce chronic joblessness and discusses at length one of them. The second topic is a 'close up picture' which will examine one particular program, Work for the Dole, as a case study, showing how it can help people out of social exclusion and why its potential to do this is not fully realized. As already noted, the big picture discussion is what it is important for an economist to put to a conference like this, but it also provides essential background to appreciate the significance of the case study.

In both parts of the chapter there is a lot of ground to be covered in a limited time and consequently there will be a number of generalisations without a great deal of supporting discussion. However, the references will enable those interested in particular points to get a feel for the discussion and evidence on those points.

5.2 The Meaning of Social Exclusion

The phrase, social exclusion, does not always mean the same thing to different people. The term originated in continental Europe and came to Australia via Britain. In 1997 the British Labour Government established a Social Exclusion Unit. Two years earlier academic interest in the concept was stimulated, when the relevant research funding body, the Economic and Social Research Council, included social exclusion, along with eight other concepts, as central themes on which to focus social science research.

For some, social exclusion is just another name for poverty, which can be used when governments do not admit that significant poverty exists. (Burchardt, Le Grand and Piachaud, 2002, p.3). However, while serious poverty usually does exclude people from society in the Western world, so too do other factors, e.g., disabilities and racial discrimination. Social exclusion can have a wider meaning than just poverty. The various factors causing social exclusion may interact. Many people with disabilities are living in poverty, but other factors, for example lack of mobility, also contribute to their social exclusion. Many indigenous communities in Australia provide examples of ethnic background and poverty interacting to cause social exclusion. In each of these cases the causal factor other than poverty adds an extra dimension to the nature of social exclusion. Also, although this does not follow from the definitions of the two terms, there is often more emphasis on the dynamics in discussion of social exclusion than there is in analysis of poverty. Hills, Le Grand and Piachaud (2002) Chapters 1–3, contains an extended discussion of these issues.

5.3 Involuntary Chronic Joblessness as a Cause of Social Exclusion

Even though the term social exclusion is usually taken to mean more than poverty, involuntary chronic joblessness is the major cause of both poverty and social exclusion.

> "Employment lies at the core of individuals' perception and experience of economic security versus economic vulnerability [and] social participation versus social exclusion" (United Nations, 2003, p. 51.)

In the case of Australia, Saunders (2002) sets out how lack of paid work (including lack of successful self employment) is the most important direct cause of poverty and social exclusion. Saunders estimates that an income unit (roughly a family) with an unemployed person as head is almost ten times more likely to be in poverty than an income unit in which the head is employed. Other studies produce similar results (see e.g. Harding and Richardson, 1998).

Obviously, the longer or the more frequently a person is unemployed, the more likely it is that the unemployment will cause poverty. However, in many cases it is not being unemployed as officially measured that causes poverty. It is being without a job that has paid remuneration that is the problem. Joblessness is a better word to use than unemployment. To be included in the official tally of unemployed one has to be actively looking for work. The jobless include those who have given up searching for paid employment because they have given up hope of finding any and hence are not counted as unemployed. It also includes those who are known as job seekers marginally attached to the labour force. These are people who want a job, are available to start work, have looked for work sometime in the previous 12 months but, for whatever reason, are not currently looking for work. In addition to the jobless there are those who are employed part time, perhaps for very few hours a week, but are unable to find more work although they would like to work more. On the other hand, the straightforward meaning of joblessness includes those without a job who have no desire to work, e.g., the majority of old age pensioners. Hence I use the phase 'involuntary chronic joblessness' to describe those whose joblessness is likely to lead to poverty and social exclusion. Only about half of those who suffer from involuntary chronic joblessness are officially counted as unemployed. If the underemployed are added to the involuntarily jobless, the total number is about three times the number of officially unemployed (Mitchell and Carlson, 2001).

Chronic joblessness is important, not only as a cause of social exclusion but because being excluded from a job is itself often a hurtful from of exclusion in our society in which one's work role is often a major part of self identity. Moreover, many men still perceive failure to be a family breadwinner to be failure as a male person.

5.4 Policies to Reduce Joblessness

It is helpful to group policies to reduce joblessness into four categories. The first is policies which increase the demand for workers. More often than not these policies are a necessary complement to those in the other categories and they will be discussed at length in this address.

Secondly, there are policies that increase the skills and the motivation to work of those without jobs. Much of the focus of the conference will be about these and there has also been emphasis on such policies for a decade or so in economics, where they are known as active labour market policies. Martin (2000) is a good survey of what economists know, and do not know, about such policies.

Policies that reduce disincentives to seeking and accepting paid work are also important. Monetary disincentives, called poverty traps, have been discussed in the economic literature for decades. Fashion has changed and this area is now more often known as welfare to work policies. An authoritative discussion of them can be found in OECD (2000, Part 4) and Ingles and Oliver (2000) looks at the issues in an Australian context.

The final category is policies that improve the process of matching job seekers and vacancies. The establishment of the Job Network has led a renewed interest in them in Australian academic literature. The Job Network, of course, provides much more than job-matching services. The June 2003 issue of the *Australian Journal of Labour Economics* is devoted to a symposium on the Job Network and contains a wide-ranging discussion of many issues about policies to reduce joblessness.

The major controversial issues relate to the first category of policies and a little background material is desirable before these are directly discussed. There are two distinct schools of thought on what causes unemployment and hence on what policies will increase demand for workers.

On the one side are neoclassical economists who hold that, if some shock increases unemployment, a capitalist economy will automatically return in a relatively short period of time to a minimum rate of unemployment that is sustainable given current institutions, the so-called "natural" rate of unemployment. If this "natural" rate is higher than society should tolerate, the solution is to change institutions. Usually neoclassical economists advocate deregulating the labour market, which means reducing or abolishing minimum wage rates, other regulations and union power.

On the other side, Keynesian economists maintain that frequently not only will the total demand for goods and services in an economy (or aggregate demand) be insufficient to provide employment for all those seeking jobs, but also that private market sector forces will not remedy this situation. It is necessary for the government to increase aggregate demand through macroeconomic policy, especially monetary and fiscal policy and perhaps direct job creation in the public sector.

The neoclassical view of the causes of unemployment is based on a model in which there is perfect competition throughout the economy. No reputable economist believes that the conditions for perfect competition exist in any actual economy, but the neoclassical economists consider that departures from perfect competition are not important enough to invalidate the use of the model as a tool for analysing aggregate employment and unemployment. Keynesians think that departures from perfect competition are so widespread that the neoclassical model is useless as a basis for policy in this area.

Because policies in the first category are controversial more discussion of them is necessary and this is also desirable for another reason. Policies to increase the demand for workers are the most important way to reduce joblessness. Other policies can certainly help individuals and for that reason alone are valuable. But they work best in reducing joblessness when the demand for workers is growing. It is no good making people ready for work and attractive to employers if there are no jobs for them to go to.

It may seem strange to emphasise this when the Australian economy is still growing relatively rapidly and the unemployment rate is the lowest it has been for over a decade. The trouble is that Australians have become too complacent about unemployment and joblessness generally. In August 2004 the rate of unemployment nationally was 5.7 percent. This was after two decades of strong economic growth yet it is higher than the average rate of unemployment over the whole of the twentieth century. What is worse is that in the first quarter of the 20th century unemployment in Australia averaged under 5 percent (Borland and Kennedy 1998). Now, despite our much increased knowledge of economics and many more tools of economic policy, after one of the longest periods of uninterrupted economic growth in our history, we think it a great achievement that unemployment has fallen to 5.7 percent. There is still a major need for policies to increase the demand for workers.

5.5 Policies to Increase the Demand for Workers

5.5.1 Deregulating the Labour Market

Neoclassical economists believe that unemployment in the economy tends fairly quickly to a "natural" rate of unemployment. However, this "natural" rate is not immutably fixed but reflects institutions in the economy. Therefore, they argue that the only way to achieve a permanent reduction in unemployment is to change institutions and, in particular, to deregulate the labour market.

Justifying itself on the basis of neoclassical theory, the Howard Government has pushed hard for two forms of labour market deregulation, relaxing employment protection through unfair dismissal laws and abolishing, or reducing the scope of, laws that encourage or help union activity, including the traditional Australian system of conciliation and arbitration. The economic literature gives little support to the view that in Australia either job protection or union activities have been major factors in adding to the average level of unemployment. For example, after a careful and thorough study across 20 OECD countries Nickell concludes

> "Labor market rigidities that do **not** appear to have serious implications for average levels of unemployment include the following: … strict employment protection legislation and general legislation on labor market standards; … high levels of unionization and union coverage, so long as they are offset by high levels of coordination in wage bargaining, particularly among employers." (Nickell, 1997, p.72, emphasis added)

Nickell's conclusion is not surprising. In the European Union the same labour market laws apply equally to all Member States, but there are states that have been notably successful in boosting employment and keeping unemployment low as well as others that have been very unsuccessful. This suggests that "employment problems are not caused by excessive labour market regulations" (Larsson, 2000, p. 35).

As far as union activity is concerned Nickell finds that greater union coverage does tend to raise unemployment when there is little coordination of wage bargaining activities between unions and employers. Nickell's explanation is that uncoordinated union-dominated systems create "an additional source of inflationary pressure that requires more unemployment to quash it" (p.68).

The conclusions of Nickell's article suggests that, while the reduction in importance of the coordinating function of the Australian conciliation and arbitration system may be unfortunate, in general labour market regulation is not a major problem in Australia as far as unemployment is concerned. This is supported by work done in Australia. Sloan and Wooden (1998) argue that labour market outcomes have been much the same in Australia, New Zealand and the United Kingdom, yet in the last two mentioned countries the labour market is much more deregulated than it is in Australia. Gregory (2000) points out that, although the USA has the best performance with respect to employment growth over the last 40 years, the UK and Australian experience were the same until 1980, but "during and after the Thatcher reforms, the UK employment performance *deteriorates* relative to Australia" (p.115, emphasis in the original). After its reforms, New Zealand did even worse than the UK.

While many neoclassical economists in Australia do not disagree with Nichols' analysis outlined above, all neoclassical economists unite in concern about one type of regulation, minimum wage laws. While in Australia at least the desirability of minimum wage laws is not an issue, there is concern that the level of minimum wages may be set too high. Reducing the actual money value of minimum wages is not advocated because of the political and industrial relations problems but a number of economists have advocated allowing the real value of minimum wages to decline by freezing them or perhaps only by increasing them at a lower rate than the rate of inflation. However, the empirical evidence reviewed in the following paragraphs is that a reduction in the price of labour (real wages) will only have a small effect, if any at all, on the amount demanded. Very large, socially undesirable, economically disruptive and politically impossible reductions are necessary to have a noticeable effect.

Studies of the responsiveness of the amount of labour demanded when there is a change in wage levels (the elasticity of demand for labour) can be made at the firm or industry level and are called micro studies. Alternatively, they can be made at an economy wide, or macro, level. Micro studies all show an elasticity of demand for labour that is close to zero.

The majority of micro studies done before 1982 found elasticities of demand for the labour of teenagers or young adults close to zero (Brown, Gilroy and Kohen 1982). Moreover, there was no convincing evidence that a cut in the minimum wage for older workers would increase their employment at all. In studies made in the 1980s and 1990s the pattern was for estimated effects of a rise in the minimum wage to be the same or smaller than those made earlier. Moreover, Card and Kreuger (1994,1995) found elasticities that were not only zero but sometimes positive, i.e. rises in the minimum wage increased employment. This started an immense controversy but neither side disputed that, positive or negative, the elasticities were close to zero.

There have been fewer studies at the macro level and the evidence is less clearcut. Moreover, reviewing estimates of the elasticity of demand for labour is less straightforward at the macro level. It is more difficult to compare studies that cover different categories of workers (e.g. total employment, private sector employment, male employment). More often there are doubts about the sample. For example, in Australia there appears to have been a break in the data at the end of the 1970s (Debelle and Vickery 1998), so that studies using data from both before and after that date need to be interpreted carefully.

The most influential Australian macro study, that of Debelle and Vickery (1998), estimated the elasticity of demand for labour as – 0.4 per cent, that is, if the real wage rose by 1 per cent the amount of labour demanded would drop by 0.4 per cent, other things being equal. Other Australian studies using data from before 1978 often have greater estimated elasticities than this. However, as noted above, there appears to be a break in the data around 1978 and there are good arguments for using data that starts after that year. Studies that do this report results consistent with Debelle and Vickery's estimate of an elasticity of –0.4. This is noticeably greater than the consensus of micro studies. Nevertheless it is still small.[1]

5.5.2 Keynesian Policies to Reduce Joblessness

Unlike the case of neoclassical policies, Keynesian policies are well supported by empirical evidence that they can increase output and employment (Nevile, 2000). However, there is also evidence that Keynesian policies may have undesirable side effects. These side effects are likely to be worse and are harder to deal with in a global economy leading some to argue that Keynesian policies are now obsolete.

The deregulation and integration of financial markets around the world has given financial markets considerable influence on government policy. These markets now have great power in determining the exchange rate, and the exchange rate has such a widespread influence on the economy that, in many countries, governments must be constantly looking over their shoulder with concern about the effects of policy actions on financial markets.

The practical effect of this is not necessarily that national sovereignty in policy making must be superseded by tailoring policies to please financial markets. While there have been assertions that this is the case, empirical studies suggest that "governments still have policy choices and fiscal policy may be the most important instrument for choice" (Keohane and Milner, 1996 p.248). The selection of fiscal policy is because monetary policy operates through influencing interest rates and, with the capital mobility that is part of globalisation, interest rates and exchange rates are closely linked, constraining the ability to change interest rates.

Traditional arguments against the use of fiscal policy, still held by politicians in Australia, maintain that budget deficits increase interest rates, but the analytical evidence is dubious and so far empirical evidence does not support the proposition either (Nevile 2000). Current arguments against the use of expansionary fiscal policy rely not on analytical economic arguments leading to hypotheses that can be tested by standard methods but on arguments about how businessmen, especially those in financial markets, would react to the use of fiscal policy. The key argument is that budget deficits will lead financial markets to fear an exchange rate depreciation (Kriesler and Nevile, 2003). If a large depreciation occurs and is perceived to be undesirable, interest rates will have to be increased, perhaps dramatically, offsetting the expansionary effects of a budget deficit. Financial markets prefer price stability, or at least no large increases in the inflation rate, which will usually lead to a rise in interest rates and a consequent fall in the value of financial assets. Thus, it is not surprising that financial markets' spokesmen argue against fiscal deficits. Conventional wisdom still holds that deficits are inflationary. In most circumstances this is not directly the case, but if deficits do increase employment and economic activity they will put downward pressure on the exchange rate, which does tend to increase prices. Preventing a fall in the exchange rate will again probably require rises in interest rates.

However, events in the last few years suggest that international financial markets now pay less attention to economic analysis. Movements in the exchange rate for the Australian dollar in the year 2000 are a good example. From December 1999 to October 2000 the value of the Australian dollar fell by 20 per cent against the US dollar and 15 per cent against the trade weighted index at a time when the economic fundamentals, that the financial market supposedly give weight to, were sound. The budget was in surplus. Apart from a once-off effect of the introduction of the GST, the rate of inflation was 2 per cent and not expected to rise significantly. Even the balance of payments current account deficit was relatively low. This type of example reduces the value of following any systematic rules to keep the approval of international financial markets. Nevertheless, it would be foolhardy for any government (except that of the United States) to ignore the attitudes of financial markets altogether when framing fiscal policy. A compromise must be found. It may be even more costly to tolerate high unemployment rather than take actions that could be thought to upset financial markets. In any case some fiscal policy action can be taken to expand employment without having a budget deficit. An increase in government expenditure usually has more expansionary effect than the contractionary effect of an equal sized increase in taxation revenue, thus stimulating economic activity and employment when both are increased by the same amount. In addition, government expenditure can be biased towards labour-intensive areas. Keynesian policies to reduce joblessness still have a vital role to play.

5.6 A Case Study: Work for the Dole

The largest part of the empirical evidence about the effectiveness of active labour market policies comes from the United States, where they clearly work best in helping sole parents return to the labour force and work badly in helping disadvantaged youth. Evidence from other countries does not contradict these conclusions (Martin, 2000). Particular people may need intensive counseling and other help. Overall, work experience programs are the most effective. Programs to increase formal skills are also valuable to a wide range of people, but generally they work best when combined with work experience. Work for the Dole is the major work experience program in Australia.

When demand for workers is growing strongly active labour market policies come into their own. In the 18 months to June 2003 my daughter Ann and I undertook a major review of Work for the Dole. This research and its results are set out fully Nevile and Nevile (2003). The rest of this paper sets out some of what we discovered as a case study of one program designed to build capacities. In what follows two of the formal objectives of Work for the Dole, those relating to local communities, are ignored. This is not because these are unimportant, but because of the focus on the outcomes for the participants themselves. These outcomes include both getting a job as a result of participation in the program as well as 'soft' outcomes, some of which are actually the official goals of Work for the Dole as far as employment is concerned.

5.6.1 'Soft' Outcomes

Most commentators on the costs of unemployment are rightly concerned with the effect on individuals. There is, of course, the loss of income by the unemployed and their families, but unemployment also "leads to losses of self-reliance, self-confidence and psychological and physical health" to quote Sen, (1999, p.21), a Noble Laureate in economics. The longer a person is unemployed the greater these costs become. More than 70 per cent of Work for the Dole participants have been on unemployment benefits for more than a year and almost half of them for more than two years. Many are in great need of help in overcoming the problems mentioned by Sen.

Both participants and Work for the Dole projects vary greatly. This wide variety in Work for the Dole projects is one of its strengths, enabling it to meet the different needs of different participants. But some participants are easier to help than others and some projects are more effective in doing this, than others. Any estimate of how helpful Work for the Dole is, can only be an overall judgement. Nevertheless, Work for the Dole does well with respect to the 'soft' outcomes of reducing the personal costs listed in the quotation from Sen, that is, in increasing capacities. Its success is in marked contrast to similar programs in England and Sweden, where to quote one authority "requirements to participate in poorly rewarded pseudo-employment in order to qualify for public income support breeds cynicism, perversely encouraging young people to reject the entire benefit-to-work package" (Ryan,2001, p. 82). Given that most participants in Work for the Dole enter the program only to avoid losing unemployment benefits, the success of the program is all the more remarkable. However, attitudes change during the course of the program and people 'dragged in kicking and screaming' come to find the experience worthwhile. After completing their 26 weeks, 77 per cent of participants rate the experience as very satisfactory or satisfactory (DEWRSB, 2000). As part of the research we interviewed 101 participants in Work for the Dole and a similar number of members of staff of Community Work Coordinators (CWCs) and Sponsor organizations.[2] The figure of 77 per cent is consistent with the responses obtained in our interviews. Why do so many participants in Work for the Dole find the experience satisfactory?

For all the participants we interviewed, the major purpose of Work for the Dole was to improve their chances of getting a job. But what made Work for the Dole worthwhile was not getting a job at the end – that was the jackpot – but the experience was worthwhile if one learnt something.

Obviously, if what participants learnt was relevant to their career aspirations that was best, but some participants simply enjoyed learning even though they did not have a clear idea of the sort of work they wanted to do or whether what they were learning was or was not related to their career goals. For example, a single mother who had been at home for the last twenty years looking after her children was having an "absolute ball" in a woodwork project which she chose because she wanted to learn something "altogether different from anything I had done before…[Also] learning about power tools will be useful because I live alone".

Participants who were unhappy were those who felt they were not learning anything and could see no prospect of future employment. For example, a participant who said that he "hated coming here", wasn't learning anything because as he said "he knew how to do all this sort of work already".

Both work relevance and learning are important in terms of providing participants with the type of work experience they value. However, relevant work experience needs to be linked to learning, whereas learning on its own is sufficient. A participant in a landscape gardening project in Adelaide is a good example. He would like an outdoor labouring job with similar work to that done on the project but was not enjoying the experience:"[t]here is nothing I like about the project…I have done all this sort of work before".

Because most participants are looking for work experience that will help them get a job, those working in group projects appreciate work sites and projects that resemble real work environments. The best example of such a project that we came across is Workskill's ComNet Project which gives participants (all of whom have experience, qualifications or a keen interest in IT) practical experience and the opportunity to apply their IT skills in a business environment by providing software and hardware support to a range of community organisations. ComNet participants enjoy the opportunity to test theory and skills acquired in the classroom in a real work situation. To quote one:

> "This project gives you the opportunity to get out there and deal with real clients, just like you would have to if you were running your own business. You have to learn how to deal with clients…to liaise with them, to find out what they want and this gives you better interpersonal skills… Being able to apply your skills in real work situations gives you confidence in your own ability."

Many participants also identified improved communication and interpersonal skills and even organisational skills as important positive aspects of Work for the Dole. I will give several quotes, since many of us do not realise the extent of the barriers to employment caused by the lack of confidence of many long-term unemployed people.

> "The project has given me confidence that I can go out and get a job"

> "I've become more confident in this placement. Before I didn't feel comfortable using the telephone – I would get embarassed if someone walked

> into the room while I was on the phone. I was given help with that and now I am fine."
>
> "I have learnt patience and how to deal with other people. I have learnt to deal with conflicts and disagreements."
>
> "I think this project will help me get a job because of the experience of working in a team, working with different people."
>
> "I didn't initially want to do Work for the Dole, but it does get you out of bed in the morning and keeps you on a level – less depressed. At least I am learning something."

These quotations, together with others in this section, give, as far as possible in the time available, a participants-eye view of Work for the Dole and indicate in a qualitative way aspects of the success of the program in achieving 'soft' outcomes.

5.6.2 Employment Outcomes

Overall, Work for the Dole does have a positive effect in helping participants obtain a paid job. In recent years around a quarter of Work for the Dole participants are employed three months after leaving the program. About two thirds of those who found employment would have done so regardless of their participation in the program. The remainder, one third of a quarter, is a little under 10 percent of all participants – so, in round figures, 10 per cent of all participants find paid work, as a result of participating in Work for the Dole. This may not sound much, and the available data in Australia is such that any estimate is far from precise. Nevertheless, it is a good result by international standards, especially since the evidence suggests that Work for the Dole works best for youth and young adults. Disadvantaged youth and young adults are a group that it is notoriously hard to help and even helping 10 percent of such a group find jobs is very valuable, because long-term unemployment is so disastrous to individuals and to society. The stakes are high.

Some argue that Work for the Dole does not help participants find jobs at all, and probably does more harm than good. The most quoted study reaching this conclusion is Borland and Yi-Ping Tseng (2004). There are a number of reasons that make this study less than convincing. First, while there is no completely suitable data to calculate the net extent to which Work for the Dole succeeds in helping participants find jobs, the data used has easily identifiable problems. Some stem from the fact that the study only related to volunteers, who are more likely to become attached to the program and hence slacken job search activity. Others were technical problems due to the nature of the FACS' data that was used. Borland and Yi-Ping Tseng apparently do not think either type of problem important but ignoring them reduces the value of the study. Even more important than the data used is the fact that the study was of the pilot project which finished over five years ago. Since then the Work for the Dole program has changed in many ways. Irrespective of arguments about the data, the Borland and Yi-Ping Tseng study is simply no longer relevant because it is out of date. Work for the Dole does on balance have a positive employment assistance effect.

5.7 Why Work for the Dole Works

5.7.1 The Commitment of Organisations and Their Staff

Helping participants find employment is not a formal objective of Work for the Dole. However, most CWCs and Sponsors do have this as an implicit aim, and the encouragement, support and assistance they give participants are aimed at increasing their chance of getting a job. Some go to extraordinary lengths to help participants get a job. An extreme example is that of a participant who was missing a fair number of front teeth.

To quote the CWC involved

> We decided he wouldn't get employed with all his front teeth missing so we wrote to the government dental service asking if we could get him fast-tracked because it was holding him back from employment. We finished up subsidizing his false teeth and he is now a very well presented young man [who is now employed].

Many, many other examples could be given of CWCs and Sponsors providing participants with more help in finding jobs than the program demands, though a number reported that with increasing financial stringency it is becoming increasingly difficult to do as much as they used to. Nevertheless, the general level of commitment is impressive. One simple indication of this is the response to the postal survey that we sent out to all CWCs and a sample of independent sponsors. It was sent out only once, with a one-page covering letter and no follow up. The response rate was between 60 and 70 percent. This shows a very high level of commitment to making Work for the Dole work. Normally, one would expect a response rate of about 20 percent for a postal survey with no follow up.

5.7.2 A Work Experience Program

Responses to questions in interviews strongly suggest that another reason for the success of Work for the Dole is because it is a work experience program. A very small minority of Work for the Dole participants volunteer because they know that they can work on a project which will give them the type of work experience that is required in the job they seek. Others choose to satisfy mutual obligation requirements through Work for the Dole for the same reason. However, the large majority of participants do not fall into either of these two categories. For the majority of those who obtain jobs, the major factor is that work experience not only gives them a chance to acquire skills and show their abilities and motivation to potential referees, but also incorporates them into an informal network, through which people hear about potential jobs and are considered seriously because they (or their referees) are members of that network.

5.7.3 Supervision

A further reason for the relative success of Work for the Dole flows from the supervision required in a work experience program. Both CWCs and Sponsors acknowledge that the value to participants of Work for the Dole depends critically on the quality of the supervision and the personal characteristics of the supervisors. Supervisors are expected to be teachers, motivators, counsellors and more. Work for the Dole is funded on the basis of a maximum of 15 participants per supervisor. Hence, there is scope for supervisors to fulfill these roles.

5.7.4 Training

The role of training in work for the dole is ambiguous, but to some extent it plays a role in the success of the program. The Department of Employment and Workplace Relations (DWER) insists that Work for the Dole is a work experience program, not a training program, but many staff, in CWCs and Sponsors, that we interviewed believe any sharp differentiation is counter-productive, since training is more often effective when it is integrated with work experience. Furthermore, a minimal level of training is a necessary part of many work experience programs, even if only for occupational health and safety reasons. Informal Departmental guidelines are that up to 12 per cent of the work experience fee[3] can be spent on training, but almost all CWCs and Sponsors would like to spend more than this. About two-thirds of them do spend more on projects than the funds they receive for this purpose from the Federal Government and usually extra expenditure on training is part of this. Large organisations are sometimes able to provide training opportunities for Work for the Dole participants by utilizing vacant places in programs run for other purposes. Many CWCs believe that more up-front training will increase the effectiveness of participants' work experience, both from the participants' point of view and from that of the organisations sponsoring projects. However, it is widely believed that projects with a substantial training component are unlikely to be regarded favourably by DEWR.

The right to training credits after completion[4] is helpful, but it would be better if training credits could be made available on a pro-rata basis, say after eight weeks' work on a project had been completed. The importance of training credits has been reduced with the introduction of Job Network Members' Job Seeker Accounts, but it is still the case that in most cases neither form of access to money for training is available until someone has been on benefits for at least 12 months.

Participants are a diverse group and the amount of training that they desire, or can benefit from, varies greatly. At one end of the spectrum are graduates from the tertiary education system who may need work experience, but not more training. At the other end are those who believe they have little ability to acquire book learning and are bored at TAFE courses because 'everything is theory'. In between are the majority of participants who desire accredited training, including some relevant theory, as an aid in getting a job or furthering their career aspirations. While the training that is provided is valuable to many participants, this is an area where much more could be done, some without any extra cost to the Government.

5.8 Weaknesses

5.8.1 Underestimating What Work for the Dole can do

The book contains 14 recommendations about ways to improve the effectiveness of the Work for the Dole program, but I will start with a discussion of a situation that has developed since the book was written. Nevile and Nevile (2003 pp. 21 and 22) forecast that the introduction of the Active Participation model in July 2003 would have far reaching consequences, because Job Network Members would want to refer their clients to a CWC with a good record of helping participants find jobs. This would maximise the Job Network Member's chance of getting an outcome fee. Soon Job Network Members would come to see Work for the Dole as a valuable option for some clients rather than routinely referring people to Work for the Dole when they reach the mutual obligation legal requirement. To some small extent this may be happening, but typically referral to Work for the Dole does still seem to be regarded as a routine requirement which people must go through in the 12 months that usually elapse before they are eligible for intensive support through customised assistance. Too many people still think of Work for the Dole solely in terms of mutual obligation and a way whereby unemployed engage in projects of value to the community. DEWR should work harder at selling the strengths of Work for the Dole as an active labour market program which complements the Job Network and is a valuable method of helping unemployed find jobs.

5.8.2 Effects of Multiple Objectives

The lack of wholehearted acceptance of Work for the Dole as an integral and important part of the collection of policies that help unemployed find jobs no doubt stems from the multiple objectives of the program. Apart from the limited amount of money spent on the program, these multiple and sometimes conflicting objectives are the major source of weakness. It is not unusual for government programs to have conflicting objectives, if only because they are often required to fulfill unstated political objectives as well as policy objectives. In the case of Work for the Dole, not only are the unstated political objectives particularly strong, both the political objectives and aspects of the formal goals make it more difficult to achieve the informal goal of helping participants find jobs.

This problem is well known in other policy areas. For example, in macroeconomic policy the conflict between reducing unemployment and keeping the ratio of inflation low is set out clearly in good textbooks, but there are also unstated political objectives such as increasing government expenditure or accumulating unspent funds to enable the government to announce tax cuts or avoid interest rate rises before elections.

In the case of Work for the Dole, an obvious example of unstated political objectives is the name of the program. The majority of the voting public like the idea of unemployed people, particularly the younger unemployed, being required to "do something" in return for government assistance (Eardley, Saunders and Evans 2000), an attitude which is reinforced by the name of the program. However, use of the word 'dole' with its strong association with the phrase 'dole bludger' stigmatizes participants by reinforcing negative stereotypes of the unemployed, thereby reducing participants' self-esteem, motivation and pride in their work. Use of the name 'Work for the Dole' also works against the program's community benefit objectives because the negative connotations surrounding the name makes it harder for CWCs to recruit sponsors.

However, the most important example is that, because the program was designed as a way that the unemployed could do something for the community in return for their benefits, projects have to be in the not-for-profit sector. This is reinforced, of course, by the opposition of many, in both business and the union movement, to extending it to allow projects in the for-profit sector. Requiring those organisations which run projects to be not-for-profit prevents many participants from gaining the type of work experience that they desire and would suit their vocational needs. For example, a number of male participants said they would like to get into security work (which they saw as a growth industry) but there were no Work for the Dole projects in this area because community organizations are not involved in this sort of work. Staff also felt that participants' job prospects would be improved if they had the opportunity to work in the private sector. As one said:

> "one of the things that participants always ask is, 'am I going to get a job out of this?' Honestly you can say there is a possibility…but it is hard when you are putting people in not-for-profit organizations. They are organizations which are cash strapped. They work with volunteers. If you are working with the corporate sector, you probably have more chance of gaining employment."

Even in work experience areas which suit participants' needs, the not-for-profit restriction can limit the value of the work experience. For example, participants involved in projects which rebuild old computers donated by organizations and individuals which are then given to not-for-profit organizations, pointed out that the skills they are able to acquire through the project are limited by the out-of-date equipment with which they work.

> "It would be better if we had slightly newer computers because then you would have experience with the up-to-date computers used in the workforce. It is easier to get a job if you have knowledge of up-to-date computers."

Hence, the first of the 14 recommendations in the book was:

> "A pilot scheme be introduced in which, at the end of 26 weeks in a spell (or spells) in Work for the Dole, participants can (if recommended by their supervisor), volunteer for six months work, for four or five days a week, in the for-profit sector. The Commonwealth Government would pay participants' wages for two of the days and the employer for the remainder" (Nevile and Nevile, 2003, p.159).

In reviewing such a pilot scheme, attention must be paid to whether participants have the opportunity to learn new skills or whether the pilot scheme proves to be only an arrangement whereby employers can obtain cheap subsidized labour on a revolving basis.

Extending the work experience available through Work for the Dole in this way will benefit the longer-term unemployed who have done a number of Work for the Dole projects and are therefore not learning any new skills, will provide an incentive for those participants, who are unable to find a project which is relevant to their career aspirations, to persevere with the initial Work for the Dole project and will help older workers who need to be re-trained in a different type of work but are better to suited to on the job training than formal classroom learning.

5.9 Conclusion

By far the most important cause of social exclusion from Australian society is chronic involuntary joblessness. Building capacities that, among other things, help people obtain and keep a job is very worthwhile. However, unless the number of workers that employers wish to employ is increasing, building capacities will only have a marginal effect on reducing joblessness. It may mean that some people will obtain sustained employment, but if the total amount of employment is not increasing significantly, this must be at the expense of other workers, probably ones with temporary jobs. Building capacities can have a significant effect on employment when, as now, the Australian economy is growing relatively rapidly Work for the Dole is one program which, at its best, can do much to build capacities to participate. However, before it can achieve its full potential, the changes outlined in the previous section need to be made.

Notes

1. The preceding discussion has quickly covered a complex literature. Nevile (2001a and 2001b) give a much fuller discussion and James, Wooden and Dawkins (2001) present the opposing viewpoint.
2. The Department of Employment and Workplace Relations contracts CWCs to manage the Work for the Dole program. CWCs find Sponsors who submit projects for approval.
3. The work experience fee is paid to cover direct costs incurred in providing work experience, e.g. tools and protective clothing.
4. Those who complete participation are given credits which can be used to pay for approved training courses.

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6
Economic Rationalism: Social Philosophy Masquerading as Economic Science

J. W. Nevile

6.1 Introduction

Future economic historians will note three major themes in economic policy in Australia in the last quarter of the 20th century. They are deregulation of the financial system, privatisation and microeconomic reform. The last includes a range of measures including tariff reductions, taxation reform and changes to Australia's traditional and unique labour market institutions. In all three cases great changes were made in the 1980s and the 1990s. The financial system was transformed. The exchange rate was floated and exchange controls abolished. There were mergers among Australia's large banks, building societies transformed themselves into banks, foreign banks entered the Australian retail banking market. There were also important technical changes which altered the way monetary policy was conducted and put great weight on interest rate changes as the major instrument of monetary policy. Both federal and state governments engaged in what seemed like an orgy of privatisation. Government enterprises, that were sold to the private sector including overseas buyers, included institutions that had previously been icons of pride in public assets such as Qantas and the Commonwealth Bank. They also included state banks originally set up to help rural Australia. In the name of microeconomic reform tariffs were drastically reduced. There was almost continual discussion of taxation reform, with the introduction of major changes, such as dividend imputation, fringe benefits tax and capital gains tax. The award system was shifted from centre stage in the wage fixing process and enterprise bargaining encouraged.

The election of the Howard Government made change even more wide ranging. The Accord, the major exception to the policy trend, was immediately abandoned and enterprise bargaining given a boost. The first stage of

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the privatisation of Telstra passed through the Senate and one of the first acts of the Howard Government was to set up yet another inquiry into the financial system.

All these changes were the visible result of the ascendancy among both politicians and bureaucrats of the ideology known as economic rationalism in Australia and market liberalism in other English speaking countries. The term economic rationalism has become a catch-all term of abuse in some circles, but since it is so influential it is important to realise what its tenets actually are. Economic rationalism is not a very tightly knit school of thought but it has an essential core which is outlined in section 2 of this chapter.

The success of economic rationalism has been remarkable, with many previously held verities turned on their heads. This is not the result of advances or of new discoveries in economic theory. All around the world there was a deliberate political campaign to change the prevailing political ideology to that held by economic rationalists. This is spelt out in section 3 below.

One of the tricks of many economic rationalists is to present their policy recommendations as no more than the logical consequences of orthodox economics. This is very far from the case. Section 4 in this paper shows that the policy prescriptions of economic rationalism depend more on the values held by economic rationalists than on the theorems of economics. In any case orthodox economics is very clear that policy recommendations must rest on both economic analysis and a set of values.

The changes resulting from the implementation of economic rationalist policies were very widespread. However, the most important was the loss of full employment as a goal of public policy. The unemployment rate rose from an average of 2.0 per cent over the five years ending in 1974 to an average of 9.4 per cent over the five years to 1994. Economic rationalism was not the only cause of this increase in unemployment but it certainly contributed to it in ways which are discussed in section 5. The most important, is the abandonment of a commitment by government to maintain or restore full employment. The Howard Government has an explicit quantitative target for low inflation. It has no quantitative goal for reducing unemployment. Economic rationalism has reversed the priorities of the ideology it replaced.

6.2 The Definition of an Economic Rationalist

Non-economists tend to define economic rationalism in far too sweeping a fashion. For example, Battin, a political scientist, maintains that the key tenet of economic rationalism is "the belief that the market is the only legitimate allocator of goods and services in *society* at large not just in the *economy*" (1991, p.296, emphasis in the original). I know of no economist who believes this or even believes that the unfettered market is the only legitimate allocator of goods and services in the economy. For example, economic rationalists do believe that society should keep from starvation those whom the market leaves without income, whether this be done through the state or voluntary organisations. They do believe that the government should intervene to prevent, or at least discourage, private enterprises from polluting the environment. They do believe that the state not the market should provide public goods[1] such as defense, and so on. A better description of an economic rationalist is one who believes that there are very few exceptions to the rule that the market is the best way of deciding what is to be produced and how it is to be produced. Moreover, an economic rationalist holds that even when market failure exists (that is when the market is not the best way of deciding what is to be produced and how it is to be produced) the consequences are usually of less importance than those of the government failing in this respect and are easier to correct.

This definition of an economic rationalist places emphasis on production, on what is to be produced and how it is to be produced. While some economic rationalists argue that unequal income distribution is important to create the right incentives, generally in Australia economic rationalists say little explicitly about income distribution, about who gets and who should get the goods and services that are produced. Certainly, they argue that market incomes should be determined by the market, for example, that wages should be fixed by market forces with no interference in the form of minimum wage laws or award wages and conditions laid down by the Conciliation Commission. However, they tend not to comment on the role of social security or the social wage, and hence on the final pattern of income distribution, except perhaps to leave a vague impression that social security will take care of those whom market forces leave living in poverty.[2]

In the past many economic rationalists argued that the adoption of the policies that they advocated would raise total production so rapidly that even those at the bottom end of the income distribution would secure rises in real income (through market forces) and hence poverty would be a diminishing problem. Today those with intellectual honesty acknowledge that counter examples, such as the cases of the United States and New Zealand, show that this is unlikely to happen, at least for a generation or two. All that is left to counter poverty is the social security system, but economic rationalists do not, in general, discuss how this role for the social security system is to be reconciled with the push for low taxation and minimal government. Overseas writers, who have inspired Australian economic rationalists, do make comments on how income should be distributed, but in Australia economic rationalists tend to focus on production arguing that in general the questions of what is to be produced and how it is to be produced should be left to the market.

One further point about economic rationalism should be noted. Those in this camp are almost always more concerned to keep inflation at a very low rate than to reduce unemployment substantially. Perhaps this is because economic rationalism downplays the existence of market failure and involuntary unemployment is traditionally associated with market failure, whereas inflation can, if one wishes, be blamed on government failure. One school of economists, the new classical school, even argues that involuntary unemployment does not exist and that it is possible through tight monetary policy to reduce inflation without affecting the level of unemployment; though to be fair I can only think of one economist, responsible for giving advice to those determining economic policy, who ever believed in the new classical school of economics. In any case, the conventional wisdom now is that it is not possible to avoid a short-run trade off between unemployment and inflation when monetary policy is used as the principal anti-inflationary instrument.[3] Economic rationalists are opposed to using incomes policy as a weapon against inflation as it involves substantial intervention in market processes. Hence, their emphasis on keeping the rate of inflation very low does involve a cost in higher unemployment. This is discussed in section 5 below.

6.3 Economic Rationalism as a Political Program

Economic rationalism is the Australian version of a political movement known in other English speaking countries as market liberalism. As Marginson (1992) points out, in his study of the works of Hayek, Friedman and Buchanan, the father figures of this movement wrote not primarily to increase knowledge but to change the world. They were laying the foundations of a political crusade more than trying to establish a new school in economics. Hayek's best known work is not that for which he received the Nobel prize in economics but his 1944 classic in political philosophy, *Road to Serfdom*. In the next few years he saw that post-second-world war society was indeed moving away from individualism, and lamented that

> "under the sign of 'neither individualism or socialism' we are in fact rapidly moving from a society of free individuals towards one of a completely collectivist character". (1949, p.1).

Hayek acknowledges that this movement away from individualism was due to politicians' implementing what the public desired, but argued that therefore public opinion should be changed through the writings of himself and like minded economists and political philosophers"

> "what to the politicians are fixed limits of practicability imposed by public opinion need not be similar limits to us. Public opinion on these matters is the work of men like ourselves, the economists and political philosophers of the past few generations who have created

> the political climate in which the politicians of our time must move". (1949, p.108).

In his Nobel prize speech Buchanan criticised the economists of his time as "ideological eunuchs" and elsewhere stated that the only purpose of science is to assist in developing propositions about how the world ought to be (Marginson 1992, p.7). Friedman drew inspiration from Hayek, whom he praised for his "influence in strengthening the moral and intellectual support for a free society". In turn Friedman threw himself wholeheartedly into the movement to change public opinion with numerous magazine articles, TV appearances and the famous book *Free to Choose*, written with his wife, in which he exulted that the tide of public opinion is turning (p.7).

In Australia, economic rationalists are equally open about the fact that their objective is to change society. For example, King and Lloyd describe economic rationalism as "a microeconomic *agenda* that focuses on reducing government intervention in markets" (1993, p.ix, emphasis in the original).

The political program called economic rationalism, or market liberalism, is firmly based on a social philosophy sometimes called libertarianism. This social philosophy places great emphasis on the freedom of the individual. To quite Friedman

> "As Liberals, we take freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements". (1962, p.12).

And he makes it quite clear that freedom has nothing to do with freedom from want etc., but with freedom to do as one wishes without restraints imposed by other people. Constraints imposed by lack of means do not raise problems of freedom. Robinson Crusoe could have no problem of freedom while he was alone on his island, even if he starved to death. (The example of Robinson Crusoe is taken from Friedman himself, 1962, p.12). Monopolies are thought of as limiting freedom but not lack of resources or capabilities or talents. Consequently, for Friedman the role of government is strictly limited.

> "Its major function must be to protect our freedom both from the enemies without and from our fellow citizens: to preserve law and order, to enforce private contracts, to foster competitive markets. Beyond this major function, government may enable us at times to accomplish jointly what we would find it more difficult or more expensive to accomplish severally. However, any such use of government is fraught with danger. We should not, and can not avoid using government in this way. But there should be a clear and large balance of advantages before we do". (1962, pp.2 & 3).

This political philosophy, rather than economics is the basis of the economic rationalists' crusade for minimal government.

6.4 Economic Rationalism is not the Logical Conclusion of Mainstream Economics[4]

Due usually to lack of caution, rather than a desire to deceive, a number of prominent Australian economic rationalists have stated that their policy prescriptions follow inevitably from standard economics and depend only on the propositions of economics and not on the values of the particular economists advocating the policies. For example, Sloan describes "those opposed to the ideas of economic rationalism" as "anti-economists" (1993, p.132) and Anderson and Blandy have described an assault on economic nationalism as "an assault on economics itself" (1992, p.36). This identification of particular policies with the conclusions of an objective study of economics is not only wrong, it is counter to the whole tradition of economics which states firmly that virtually any policy prescription must rest on values. There is almost always a cost as well as a benefit and the relative weight given to each depends on one's values.

Mainstream economic thought around the world divides economics into two streams: positive economics, which is the study of what is, and normative economics (including all policy advice), which is concerned with what ought to be or what is desirable. Since normative economics takes into account what is considered desirable it depends on value judgements on which men and women may continue to differ however intelligent and knowledgeable they may be. On the other hand, according to conventional wisdom, positive economics is value free so that any two intelligent people should be able to reach agreement on the correctness or otherwise of a proposition in positive economics, through rational discussion and empirical observation.

Although most economics departments teach that positive economics is value free, this can be and is challenged. I argue that positive economics is not free of value judgements in at least two respects. Deductive reasoning should conform to the rules of logic, which are certainly value free. But in general positive economics is not just a matter of deductive reasoning. It also requires an appeal to empirical studies. Moreover, the facts that an economist studies are not facts produced in carefully controlled conditions in a laboratory. They are facts thrown up by real world situations and some judgement is required in interpreting the facts. This judgement is heavily influenced by the values of the person making the judgement. The case for reducing government regulation of, and intervention in, the economy rests on the empirical judgement that cases of market failure are uncommon, that is, if left to itself, it is very unusual for the market not to produce an efficient outcome. Economic rationalists who place a high value on political and personal liberty are suspicious of government intervention and regulation, which they see as reducing personal liberty. It is perhaps not surprising that such economists generally make the professional judgement that market failure is rare. Given the values that they hold, the costs of unnecessary government intervention are high. From this viewpoint it is responsible to be very cautious in claiming that market failure exists.

Other economists are more concerned about the costs of not intervening when to do so will be beneficial to the economy. If there is market failure, the people who suffer are usually the economically weak, who may well experience very real poverty. This is particularly true of the labour market where a major symptom of failure is involuntary unemployment. Economists who put a high value on economic security for all, on preventing anybody falling below a certain level of income, are far more likely to make the professional judgement that market failure is an important problem in an unregulated capitalist economy than are those with a libertarian social philosophy.

For those who know statistical jargon, it is all a matter of type 1 and type 2 error. Economic rationalists, and others, who believe that positive economics is value free, forget that there is no objective way of deciding whether type 1 or type 2 error is more important. It is a matter both of the consequences of each type of error and one's value judgements about the relative undesirability of each set of consequences. It is entirely proper for economic rationalists to allow value judgements about freedom to influence their policy prescriptions. It is improper, and more importantly incorrect, for them to claim that these policy prescriptions flow simply from the laws of economics. It is very important for the rest of us to realise that their policy conclusions flow as much from their social philosophy as from their economics.

The second reason why positive economics is not value free is the very human tendency to give more weight to empirical observations that tend to support ones preconceived ideas, than to those that tend to disprove them. If you doubt this consider the large number of times media commentators, who are economic rationalists, point out that in the United States, where there is a deregulated labour market, there was only a small rise in unemployment in the eighties whereas they never mention that when Mrs Thatcher deregulated the labour market in the United Kingdom there was a very large rise in unemployment in that country.

In many circumstances, this very human tendency to give more weight to observations that tend to support a position already held is not improper. It may be appropriate, especially when one's preconceived ideas rest on a firm empirical foundation. But it is important to realise that in practice ones preconceived ideas often rest on the values that one holds, as well as on deductive reasoning and empirical observation. Because many economic rationalists transfer some of the value they place on freedom to the market itself, they often discount evidence that the market does not work well.

In short, the policy prescriptions of economic rationalists do rest to a large extent, more in some cases than others, on the values held by economic rationalists. And the over-riding value, that greatly influences the results they obtain, is the worth given to individual freedom from so-called arbitrary restraint on individuals by other individuals, notably those in government.

I have spent some time presenting the argument that positive economics is not value free because I think it is important. However, it is a controversial point and it is necessary to emphasise that the proposition that the policy prescriptions of economic rationalists do not flow automatically from mainstream economics, does not depend on whether or not positive economics involves value judgements. If it does the case for the misleading nature of economic rationalists' claims is even stronger. But irrespective of that it is clear that economic rationalist policy prescriptions are not just orthodox economics. In case you think that the strength of this statement comes from my ideological bias let me quote Geoff Brennan, who is the most eminent Australian economist among those espousing the Buchanan school of economics. Brennan argues that "there is no presumption in ... economics in favour of a minimal state' concluding that

> "Welfare economics after the public-goods revolution is as much a catalogue of possible market failures as of general market success. To argue that mainstream economics argues for a minimal state is in that sense simply a mistake" (1993, p.7).

6.5 Economic Rationalism and Unemployment

The dramatic rise in unemployment over the last 20 years was noted in section 1 of this paper. Economic rationalism is implicated in many ways in this. In the short run microeconomic reform has increased unemployment and this has also proved to be true in the longer run, financial deregulation has reinforced pressures to give priority to low inflation except for brief periods where unemployment is unusually high, and progressive deregulation of the labour market makes necessary increasing reliance on unemployment to control inflation.

The fundamental problem is the emphasis on low inflation as a policy goal which is a feature of economic rationalism. It is natural for an ideology which downplays the existence of market failure to be less concerned about involuntary unemployment, which is a consequence of market failure, than with inflation, which, if one wishes, can be blamed on inappropriate economic policies.

It was pointed out in section 2 that it is impossible to avoid a short-run trade off between unemployment and inflation when monetary policy is used as the principal anti-inflationary instrument. The argument is whether there is also a long-run trade-off. There is increasing evidence for hysteresis, that is for the proposition that not only is unemployment determined in part by the level of unemployment last year, but that the equilibrium level of unemployment is also determined by past levels of unemployment. Hence, more and more economists are coming to the view that there is a long-run trade-off between inflation and unemployment when monetary policy alone is relied on to control inflation. It is no longer possible to take the easy way out and maintain that tight monetary policy to reduce inflation will not also increase unemployment. Nevertheless, there is continual pressure from financial markets to make low inflation the over-riding policy goal.

Economists employed in the financial sector and financial journalists do not necessarily argue that reducing inflation is costless. Sometimes they argue that interest rates should rise to reduce the rate of growth of employment because falling unemployment is producing unacceptable inflationary consequences (See eg, Max Walsh in the *Sydney Morning Herald* 10/3/95). More often they omit consideration of unemployment. Consider the following quotation from Max Walsh:

> "given that monetary policy is an anti-inflationary tool and fiscal policy is useful as a medium term determinant of national savings...the most important question ..is how do we address periodic balance of payment crisis". (*Sydney Morning Herald*, 16/11/94).

Max, being a humane, intelligent if sometimes pessimistic observer of the economy, probably meant how do we address balance of payments crises without causing unacceptable increases in unemployment, but many in financial markets may not pick that up. Apart from that point, it is significant that the quotation gives a simple anti-inflationary role to monetary policy and does not assign to any policy instrument the task of reducing unemployment. Indeed some financial journalists and some spokespersons for the private business sector believe that this is not a proper concern of macroeconomic policy, but should be tackled through microeconomic reform, which in this context is largely a euphemism for cutting the wages of the less skilled.

It may be that institutions in the financial sector always placed much more weight on controlling inflation than on reducing unemployment. The point is that, because of financial deregulation, driven partly by technological change but also by the ideology of economic rationalism, financial market institutions now have much more power to impose their views in the government. Financial deregulation has both hastened and heightened the decline in power and influence of governments, and of authorities like the IMF, in global financial markets. Governments have lost control over the exchange rate for their currency – probably the most important single price in the economy.

The Economist (14/1/95 pp. 48–49) speaks of a government being punished by financial markets and similar language is used by Australian financial journalists. The language may be extravagant but the underlying point is correct. The exchange rate has such a widespread influence on the economy that governments must be constantly looking over their shoulder with concern about the effects of policy actions on financial markets.

The corollary to this is obvious. The priority given by financial institutions to anti-inflationary policy now has a real influence on government actions and is an important factor in the persistence of unacceptably high levels of unemployment in Australia. Moreover, it has prevented unemployment caused by other economic rationalist policies from being reduced. In particular, structural unemployment caused by microeconomic reform, especially the removal of tariffs and the corporatisation of government business enterprises, has not been effectively tackled for fear of inflation. The situation was summed up in a speech by Mr Bernie Fraser, the former Governor of the Reserve Bank of Australia. As reported in the *Sydney Morning Herald* of 16th August 1996 he said that monetary policy was becoming the hostage of influential financial markets with a vested interest in making the Reserve Bank give greater weight to low inflation than to employment and growth. Mr Fraser said it would be "ironic ... if the short-terminism of politicians were to be replaced by the short-terminism of the financial markets".

Moreover, the situation has become worse with the demise of the Accord, the increased emphasis on enterprise bargaining and the consequent removal of centralised constraints. In the eighties centralised wage fixing under the Accord enabled a marked decline in both unemployment and inflation and laid the basis for the very low levels of inflation in the early nineties. This restraint on inflationary wage pressure will become much less potent as the labour market is further deregulated and enterprise bargaining further developed. It is to be replaced by the fear of unemployment. Unemployment will have to be high enough to make that fear credible. There could not be a more pointed contrast with the commitment to maintain full employment in the era when Australian governments had a Keynesian ideology.

6.6 Conclusion

Economic rationalism is often described as gross intellectual imperialism as economists apply economic ideas to social issues to such an extent that social and political ideas are excluded from the discussion. While superficially this may be true, when one probes below the surface the reverse is true. Economic rationalism is the result of economics being taken over, hijacked one might say, by a particular social ideology. As it happens I think some of the policies advocated by economic rationalists are very good, some are appalling and some will not make a great deal of difference to general economic welfare if they are adopted. But while it is important to evaluate individual policies it is also important to look at the nature and characteristics of economic rationalism as a whole. I have tried to show that the phrase economic rationalism is a misnomer. Economic rationalism does not, in any fundamental way, spring from economics but from social philosophy. Thus, the distinguishing characteristic of the state, that emerges when thoroughgoing economic rationalism is applied, is not that it is a society ordered by economic principles, but that it is a libertarian state. Moreover, it is a state which has explicitly rejected a previous fundamental contract: a social contract to maintain full employment.

Notes

This is a substantially revised version of a presentation originally given at a workshop on "Contract state, social charter or social compromise" sponsored by The Academy of Social Sciences in Australia and held at Sydney University in December 1995.

1. In this context a public good is defined as a good which can not be provided to one person without simultaneously providing it to others.
2. This is the major way economic rationalism Australia is at variance with the writings of these who inspired it. Milton Friedman, for example, has stated that

    "The ethical principle that would directly justify the distribution of income in a free market society is 'To each according to what he, and the instruments he owns, produced'" (1962, p.162).
3. In summing up the discussion at the conference reported in Adrian Blundell-Wagnell (1992) Max Corden stated that "Consensus did exist on three crucial matters .... [of which the first was] you can not deflate without some cost" (p.341).
4. This section is a revised version of material previously published in Nevile, 1994, pp.30–32.

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7
Deregulation and the Welfare of the Less Well Off

J. W. Nevile

7.1 Introduction

In the 1980s income distribution became more unequal in Australia and many blamed at least part of this on deregulation (Nevile, 1994; Saunders, 1993). With increasing inequality and slow growth of average real incomes, the real incomes of those at the bottom end of the scale fell significantly. It was not just a case of the rich getting richer while the rest of the population saw little change in their real incomes. Whether it was deregulation or something else, whatever caused the increased inequality must be implicated in the poor getting poorer.

Many of those who blamed deregulation for depressing the living standards of the poor did so on the basis of an examination of trends in disposable income, i.e. income after tax and social security payments. While this is certainly the appropriate concept to use when looking at living standards, it is not the best one to use when looking at the effects of deregulation on income distribution. A substantial minority of those at the bottom, whose real incomes fell, were old age pensioners, virtually all of whose income came from the pension. The real value of the pension did not fall, so the decline in real income of these pensioners was presumably due to better targeting of social security benefits, including the introduction of the assets test. If there is a causal link between deregulation and increased inequality it should be sought, in the first instance, in an examination of increased inequality in private or market incomes, i.e. incomes before income tax and social security payments. The extent to which changes in inequality in private income are offset by income tax or social security payments is a separate study which lies outside the scope of this chapter.

Revised from *International Journal of Social Economics*, 23(4/5/6), 310–325, 1996, 'Deregulation and the Welfare of the Less Well Off,' by Nevile, J. W. With kind permission from Emerald Group. All rights reserved.

This chapter, therefore, focuses on private income. A description of the data and definitions used is given, followed by a section which examines changes in inequality in private income in Australia in the 1980s. More specifically, it examines changes between 1981–82 and 1989–90, the years of income distribution surveys nearest to the beginning and the end of the decade. In addition to a discussion of changes in the level of inequality, changes in the real income of the bottom 20 per cent of income units are examined.

The next section considers whether deregulation is an important causal factor in the increase in inequality and the decline in real income of the less well off that is documented in the previous section. International comparisons are made of the size of the increase in inequality in countries where deregulation was prominent with the size of the increase in countries where deregulation was much less important. Also, the evidence, in the case of Australia, for the other major explanation of increasing inequality, is examined. The penultimate section considers how deregulation is likely to increase inequality in ways that are not picked up in the comparisons previously made, and the policy implications are briefly discussed in the final section.

7.2 The Data

The basic data are the unit record tapes of the Australian Bureau of Statistics' 1981–82 and 1990 *Income Distribution Surveys*. The unit of analysis used is the income unit as defined by the Australian Bureau of Statistics. A sole parent with one or more dependent children or a couple with or without dependent children form a multiperson income unit, and everyone else is a single person income unit. Thus, a family consisting of a married couple, two children at school and an 18-year-old living in the family home, but earning an independent income, is split into two income units. The 18-year-old is a single person income unit and the rest of the family is a multiperson income unit.

Since different income units are of different sizes, this in itself can introduce inequality into the distribution of income. Even if everyone in Australia had exactly the same standard of living, there would still be inequality among income units since multiperson units would have a larger income than single person units. One way round this is to work in terms of income per head, but this overcorrects. While two cannot live as cheaply as one, they can live more cheaply than two people living apart. The usual way is to use an equivalence scale which gives a weight of unity to the first member of an income unit and smaller weights to any additional members. The trouble is that all equivalence scales are at least somewhat arbitrary. In this chapter we will use the OECD equivalence scale, simply because it is well known and widely used throughout the world. This scale gives a weight of 1 to the first adult in an income unit, a weight of 0.7 to a second adult, and a weight of 0.5 to each dependent child or teenager. However, to some extent we will avoid the problem by looking at particular groups in society, e.g. singles of working age. In only one case, couples with children, does the choice of equivalence scale affect the detailed comparisons made in the chapter.

The analysis in this chapter excludes all income units which reported any income (positive or negative) from self-employment i.e. from working in a partnership or owning one's own unincorporated business. Around the world statistical agencies have great difficulty in measuring the income of the self-employed. They have not solved this problem, but agree that the incomes reported by self-employed in surveys are a very poor measure of their actual income. In Australia there is an additional problem. When comparisons are made between two particular years the variability of the incomes of the self-employed can create problems, especially if a significant proportion of them have their incomes strongly influenced by a factor which does not affect the rest of the population. Farmers in Australia are a good example of this. For both these reasons it is probably better to exclude the self-employed, and this is done in this chapter. Most of those reporting zero or negative disposable income are self-employed, but there are a small number of other cases. Some of these are people who have misunderstood the survey questions, or for other reasons have incorrectly reported their incomes. A few may be investors who have included capital losses in their income. It seems better to exclude all with zero or negative disposable income along with the self-employed.

In addition, there is a practical reason for excluding those with zero or negative incomes. On the 1981–82 data tape negative income was recoded to zero before the tape was issued. It is possible to recode 1989–90 negative incomes to zero but we do not know if these incomes showed the same pattern in 1989–90 as they did in 1981–82. Therefore, if negative and zero incomes are included, comparisons between 1981–82 and 1989–90 may be distorted to an unknown extent.

In the next section some summary results are given for all types of income units considered together. Then attention is focused on three particular types of income unit: single people between the ages of 25 and 64 inclusive, couples under 65 without dependent children, and couples with dependent children. The age limits refer to the age of the reference person, who in the case of couples is the male. Couples are defined to include de facto relationships as well as marriages.

It was originally intended to focus attention in turn on all categories of income units where the reference person was of working age, and thus likely to be an actual or potential member of the labour force. However, sole parents were not considered separately because 40 per cent of sole parents received virtually no market income in either 1981–82 or 1989–90. There is no point in this context in looking at what happened to the bottom quintile of sole parents. Even overall, only among the top third of sole parents was market income more important than social security payments as a component of income.

Single people under 25 were excluded for a different reason. Many of these people although not legal dependants, may be living at home with their parents, and only be loosely attached to the labour force while they pursue full-time study (or other pursuits). Their welfare may depend more on their parents income than their own. While a case can be made for including or excluding single young person income units, the decision was made to focus attention on single people between the ages of 25–64 inclusive. This makes the results easier to interpret. Also it is the decision less favourable to the conclusion reached in the paper that deregulation harmed the welfare of the less well off, since the effects (if any) of deregulation on the casualness of the work of young adults is not taken into account. Hence, excluding singles under 25 strengthens, if anything, the conclusion that deregulation has hurt the less well off.

7.3 Changes in the Distribution of Private Income

As Table 7.1 shows, the Gini coefficient for market income increased from 0.40 in 1981–82 to 0.45 in 1989–90. An increase of 12.5 per cent is a substantial increase in a Gini coefficient even over a period of eight years. The increase in the Gini coefficient for equivalent disposable income over the same period was much smaller, from 0.30 to 0.32. (Nevile, 1995, p. 16).

The Gini coefficient has the advantage of being widely used and well understood, but it is most heavily influenced by changes in the middle of the distribution. We are particularly interested in changes at the bottom-end of the distribution. It is clear from Table 7.1 that the bottom quintile did particularly badly, with its share of income falling by 35 per cent. Figure 7.1 shows that the average real income of the bottom quintile fell by nearly one-third between 1981–82 and 1989–90.

In theory, at least, it is possible that this increase in inequality in the 1980s could be due to demographic factors. People have different incomes

Table 7.1 All income units: distribution of private equivalent income 1981–82 and 1989–90

	1981–82	**1989–90**	**Percentage change**
Mean in 1989–90 dollars	16,598	17,291	4.2
Gini coefficient	0.401	0.451	12.5
Percentage quintile share			
1	1.82	1.18	–35.2
2	11.35	9.46	–16.7
3	18.55	17.53	–5.5
4	26.44	25.88	–2.1
5	41.84	45.96	9.8

Note: Self-employed, and income units with zero and negative incomes are excluded.

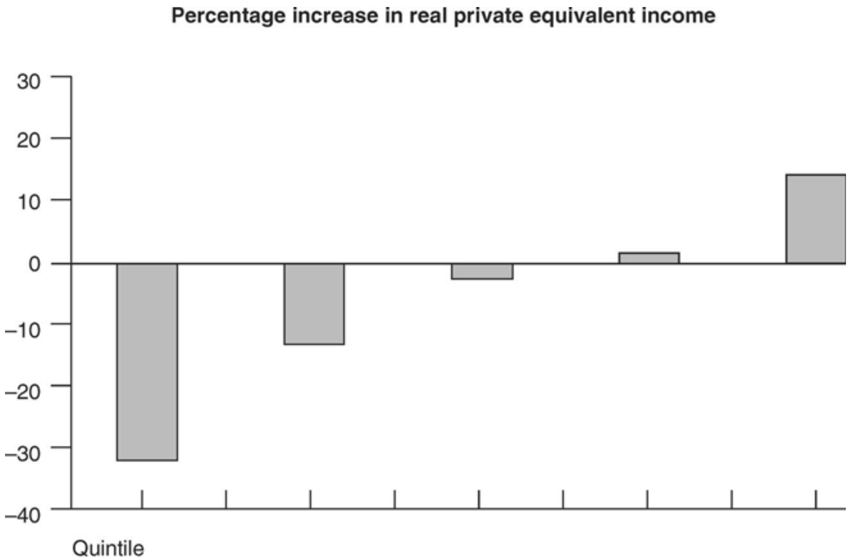

Figure 7.1 Percentage increase – all cases

at different stages of their life cycle. Retired people generally have lower incomes than do people at the height of their career, and so do people just starting on their working lives. Life cycle differences are important, accounting for between 30 and 40 per cent of total recorded income inequality in disposable income and much more in market income. It could be that the greater inequality in 1989–90 was simply due to increasing numbers of people in the high and/or the low income stages of the life cycle. In fact this was not the case. Nor was it the case that increasing inequality simply reflected increasing inequality in those categories of income units where market income was unimportant. In general, Gini coefficients for particular categories of income units increased by more than the Gini coefficient for all income units. The notable exception is for couples under 65 without dependent children.

Let us turn now to the first of the categories of income units of particular interest. Table 7.2 and Figure 7.2 give details for single people between the ages of 25 and 64 inclusive. The Gini coefficient increased by 15 per cent; the share of the bottom quintile fell by 21 per cent and the average real income of that quintile declined by 21 per cent. In this category of income units, income distribution became much more unequal in the 1980s. Moreover, the poor became poorer as did many of the middle class. Indeed, in every quintile except the top, average real income declined between 1981–82 and 1989–90.

Table 7.2 Singles aged 25 to 64: distribution of private equivalent income 1981–82 and 1989–90

	1981–82	**1989–90**	**Percentage change**
Mean in 89–90 dollars	23,309	23,509	0.9
Gini coefficient	0.346	0.396	14.6
Percentage quintile share			
1	2.26	1.79	–20.8
2	14.02	12.25	–12.6
3	20.67	19.38	–6.2
4	25.57	24.88	–2.7
5	34.47	41.71	21.0

Note: Self-employed, and income units with zero and negative incomes are excluded.

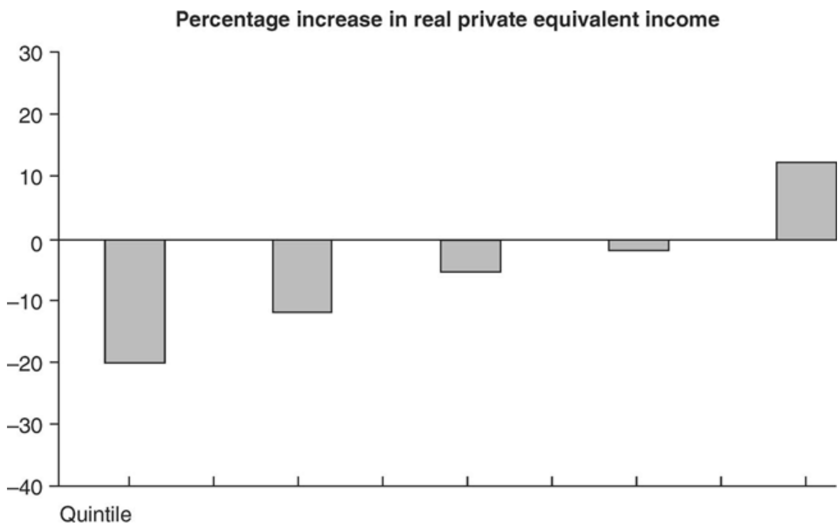

Figure 7.2 Percentage increase – singles 25–64

The next group, couples with children, did rather better. As Table 7.3 shows, the Gini coefficient increased even more than in the case with singles, at least in percentage terms, but the average real income for the category as a whole increased substantially, by over 11 per cent. Therefore, only the bottom quintile suffered a fall in average real income. Figure 7.3 shows that there was a small increase in the real income of the second quintile and increasingly larger increases as one moves up the quintile range. Nevertheless, average real income in the bottom quintile fell by 4.4 per cent so that the least well off in this category were poorer in 1989–90 than in 1981–82.

Table 7.3 Couples with children: distribution of equivalent private income 1981–82 and 1989–90

	1981–82	**1989–90**	**Percentage change**
Mean in 89–90 dollars	15,253	16,779	11.1
Gini coefficient	0.275	0.316	14.9
Percentage quintile share			
1	7.89	6.79	–13.9
2	14.55	13.33	–8.4
3	18.49	17.91	–3.1
4	23.56	23.53	–0.1
5	31.51	38.44	8.3

Note: Self-employed, and income units with zero and negative incomes are excluded.

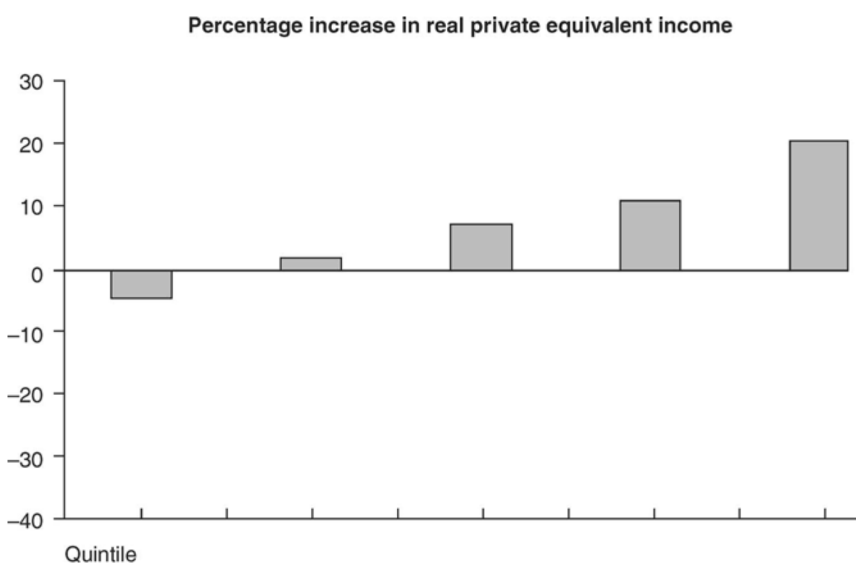

Figure 7.3 Percentage increase – couples with children

Table 7.4 shows changes in the pattern of income distribution for couples under 65 without children. It is quite atypical. At 10.2 per cent, the increase in the Gini coefficient was relatively small. This was in part because there was only a small decline in the share of the bottom quintile and the average real income of the bottom quintile actually increased (see Figure 7.4). There was virtually no change in the average real income of the second quintile, but, not surprisingly, higher quintiles showed increases in their average real incomes.

Table 7.4 Couples under 65 without children: distribution of equivalent private income 1981–82 and 1989–90

	1981–82	1989–90	Percentage change
Mean in 89–90 dollars	23,031	25,228	9.5
Gini coefficient	0.314	0.346	10.2
Percentage quintile share			
1	4.64	4.56	–1.7
2	14.19	12.97	–8.6
3	19.67	18.67	–8.6
4	25.36	24.57	–3.1
5	36.15	39.23	8.5

Note: Self-employed, and income units with zero and negative incomes are excluded.

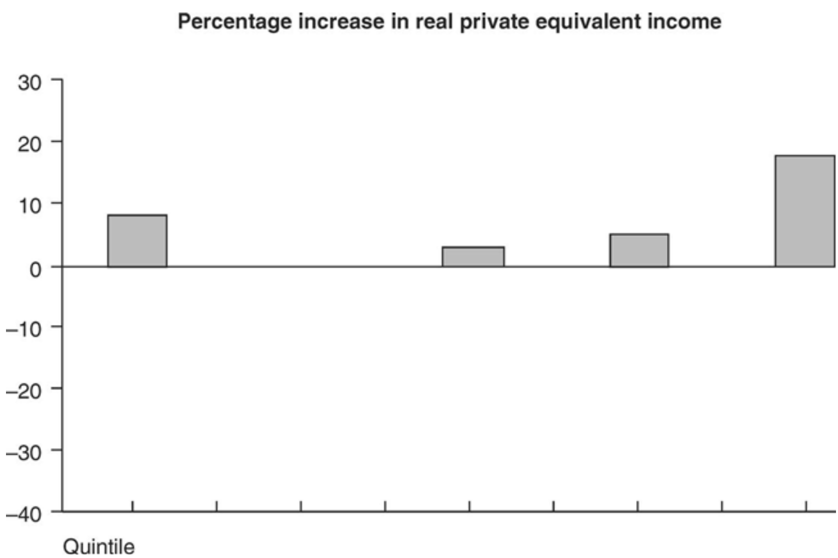

Figure 7.4 Percentage increase – couples under 65 without children

It is not hard to find an explanation of this atypical pattern. The category, couples under 65 without dependant children largely consists of two disparate groups: couples who have not yet had children and those whose children have grown up and are no longer dependants. The first group are generally much younger. While the young couples tend to have lower incomes they are also of the age in which married women's participation in the labour force has increased the most. Older couples generally have higher incomes. While there are, of course, a relatively small number of couples who have never had children and where both spouses have worked since marriage, older couples generally are of an age where married women's participation in the labour force is lower. Thus, it is not surprising that while overall average real income has increased less for couples without children than it has in the case of couples with children, it has increased more at the bottom end.

Tables 7.1 to 7.4 and Figures 7.1 to 7.4 show a clear pattern of increasing inequality in equivalent private income. The share of income rose in the top quintile and fell in every other quintile both in the case of all categories of income units considered together and also in each of the particular categories looked at separately. Moreover, except in the case of couples under 65 without dependent children, the average real income of the bottom quintile fell in the 1980s.

Having said that, one should immediately make clear what is implied by the statement that average real private income declined in the bottom quintile. The fact that average real income was lower in 1989–90 than in 1981–82 does not mean that the income units which were in the bottom quintile in 1981–82 will have a lower real income in 1989–90 than they did in 1981–82, even on average. For example, consider the category, couples with dependent children. Some of these who were at the bottom of the income distribution in 1981–82 will have risen to the middle or even the top by 1989–90. Moreover, some will have divorced and left the category altogether and others will no longer have dependent children and will have left the category for that reason. Nevertheless, although Australian society is fluid it is not all that fluid, and it is a reasonable generalization that most couples with children who were rich in 1981–82 were even richer in 1989–90 and that most of the others did not do so well. Moreover, in the context of private income, we can say with certainty that couples with children who were at the bottom of the distribution in 1989–90 were worse off than couples with children at the bottom of the distribution in 1981–82.

7.4 The Cause of Increased Inequality

Increasing income inequality occurred in the 1980s in a number of other countries around the world besides Australia. There are two main explanations of this increasing inequality in the literature. One is that it is the result of deregulation and the other that it is one of the effects of the type of technological change occurring in that decade. Both of these explanations are probably part of the story and the relative importance of each probably varies from country to country. However, at least in the case of Australia, the evidence is that deregulation is much more important in explaining what happened to income distribution in the 1980s. (The material which follows is a summary of the section entitled "Economic rationalism and income distribution" in Nevile (1994).)

Two different approaches have been used to examine the effects of deregulation on income inequality. The first is to focus on labour markets, since the very point of deregulating labour markets is to increase wage inequalities.

Saunders (1993) is a good example of a study in this genre. Saunders considers the increase in wage inequality in five countries which had data in both the first and the second sets of Luxemburg Income Study data. While wage income inequality increased in all countries the increase was very much greater in the two countries with deregulated labour markets (the USA and Canada) than in the countries with regulated labour markets (Australia, West Germany and Sweden). The Gini coefficients in Canada and the USA increased by around 15 per cent as compared to about 2 per cent for Australia and about 5 per cent for West Germany and Sweden.

Saunders also examined work done by the OECD relating real wage rigidity, due to labour market regulation, to wage differentials or inequality in earnings. There was a noticeable correlation between the two variables (the correlation coefficient was about 0.85). Largely deregulated markets with substantial wage flexibility showed much greater wage differentials.

Saunders(1993) concluded that the responsibility for the increase in inequality is:

> in the hands of those whose deregulatory zeal have strengthened the role of market forces in the Australian and other economies throughout the world (p. 36).

Some economic rationalists would argue that the Saunders' evidence does not go far enough, and that the increased inequality in wage earnings accompanying deregulation of the labour market will lead to reduced unemployment, so that overall inequality decreases as those on the bottom increase their incomes as they become employed. Unfortunately, the facts do not bear this out. The USA now has one of the most deregulated labour markets in the world. While unemployment in the USA has not increased as much since 1973 as it did in many countries, overall income inequality did, so that there is now a new class of poor in America, the working poor. Income inequality increased substantially in the USA over the years of the Reagan presidency.

The second way of analysing the effects of deregulation on income distribution is to do a more general comparative international study of changes in income inequality. This was done by Fritzell (1993), who undertook a cross country study of the increases in inequality in the first half of the 1980s. In the countries where deregulation was prominent, the UK and the USA, there were large increases in inequality, much larger than the increases in countries where deregulation was not emphasized, Sweden and West Germany. (It is true that in Sweden there was a large increase in the Gini coefficient in percentage terms but it was from a very small base and, at the end of Fritzell's period, inequality was still much lower in Sweden than in any other country included in his study.)

Since we are particularly interested in what deregulatory policies have done to the standard of living of those at the bottom end of the income scale, another way of studying the question is to compare the numbers living in poverty in a country such as the USA with those in countries such as Germany or Sweden which do not have the same commitment to market liberalism. Smeeding *et al*. (1988) show that although countries like West Germany, Norway and Sweden have lower average levels of income than does the USA, even the poorest of them has a significantly lower proportion of their population living in poverty than does the USA, even when the US poverty line is used to define poverty. Their data are for the early 1980s, and are rather dubious in that different countries may have been at different stages of the business cycle when their data was collected. Nevertheless, the differences are great. Sweden, for example, had less than 6 per cent of its population living below the official US absolute poverty line compared to 13 per cent in the USA.

The study by Fritzell (1993) also looks at the effect of economically rationalist policies on the less well off. Fritzell looks at what happened to a family 20 per cent from the bottom of the income distribution in a number of countries over the first half of the 1980s. These countries include both the USA and the UK, the two countries noted for the adoption of deregulatory policies and increasing income inequality in the 1980s. In both cases the income of a family 20 per cent from the bottom decreased in real terms. In the case of the UK the size of the decrease in real income was truly startling. It was 17 per cent, and this was for disposable income not private income. Fritzell also showed that the major reason for the increase in inequality, and the decline in incomes of those at the bottom end in the USA and the UK was the increased inequality of private incomes and not changes in taxation and social security benefits.

Other studies could be cited. In particular the influential Rowntree Foundation in England recently released a report which showed that inequality has increased more in England than in any other OECD country. New Zealand was second on this league table and Australia fourth (*The Age*, 13 February 1995). All these countries are noted for their zeal for deregulation in the 1980s.

Of course, studies pointing to the effects of deregulation in increasing income inequality do not show that technological change is not also important. However, even if technological change is an important contributing factor, cross country studies suggest that the increase in inequality is much greater in countries where deregulation has been emphasized.

Now let us turn to the effect of technological change on income distribution. The argument that technological change, of the sort experienced in the last decade or two, will increase income inequality in developed countries has been put most forcibly by Reich (1991) in his book *The Work of Nations*. Reich's argument revolves around what has been called globalization. This is a term coined to describe the much greater interdependence, even integration, of national economies, which is largely due to the computer revolution in the transmission of information. It is most obvious in financial markets. Vast sums of money cross national boundaries each day.

Transactions are made by computer, institutions all around the world are linked by computers and professionals can deal as easily in a country on the other side of the world as in their own city. The consequences of this virtual integration of financial markets around the world are seen every day in our newspapers, e.g. when Australian share prices fall the day interest rates rise in New York.

However, the integration of financial markets around the world is probably not the most important manifestation of globalization. Globalization also affects many relatively low-skilled white collar jobs, with a tendency to shift them to developing countries. To give two examples from Reich's (1991) book, American Airlines employs over 1,000 data processors in Barbados and the Dominican Republic to enter data into a computer bank in Dallas, Texas. The same tendency to locate jobs in the cheapest wage countries where the necessary skills are available can be seen at a somewhat higher skill level, e.g. New York Life Insurance Co. has its claims processed in Ireland (p. 211).

With the increase in ease of communication and a decline in transport costs, many blue-collar jobs are also shifting from high to lower wage countries. Not only are straightforward manufactured products like clothes and textiles increasingly produced in low wage countries, but parts of more complex manufactured products are produced in whatever country a multinational corporation finds most advantageous.

Reich argues that those in developed countries, who have no skills or only the skills to do repetitive jobs, will suffer declining real incomes as they compete with workers from low wage countries. On the other hand, the highly educated, who have the ability to undertake what Reich calls symbolic analysis, will have increasing real incomes as their services are sought by firms all around the world. Symbolic analysis involves identifying and solving problems and managing ideas. Reich lists, for example, the occupations of research scientists, engineers, management consultants, and indeed a whole host of various types of consultants, writers, editors and journalists and even (his word) university professors among those occupations pursued by symbolic analysts.

Thus, there is a simple test of Reich's theory. If his view of what is happening is correct it will be the well educated whose salaries increased over the 1980s. In other words after allowing for changes in the general wage level, and for such things as work experience and sex, the extra earnings received by the highly educated will be greater at the end of the 1980s than at the beginning. There is evidence that this happened in the USA (Blackburn and Bloom, 1994).

However, there is no evidence that the return to education increased in Australia over the 1980s. A comparison of the earnings equations for 1981–82 estimated by Tran-Nam and Nevile (1988) with those for 1989–90 made by Langford (1993) suggest that the return to education at best remained constant in Australia over the 1980s. Blackburn and Bloom (1994) also find that little of the increase in inequality in income in Australia is the result of the return to education. They are looking at family income, and after commenting that the widening of education earnings differentials explains a significant proportion, but by no means all of the increase in inequality in the USA, they state:

> Changes in education-related earnings differentials were much smaller in Canada and Australia during the 1980s, and so can explain almost none of those countries' increases in husbands' earnings inequality (p. 24).

Similarly, the annual survey of the Graduate Careers Council of Australia for 1994 showed that graduate starting salaries were at their lowest level relative to average weekly earnings since 1977. (*Sydney Morning Herald*, 5 October 1994) Reich's thesis about the cause of increasing inequality is not supported by the evidence in Australia.

Technological change and the resulting globalization of national economies may well have been important in affecting the pattern of income distribution in the USA. However, it does not seem to have had much impact in Australia. While it may do so in the future, deregulation appears to have been much more important in increasing income inequality in the 1980s.

7.5 Unmeasured Increases in Inequality

There are at least two ways in which deregulation increases inequality which were not evident in the section on changes in income distribution. Both of these increase inequality and reduce the welfare of those at the bottom end of the income distribution. One is a change from the easy acceptance of cross subsidies to a user-pays regime. The most prominent current example of this in Australia is the imposition by banks of fees on accounts which do not maintain a minimum balance. In this case financial deregulation ended a system of cross subsidies, which among other things helped those on very low incomes. It also, of course, helped many other people who found a savings account a very convenient storage place for money held short-term for transactions purposes. But there is a difference between these people and the pensioners whose plight has been so graphically described in the media. Those receiving government benefits do not have a choice about maintaining the account and paying fees on it. This is because the Department of Social Security will normally only pay government benefits and pensions into a bank account. Deregulation, and the end of cross subsidies, has, in effect, meant a new tax has been imposed on the very poorest in our society.

This is of course only one example of deregulation ending cross subsidies which help those on low incomes. It is easy to think of others, e.g. the change in pricing policies of water boards as they are corporatized. One Australian example which may have far reaching consequences is the effects of deregulation on banks' dealings with farmers, which obviously has a big impact on the psychological wellbeing as well as the standard of living of a significant group of low income Australians. Enough is not known of the facts to discuss this matter in detail but there is a widespread view in the rural community that the banks can and should do much better. If they do not change their policy, we shall probably see considerable pressure for the re-establishment of publicly owned rural banks.

However, while one should not detract from the importance of the implementation of the "user pays" principle on the welfare of the least well off, it is less important than the priority given to the goal of low inflation over the goal of low unemployment that is part of the philosophy of market liberalism and which has accompanied deregulation. As it happens, 1989–90 was a very strong boom year and unemployment was at the same level that year as it was in 1981–82. However, unemployment was much higher over the two cycles from 1982–83 to 1989–90 than it was over the cycles from 1974–75 to 1981–82.

Deregulation is implicated in many ways in this. In the short run microeconomic reform has increased unemployment and this has also proved to be true in the longer run; financial deregulation has reinforced pressures to give priority to low inflation except for brief periods when unemployment is unusually high, and progressive deregulation of the labour market makes necessary increasing reliance on unemployment to control inflation.

Market liberalism downplays the existence of market failure and tends to be less concerned about involuntary unemployment, which is traditionally associated with market failure, than with inflation which, if one wishes, can be blamed on government failure. One school of economists, the new classical school, even argued that involuntary unemployment does not exist and that it is possible through tight monetary policy to reduce inflation without affecting the level of unemployment; though to be fair I can think only of one economist responsible for giving advice to those determining economic policy who ever believed in the new classical school of economics.

In any case, the conventional wisdom now is that it is impossible to avoid a short-run trade-off between unemployment and inflation when monetary policy is used as the principal anti-inflationary instrument, though there are ways of minimizing the trade-off. In summing up the discussion at the conference reported in Blundell-Wignall (1992), Max Corden stated that "Consensus did exist on three crucial matters...[of which the first was] you can not disinflate without some cost" (p. 341). The argument now is whether there is also a long-run trade-off. There is increasing evidence for hysteresis, that is for the proposition that not only is unemployment determined in part by the level of unemployment last year, but also the equilibrium level of unemployment is path-determined. Hence, more and more economists are coming to the view that there is a long-run trade-off between inflation and unemployment when relying on monetary policy alone to control inflation. It is no longer possible to take the easy way out and maintain that tight monetary policy to reduce inflation will not also increase unemployment.

Economists employed in the financial sector and financial journalists do not necessarily argue that reducing inflation is costless. Sometimes they argue that interest rates should rise to reduce the rate of growth of employment because falling unemployment is producing unacceptable inflationary consequences. More often they omit consideration of unemployment. Consider the following quotation from Walsh (1994):

> given that monetary policy is an anti-inflationary tool and fiscal policy is useful as a medium term determinant of national savings...the most important question...is...how do we address periodic balance of payment crisis.

Walsh, being a humane, intelligent, if sometimes pessimistic, observer of the economy, probably meant how do we address balance of payments crises without causing unacceptable increases in unemployment, but many financial markets may not realize that. Apart from that point, it is significant that the quotation gives a simple anti-inflationary role to monetary policy and does not assign to any policy instrument the task of reducing unemployment. Indeed, some financial journalists and some spokespersons for the private business sector believe that this is not a proper concern of microeconomic reform, which in this context is largely a euphemism for cutting wages for the less skilled.

It may be that institutions in the financial sector always placed much more weight on controlling inflation than on reducing unemployment. The point is that financial market institutions now have much more power to impose their views on the government. Financial deregulation has both hastened and heightened the decline in power and influence of governments, and of authorities like the IMF, in global financial markets. Governments have lost control over the exchange rate for their currency – probably the most important single price in the economy.

The Economist (14 January 1995, pp. 48-9) speaks of a government being punished by financial markets and similar language is used by Australian financial journalists. The language may be extravagant but the underlying point is correct. The exchange rate has such a widespread influence on the economy that governments must be constantly looking over their shoulders with concern about the effects of policy actions on financial markets.

The corollary to this is obvious. The priority given by financial institutions to anti-inflationary policy now has a real influence on government actions and is a factor in the persistence of unacceptably high levels of unemployment in Australia. There is overwhelming evidence that high levels of unemployment do much more to reduce the living standards of the less well off in Australia than moderate inflation. Nevile and Warren (1984), and others, have shown that moderate inflation has little effect, in aggregate at least, on income distribution. Saunders (1992) documents the obvious point that a rise in unemployment significantly increases income inequality.

There is no doubt that deregulation has increased unemployment in Australia. Structural unemployment caused by microeconomic reform, especially the removal of tariffs and the corporatization of government business enterprises, has not been effectively tackled for fear of inflation. The green paper *Restoring Full Employment* suggested that an average of 4.5 to 5 per cent growth is necessary if unemployment is to be reduced to 5 per cent by the year 2000. The 1995 annual report of the Reserve Bank states that "attempts to sustain growth rates noticeably above 4 per cent carry significant risks [of greater inflation]" (p. 13).

Moreover, the situation may well become worse in the future. The move to enterprise bargaining and the consequent removal of centralized constraints increase the non-accelerating-inflation-rate of unemployment. In the 1980s centralized wage fixing under the Accord enabled a marked decline in both unemployment and inflation and laid the basis for the very low levels of inflation in the early 1990s. This restraint on inflationary wage pressure will become much less potent if the labour market is further deregulated and enterprise bargaining further developed. It is to be replaced, if deregulators have their way, by the fear of unemployment.

7.6 Policy Implications

This paper is more concerned with setting out what has occurred than with laying down what should be done to change unwelcome effects of deregulation on the welfare of the less well off. Nevertheless, instead of concluding with a summary of what has already been said, a very brief indication of policy implications will be given.

While one would wish that deregulation, especially financial deregulation and corporatization of government business enterprises, had not occurred so rapidly in Australia, much of it was inevitable and some of the rest desirable. By and large, rather than reverse it, it is better to do much more to offset the unfortunate consequences of deregulation on the less well off in our society. This will require increased government expenditure and hence an increased level of taxation. Advocates of deregulation tend to argue, if pressed, that any adverse distributional effects of deregulation should be addressed through the taxation-social security system. But then they argue that taxation should preferably be reduced and never increased. For example, in its 1995 budget submission the Business Council argued that there should be no tax initiatives, but cuts to government outlays of A$5 billion (*Business Council Bulletin,* July 1995, p. 4).

However, expenditure cuts are precisely the method of tightening fiscal policy which will have the greatest impact on employment. More importantly, if, without increasing the budget deficit, anything significant is to be done to help the unemployed and others whose living standards have been adversely affected by deregulation, it will be necessary to increase taxation. Moreover, the sort of skill-augmenting measures required to reduce unemployment without increasing inflationary pressures require substantial public expenditure which must be financed through taxation.

Deregulation has had regressive effects on living standards in Australia. This is not to say that the clock should be wound back to the regulated environment of the early 1970s, but the regressive effects of deregulation should be mitigated through government action. This will require increased taxation.

Labour market deregulation has not proceeded anywhere near as far as many would wish in Australia. Yet it may have already proceeded far enough to undermine a viable incomes policy. Without such a policy unemployment will be higher, inflation will be greater, or both. Any increased deregulation of the labour market in Australia should be approached very cautiously.

Note

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8

Economic Rationalism, Income Distribution and Productivity

On throwing out the bathwater, but saving the baby

J. W. Nevile

Giblin was not just a good economist, he was a great economist. It would be presumptuous to state definitively what part of modern economic policy discussion he would regard as bathwater, but we can be sure that he would be extremely concerned to separate the baby from the bathwater, lest the bathwater stop the valid insights of economics being used in formulating policy to improve the welfare of ordinary Australians. While I never met Giblin, I was taught at the University of Western Australia by a person who had been his colleague in Melbourne University and by another who had known him in Tasmania. I learnt enough about him second hand to be filled with admiration for him, as a person as well as an economist. He was a truly remarkable man, with a deep concern for his fellow men and women.

Although Giblin was one of Australia's greatest economists with a profound influence on economic policy in this country, he did not turn to economics until he was fifty. His first publication in economics was at the age of 52 and his first appointment as an economist—to the Ritchie Chair in Melbourne University was when he was 56. Giblin's tertiary education was at Kings College Cambridge where he took out a degree in mathematics. After graduating he was a gold prospector in the Klondike, an able bodied seaman, an orchardist in Tasmania and a Labor member of the Tasmanian Parliament. During the First World War he served as a major in the AIF in France. He loved adventure and he loved people. In France his troops called him Dad behind his back. The only exception was his batman who called him Dad to his face.

After the war he was appointed Government Statistician in Tasmania. He developed an interest in economics and rapidly became known for his original contributions. His interest sprang not only from the intellectual

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fascination of the subject, but also from a genuine concern for ordinary men and women, whose welfare in the 1920s and even more in the 1930s was profoundly affected by economic policy. Although he made several important theoretical contributions to economics his concern was always with practical matters—with economic policy. His career as an economist was well summed up by Sir Ronald Wilson:

> A fabulous old man, who almost single-handed founded an Australian school of political economy, and who did more than most to discover, train and encourage its acolytes and prophets.

In Giblin's time economists had a high reputation in Australia, perhaps higher than anywhere else in the world. Today things are rather different. Economists have been having a bad press lately, and the term dismal science has taken on a new meaning. The term dismal science was coined by the arch conservative Carlyle, in reaction to the claim that economics showed that slavery in the American south was not viable in the long run. Today, it is thought of as a term that fittingly describes the studies of people who think that gaining material wealth has priority over any other social values, and economists are looked down on as people who want to cut costs at the expense of employment, make old age pensioners pay by the second for local telephone calls, allow pollution if discouraging it also discourages mineral production and so on. In short economists are widely seen as soulless people, lackeys of big business, as much perhaps to be pitied as scorned. Just how bad things have become was brought home to me when at a party, I fell into conversation with a vivacious women who asked me what I did for a living. When I replied that I was an economist she exclaimed 'Oh! You poor thing'.

Now this popular view of economics is a caricature, though it does have a few grains of truth. The public have identified economic rationalism as the whole of economics and have a somewhat distorted view of what economic rationalism is.

This is partly because they take at face value the distorted view of economics and economic rationalism propagated by some people in other disciplines. But it is partly the fault of economists themselves—we have not, as a profession in Australia, devoted much time to a dispassionate analysis of economic rationalism and of the extent to which its prescriptions are an inevitable consequence of standard orthodox economic analysis rather than the outcome of ideology or value judgements which may have been fed into the analysis. Moreover, prominent advocates of economic rationalism are not above claiming that their policy prescriptions follow inevitably from standard economic analysis and do not depend on any value judgements except the judgement that more is better than less. This is not the case, but in the light of such statements the public can be pardoned for confusing the policy prescriptions of economic rationalism with economics as a whole. This is a pity, to say the least. The inevitable backlash against economic rationalism may well sweep away economic rationalist policies that are desirable as well as those that are more dubious.

This chapter is offered as an introduction to discussion about what is economic rationalism, what part do value judgements play in determining the policy prescriptions of economic rationalists, what are the weaknesses of economic rationalism and what are the strengths of this school of thought?

8.1 Economic Rationalism and Income Distribution

What then are the areas or issues in which the application of the policy conclusions of economic rationalism is likely to be helpful and when is the application itself likely to lead to problems? The analysis so far suggests that economic rationalism will lead us astray when questions of income distribution are important or when market failure is likely but not inevitable.

The theory behind economic rationalism concentrates on production and exchange so income distribution is the obvious candidate as an area where economic rationalism will cause problems.

Friedman is quite forthright about income distribution.

> The ethical principle that would directly justify the distribution of income in a free market society is, 'To each according to what he and the instruments he owns produces' (1962: 162).

However, the source of this quotation makes clear that the arguments supporting it are based on value judgements, not economics. Moreover, one cannot ascribe this rather draconian guiding principle to Friedman's followers in Australia. As I said most economic rationalists in Australia say little about income distribution.

Nevertheless, there are a priori reasons for believing that unless their effects are compensated for by other policies, economic rationalist policies will increase income inequality, at least in anything but the very long run in which we are all dead. For example, the Treasurer, Ralph Willis, has stated in public that microeconomic reform will increase unemployment in the short run, and the very point of the labour market policies espoused by economic rationalists is to increase wage inequalities.

In the next chapter of this volume I argue that economic rationalist policies had increased income inequality in Australia. That was written for a conference in 1989 so that the last data available was for 1985–86. Nevertheless, the data showed that, while the pattern of income distribution had been relatively stable up until the mid-nineteen seventies, some time after Malcolm Fraser came to power there was a notable increase in income inequality so that even by 1982 income was more unequally distributed than in 1978 (two years in which the unemployment rate was virtually the same). This increase in inequality continued to 1985–86.

Of course, an increase in income inequality over the period in which economic rationalist policies were introduced does not prove that the second caused the first. What I did show was that inequality in market incomes, or incomes before taxation and social security benefits, increased by an extraordinary amount following the introduction of economic rationalist policies. For example, the share of the bottom 20 per cent of households fell from around 4 per cent in 1975–76 to less than 1 per cent in 1984, and this was the case after correcting for changes in the size of households. The pattern of income distribution usually changes very slowly so that this is an extremely abrupt and dramatic change. It must have been caused by some major change such as a switch to economic rationalist policies. Secondly, the paper showed that other explanations, popular in some circles at the time, were not the cause of this increase in inequality. It could not be explained by social and demographic changes, particularly the increase in sole parent families. It was not due to increased unemployment. Nor was it due, as some argued at the time, to the fact that the labour market had been largely insulated from the policies of economic rationalism. The conclusion was the modest one.

> One can not reject the hypothesis that the pursuit of policies which emphasis economic efficiency and place great faith in the free market has increased income inequality in Australia (Nevile, 1991: 107).

I guess the spirit of the paper was if you can think of a better explanation for the increase in inequality let's hear it, but in the meantime I'll tentatively conclude that economic rationalism has increased income inequality in Australia.

The paper examined data up to 1985–86. Income inequality continued to increase, though at a slower rate up until 1989–90, the last year for which we have data. This was particularly true for market income. After income tax and social security benefits are taken into account inequality in some groups, e.g. sole parents, declined between 1985–86 and 1989–90. Nevertheless, overall inequality increased in Australia between 1985–86 and the end of the decade, both in terms of market income and in terms of disposable income. I see no reason to change my previous tentative conclusion that economic rationalism is the cause of this increase in inequality.

In a recent paper Peter Saunders (1993) has also examined this question. After documenting that income unequality increased in Australia throughout the nineteen eighties, as economic rationalist policies were introduced, Saunders marshalls evidence suggesting a causal relationship. He shows that market income was much more unequal in Australia at the end of the 1980s, when the economy was less regulated than at any previous time since federation and than it was when the economy was extremely regulated during the Second World War. As well as examining the Australian experience, Saunders looks at international evidence, mainly relating to wage inequality. He considered the increase in wage inequality in five countries which had data in both the first and the second sets of Luxemburg Income Study data. While wage income inequality increased in all countries the increase was very much bigger in the two countries with deregulated labour markets (the USA and Canada) than in the countries with regulated labour markets (Australia, West Germany and Sweden). The Gini coefficients in Canada and the United states increased by around 15 per cent as compared to about 2 per cent for Australia and about 5 per cent for West Germany and Sweden.

Saunders also examined work done by the OECD relating real wage rigidity, due to labour market regulation, to wage differentials or inequality in earnings. There was a noticeable correlation between the two variables (the correlation coefficient was about .85). Largely deregulated markets with substantial wage flexibility showed much greater wage differentials.

Peter Saunders summed up this evidence as follows:

> the three pieces of evidence presented so far present a case for the view that deregulation *will* lead to an increase in inequality of earnings and, unless government programs offset this, of income also (1993:8).

Some economic rationalists would argue that the Saunders' evidence does not go far enough, and that the increased inequality in wage earnings accompanying deregulation of the labour market will lead to reduced unemployment, so that overall inequality decreases as those on the bottom increase their incomes as they become employed. Unfortunately, the facts do not bear this out. The United States now has one of the most deregulated labour markets in the world. While unemployment in the US has not increased as much since 1973 as it did in many countries, overall income inequality did so that there is now a new class of poor in America, the working poor. Income inequality increased substantially in the United States over the years of the Reagan presidency.

A third study, that of Johan Fritzell (1993), also suggests that economic rationalist policies increase income inequality. Fritzell undertook a cross country study of the increases in inequality in the first half of the 1980s. In the countries with economic rationalist policies, the United Kingdom and the United States, there were large increases in inequality, much larger than the increases in countries far from the economic rationalist end of the spectrum, Sweden and West Germany. (It is true that in Sweden there was a large increase in the Gini coefficient in percentage terms but it was from a very small base and at the end of Fritzell's period inequality was still much lower in Sweden than in any other country included in his study.)

Saunders concluded that the responsibility for the increase in inequality is:

> in the hands of those whose deregulatory zeal have strengthened the role of market forces in the Australian and other economies throughout the world (1993: 8).

I judge that this conclusion is reasonably accurate. It is clear that the major reason for the increase in inequality is changes in market income, and that the biggest increases in inequality are in countries—notably the United Kingdom but also the US which pursued economic rationalist policies in the 1980s. Apart from economic rationalist policies, the only plausible explanation for the sudden increase in inequality is changes in technology, but even if this is a contributing factor, cross country studies suggests that the increase in inequality is much greater if economic rationalist policies are dominant.

Many economic rationalists agree that their policies will lead to increased inequality in income distribution, but maintain that even if the policies that they advocate increase inequality they will also increase productivity so much that everyone, even the least well off, will have their economic welfare increased in absolute terms, however much their relative position declines. Businessmen seem particularly fond of this argument, stating that we need more pie-growers and less pie-cutters to quote from a sentence that was repeated a lot at a conference I attended recently. How much empirical evidence is there to support, or otherwise, this hypothesis?

There are various types of evidence that are relevant. The first is to look at what has happened to the least well off in countries that are noted for their adoption of economic rationalist policies. The United States is the example, par excellence, of a country which was always at the economic rationalist end of the spectrum and which pursued deregulation with vigour in the late 70s and 80s. What did this do to productivity growth and was this enough to offset increasing income inequality as far as the least well off are concerned?

In the US, productivity growth was greater in the 1980s than in the 1970s, though it was less than it was in the 1960s. This was also true of a number of countries ranging from Norway and Sweden to New Zealand and Switzerland. The main thing that all these countries had in common, was a very poor productivity growth performance in the 1970s. Confining our attention to the US, the question is did the increase in productivity and economic growth improve in an absolute way the welfare of the least well off in that country?

The article most quoted in answer to this question is that of Danziger and Gottschalk in the 1986 *American Economic Review*. They look only at households headed by males aged 25 to 64, thus avoiding many of the major effects due to changing demography, though the effects of increasing female participation rates are included. They show that by 1979 increasing inequality in income distribution had more than offset the effects of increasing average incomes on the numbers in 'absolute' poverty, and that this trend continued over the next three years. Unfortunately the data they used was only up to 1982: before much of the more rapid growth in the United States in the 1980s. We know that inequality continued to increase in the US over the 1980s and that the average level of real wages did not increase in the US over the 1980s which suggests that their conclusion probably still holds.

Another way of looking at this question is to compare the numbers in absolute poverty (rather than relative poverty in each country) in the USA with those in countries such as Germany or Sweden which do not have the same commitment to market liberalism. Smeeding, Torrey and Rein (1988) show that although countries like Western Germany, Norway and Sweden have lower average levels of income than does the US, even the poorest of them has a significantly lower proportion of their population living in poverty than does the US, even when the US poverty line is used to define poverty. Again their data is for the early 1980s, and is a bit dubious in that different countries may have been at different stages of the business cycle when their data was collected. Nevertheless, the differences are great. Sweden for example, had less than six per cent of its population living below the official US absolute poverty line compared to 13 per cent in the US. This suggests that, while market liberalism may increase the size of the cake, it will not ensure that the least well off have increases in their welfare unless policies are put into place that are more effective than American ones in ensuring this. In particular, the phobia of big government will have to be overcome. All the countries with lower levels of absolute poverty than the US, tax much more heavily than does the United States and have more extensive social security measures than are in place in the US.

Perhaps the most telling evidence is given in Fritzell (1993) that the increase in inequality in the 1980s in countries with economic rationalist policies, did not increase productivity enough to prevent the incomes of the least well off from declining. He looks at what happened to a family 20 per cent from the bottom of the income distribution in a number of countries over the first half of the 1980s. These countries include both the USA and the United Kingdom: the two countries noted for the adoption of economic rationalist policies and increasing income inequality in the 1980s. In both cases the income of a family 20 per cent from the bottom decreased in real terms. In the case of the United Kingdom the size of the decrease in real income was truly startling. It was 17 per cent. Fritzell also showed that the major reason for the increase in inequality and the decline in incomes of those at the bottom end was the increased inequality of market incomes and not changes in taxation and social security benefits.

Finally on this point let us look at what happened in Australia. It is useful to look at both market income and disposable income to see what would have happened without any government redistribution, and what actually did happen. I've already mentioned that the share of market income of the bottom 20 per cent of households fell disastrously between 1975–76 and 1984. Their absolute amount of market income also fell greatly over this period, though their disposable income rose slightly. If it had not been for the social security system, the level of real income of those at the bottom would have fallen disastrously between the mid-seventies and the mid-eighties.

What about the 1980s themselves? Given the magnitude of trade cycle fluctuations in this decade, it is important to compare years at the same stage of the cycle. Luckily we have data for 1981–82 and 1988–89. Due to measurement problems with the income of the self-employed, I have excluded them from the analysis. The data is in terms of income units, not households. Half the bottom 20 per cent of income units were old age pensioners whose market income was very low and the rest were almost all other types of social security clients who also had little market income. It is more interesting to look at some particular types of income units where market income is important even at the lower end. Let us first look at the archetypical Australian family unit: a married couple with children. From 1981–82 to 1989–90 the real market income for the unit 20 per cent from the bottom of this type of income unit declined by one per cent. What about couples under 65 without children? The real market income of the unit 20 per cent from the bottom increased by 5 per cent. The contrast between this and the case of couples with children probably reflects the great increase in the prevalence of two income households among couples without children. If one looks at singles under 65 this bears out this supposition. Not only did the real market income of the person 20 per cent from the bottom decline substantially but that of those 30 per cent from the bottom declined a little.

So in Australia over the 1980s at the lower end of the income distribution, real market income increased for couples of working age without children, decreased slightly for couples with children and decreased substantially for singles under 65.

After tax and social security benefits are taken into account the picture changes. The real disposable income of couples under 65 at the bottom end of the income distribution, with or without children, changed very little over the decade. The figure actually declined slightly in both cases but the decline is less than any margin of error in measuring inflation without even considering sampling variation. The real disposable income of singles under 65 declined but only moderately.

All this suggests to me that in the case of Australia, before taxation and social security benefits are taken into account economic growth in the 1980s did not increase incomes at the lower end except in as much as it facilitated the spread of two income families.

To sum up this section, a very wide range of evidence which looks at experience in countries noted for economic rationalist policies, which makes cross country comparisons and which examines the Australian experience, suggests that the effect of economic rationalist policies in increasing inequality is not sufficiently offset by any productivity increasing effects to stop the incomes of the worst off declining.

8.2 The Bias Against Recognising Market Failure

Our earlier analysis suggested that another reason why the economic rationalist approach may lead one astray is its bias against recognising market failure. In Australia, one case in which I believe this is important is to be found in the push to deregulate the labour market. The essential point can be made briefly. Arguments for labour market deregulation are concerned to produce productivity growth and ignore macroeconomic consequences. If all wage bargains are made at the enterprise level with no reference to any central tribunal, there cannot be any overall wages policy. One may have guidelines that wages in each enterprise should not increase faster than productivity in that enterprise. However, the wage bargains will be determined by employees and the employer in each enterprise, and will reflect union and employer attitudes and relative bargaining strengths. Moreover, given the long history of comparative wage justice in Australia, large increases in some, perhaps highly productive, enterprises are likely to influence upwards wages in other enterprises unless restrained by high levels of unemployment. Also, there is the very real danger in an economy like Australia's, where oligopoly is so widespread, of employers believing that it will be more profitable to accede to union wage demands and pass them on in higher prices than to face disruptive strikes. Unless aggregate demand is depressed (restraining employers) and consequently unemployment is high (restraining unions), enterprise wage bargaining is unlikely to prevent wages rising faster than productivity once unemployment falls substantially.

Economic rationalists are usually very concerned to restrain inflation but argue that monetary policy should be the major instrument to achieve this. Tight monetary policy can, usually after a lag, restrain and indeed reduce inflation, as the events of 1991 demonstrated. However, it does this at the cost of increased unemployment. Incidentally, tight monetary policy also leads to a high value of the Australian dollar on foreign exchange markets, which worsens the current account deficit. However, the major point is that relying on monetary policy to restrain inflation without any assistance from incomes policy is likely to lead to greater unemployment than when incomes policy is used.

8.3 Economic Rationalism and Productivity Growth

That is a lot about the bathwater; what about the baby? The argument for economic rationalist policies is that they increase productivity. Have these policies actually increased productivity growth and economic growth in Australia or elsewhere? I think they have, but it is hard to get convincing evidence of this at a macro level. Institutional factors are obviously important in productivity growth but not apparently in any systematic way. If one regresses real GDP growth on the usual explanatory variables namely growth in labour input, the investment ratio and initial GDP relative to that in the US, it is hard to find stable systematic relationships between the residuals and economic rationalist policies—or much else. To quote one thorough and careful study:

> It should be noted, however, that I failed to find any significant correlations between the residuals for 1979–88 and a wide variety of supply-side variables including measures of tax and subsidy rates and expenditure on labour-market policies (Crafts, 1992).

It is easy to find particular examples at the micro level where economic rationalist policies have improved productivity growth, but at the macro level it is largely a matter of faith. Nevertheless, at least in the case of Australia, which is the country that I know the most about, I believe economic rationalism has contributed significantly and positively to raising our rate of economic growth.

In this country economic rationalists have one great achievement to their credit which has already contributed to economic growth, and which will continue to do so. Its effects have not yet fully been worked out so further benefits in terms of raising the growth rate can be expected in the future. I refer, of course, to the change in attitude, not only among economic policy makers but also in industry itself, the change in attitude towards protection. The frequently maligned Industry Commission deserves a lot of credit for this. Ten years ago it was just possible to see the beginnings of a change in attitude from inward looking industries constantly agitating for made-to-measure protection to an intellectual, if not emotional, acknowledgement that industry in Australia must become more export oriented. The change still has a long way to go. A very small proportion of Australian manufacturing firms are export oriented, at least once one gets to more elaborate transformations than tinning food or smelting metals. Most elaborate transformation manufacturing firms still only export what they cannot sell in Australia and don't make exporting an integral part of their company strategy. Some seem to want to replace made-to-measure tariffs with made-to-measure export subsidies. But very few are prepared to argue for a return to the tariff system of the 1950s or the 1960s. All pay lip service to the need to be internationally competitive and outward looking.

I believe that this is a great step forward. If Australia is ever going to escape from the boom and bust of the commodity cycle it must diversify its exports much more. Exporting must become central to the strategy of many more firms in parts of the economy other than the primary sector. We have a very long way to go, but the economic rationalists deserve great credit for turning the intellectual climate around from inward looking protectionism to outward looking economic policies.

8.4 To Sum Up

The conclusions of economic rationalism do not flow inevitably from some science of economics. They are based in part on judgements held by economists which in turn reflect the values held by those making the judgements. Economic theory is not a set of immutable scientific laws, but a tool kit of ways of thinking that are useful in solving economic problems. Different tools are appropriate in different circumstances. In each case it is a matter of judgement which tool to use. The art of economics lies in part in selecting the best tool. Sometimes it is very clear which is the best tool, but often it is not, and in these cases one's judgement in making the selection is influenced by the values one holds.

Economic rationalists sometimes get it right, but sometimes get it wrong. As I have just said, economic rationalists have made, and are still making, an important contribution in changing Australia from an inward looking country emphasising protection to an export oriented country. To be painfully honest what this sentence really means is that in this case I agree with the judgement of economic rationalists. In some other cases I believe that the great bias of economic rationalists against acknowledging market failure leads to flawed policy advice, which may be important in itself, but which is also important because it gives all policy pronouncements by economic rationalists, or even by economists, a bad name. Even more important is the very widespread tendency of economic rationalists to ignore, or at least downplay the distributional consequences of their policy recommendations. This, I think is a major cause of an increasing backlash against economic rationalism which may lead to the abandonment of good policies as well as bad. It is very important to take full account of the consequences of economic rationalist policies on income distribution, and either modify policies or compensate for adverse consequences. It is important to do this both for the sake of those at the bottom end of the income distribution who are adversely effected and also to ensure that the backlash against economic rationalism does not destroy progress in Australia towards a diversified open economy.

Note

This paper was first presented as the Giblin Memorial lecture at the 1993 ANZAAS Congress at Curtin University. The Section "What is economic rationalism" is omitted as it is a summary the material in Chapter 6 of this volume.

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9

Economic Rationalism: The Human Dimension

J. W. Nevile

The title given to this chapter is sufficiently general to encompass three things. First, it permits me briefly to discuss what is meant by the phrase economic rationalism. Second, I will consider one interpretation of the title—the human dimension in determining what is economically rational: why it is that economists differ, indeed often seem to quarrel violently, about what is the economically rational course of action, about what is the appropriate economic policy to maximise the welfare of a country's citizens. Then, finally, I will examine the effects on individuals when a government pursues policies espoused by those who glory in the label of economic rationalists. In particular, does the available evidence support the popular belief that policies pursued in Australia in the name of economic rationalism have benefited the rich and powerful and hurt the poor and economically weak, making income distribution more unequal?

9.1 Definitions of Economic Rationalism

The term economic rationalism has two meanings, or at least two shades of meaning or usages, that are quite different. Its straightforward meaning is a body of thought that leads to courses of action which maximise economic well-being. However, to some extent the term has been appropriated, hijacked one might almost say, by those who believe that, in virtually all circumstances, leaving things to be decided by the workings of the market will produce the best outcome. These people start with a great stress on economic efficiency, which can be loosely defined as minimising the inputs needed either to produce a given output or to produce something else which can be exchanged for that given output. Then they make a judgment that the market mechanism almost always produces the most efficient, in an

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Revised from *Commonality and Difference: Australia and the United States*, 93–107, 1991, 'Economic Rationalism: The Human Dimension', by Nevile, J. W. With kind permission from Allen and Unwin Australia. All rights reserved.

economic sense, answers to questions: what is to be produced and how will it be produced?

I believe that the market is a good servant but a bad master and find it unfortunate that the term economic rationalist is often used as a label for those who make specific empirical judgments that markets generally function so well that any intervention by the government can only make things worse. I might add that these empirical judgments are sometimes anything but rational. One famous economist has asserted that the majority of those unemployed in the United States in 1932 were unemployed by choice, because they did not want to work at the going wage rate. This startling statement is the result of a logically consistent argument, but deduction is not the whole of rational thinking. When it leads to conclusions such as the one just cited, a truly rational person questions the assumptions on which the argument is based. Both the capitalist economic system in general and the labour market in particular do not always function so efficiently that they cannot be improved by government action. It is no more rational for economists to ignore important examples of market failure than for physicists to ignore the fact that water does not contract consistently as the temperature falls from 100°C to 0°C.

Moreover, even apart from underestimating the extent of market failure in a capitalist society, economic rationalism, with this second specific meaning, is a truncated, narrow view of the world. In addition to the two questions what is to be produced and how will it be produced, economics is concerned with a third, very important and related question: who is to get the fruits of production? Economic rationalists in the narrow sense tend to put this to one side to be determined, through taxation and social welfare policy, quite separately from decisions about production. Although there are honourable exceptions, many economic rationalists then tend to forget about the question of how the cake should be divided, or perhaps consciously decide that this is a subject in which they have no expertise and is one best left to non-economists.

However, in the real world there are political limits on the extent to which income can be redistributed through taxation and cash benefits. What appear to be economically inefficient policies may be the only feasible way of achieving income distribution goals—a point well known to an earlier generation of Australian economists who argued for tariffs as a means of redistributing income from the rural export sector to the urban sector. In short, it is not always realistic to ignore the income-distribution consequences of policy decisions on the grounds that these can be taken care of through the taxation and social security systems.

Thus the term economic rationalism has both a broad literal meaning and a narrower meaning which focuses on production and exchange as against income distribution, emphasises economic efficiency and puts great faith in free markets. It is not always appropriate to use the term rational to validate the policies espoused by economic rationalists thus narrowly defined. Opposing policies may be at least equally rational, even from an economic point of view.

9.2 The Human Factor: Why Economists Disagree

As you can see from the tone of what I have just said, while I do value the market as a mechanism to determine what is to be produced and how it is to be produced, I do not entirely agree with those of my colleagues who are always stressing the virtues of a free market and eulogising 'the level playing field'. Moreover, it is not hard to find far more violent disagreements among economists than my belief that those who pin all their faith on the free market should be more open to the possibility of market failure.

Why is this? Should not practitioners of the so-called science of economics be able to agree on what their science has established and what remains to be determined, what advice they can offer to governments with the full backing of economic science, and when to say that in this area economists do not yet know the likely consequences of different courses of action? Real life is not like this. Economists often claim the full authority of their discipline and the weight of rational economic analysis when advocating opposing policies.

This could be because economists, being human, forget to point out that they, as individuals and not as economists, give different priorities to different policy goals and that this often leads to diametrically opposed policy advice. To overcome this problem, and to remind economists of their responsibility to make clear their own personal value judgments, conventional wisdom in economics makes a sharp distinction between positive economics, the study of what is, and normative economics, or the study of what ought to be or what is desirable. Positive economics is thought to be value-free, so any two intelligent people should be able to reach agreement on the correctness or otherwise of a proposition in positive economics through rational discussion and empirical observation. On the other hand, propositions in normative economics depend in part on value judgments on which men and women may continue to differ, however intelligent and knowledgeable they may be.

The distinction between positive and normative economics was originally emphasised, I think, because of the way Marxian economists mixed up ideological axioms, deductive reasoning and empirical observation in one statement. It is obviously easier to hold a discussion if one can unpack the three different elements in the argument. Of course, Marxian economists were, and are, not the only type of economists to present as 'scientific' propositions statements which depend on ideological assumptions. Economists of many schools tend to do the same thing. One of the greatest twentieth-century Australian economists, after his conversion to Roman Catholicism, was noted for his support of the proposition that, if properly managed, the world economy could support all those likely to be born so that there was no economic justification for birth control. He may or may not have been correct, but it is difficult not to think that his conclusion owed more to his religion than to economic science.

However, while it is true that economists often do slide from positive economics to normative economics without warning the listener what they are doing, this is not the major cause of controversy in economics. Economists are comfortable with the sort of advice that goes 'if you want A, then B is the best course of action', but disagreements often arise over whether B or C *is* the course of action most likely to produce A. That is, they arise in the area of positive economics, yet they cannot be resolved with goodwill and rational argument. This suggests that positive economics, the study of what is, involves value judgments which are at least as potent a cause of controversy as are the explicit value judgements of normative economics, or the study of what ought to be.

I argue that positive economics is not free of value judgments in two respects. The first is the relatively trivial one that the particular aspects of positive economics one studies (or indeed, whether one studies it at all) depend on one's values. The second is far more important. Positive economics is not just a matter of deductive reasoning. It also requires an appeal to empirical studies. But the facts an economist studies are not facts produced in carefully controlled conditions in a laboratory. They are facts thrown up by real-world situations, and some judgment is required in interpreting the facts. This judgment is heavily influenced by the values of the person making the judgment. To give a simple example, the case for reducing government regulation of, and intervention in, the economy rests on the empirical judgment that cases of market failure are uncommon, that is, that if left to itself it is unusual for the market not to produce an efficient outcome. Economists who place a high value on political and personal liberty are suspicious of government intervention and regulation, which they see as reducing personal liberty. It it perhaps not surprising that such economists generally make the professional judgment that market failure is rare. Given the values that they hold, the costs of unnecessary government intervention are high. From this viewpoint, it is responsible to be very cautious in claiming that market failure exists.

Other economists are more concerned about the costs of not intervening when to do so will be beneficial to the economy. If there is market failure, the people who suffer are usually the economically weak, who may experience very low levels of real income. This is particularly true of the labour market, where a major symptom of failure is involuntary unemployment. Economists who put a high value on economic security for all, on preventing anybody falling below a certain level of income, are far more likely to make the professional judgment that market failure is an important problem in an unregulated capitalist economy than are those with a libertarian philosophy.

Not only do economists disagree in public, they often do it with considerable passion. This stems, I think, from a virtue of economists as a group. A little while back I was rude about conservative economists, so it may restore the balance to make a point in their favour. Right-wing economists, just as much as left-wing economists and those in between, like myself, are concerned about the effects of economic policies on individuals. The human dimension is, to economists, the point of economic rationalism. At least until very recently, the majority of economists were reformers concerned to make the world a better place and to improve the welfare of as many individuals as possible. This is still true of the vast majority of outstanding or even well-known economists. In the last decade the number of economists employed by businesses, especially in the financial sector, has exploded, so that I suspect there are now many economists out there who are not at all that interested in changing the world, but who see themselves as using their skills to improve the profits of their companies, just as do accountants or engineers or personnel managers. But these people are all young and not yet great figures in the profession. The vast majority of great economists are motivated by a genuine concern to make the world a better place, to improve the welfare of humanity.

You may think that when a right-wing economist advocates cutting the income tax rates that apply to high incomes, he or she is motivated by self-interest. Anyone's motives may be mixed, but generally those economists who argue for lowering high marginal income tax rates and increasing taxes on consumption believe that this will improve the lot of most people and not just that of the well-off (which most economists are). Actually, there is a good simple test to see how pure such people are. If economists are strong on reducing high marginal income tax rates but soft on supporting a capital gains tax, suspect their motives. There is far more support in economics for capital gains taxation than for cutting income tax rates, but most capital gains tax is paid by the rich. In Australia the richest 2 per cent of income tax payers pay two-thirds of all capital gains tax.

However, this last point is somewhat of a digression. My point is that the economists you hear arguing about economic policy are mainly committed reformers. The flip side of reformist zeal is that ideological underpinnings are usually not far from the surface, and many economists are passionate about their ideologies.

9.3 Economic Rationalism and Income Distribution

I turn now to my other theme: the effects on the distribution of income among individuals of the policies espoused by those who glory in the title of economic rationalists. Since the mid 1970s there has been an increasing emphasis on the benefits of the free market in economic policy-making in Australia. This trend towards greater reliance on the market mechanism has accelerated since the election of the first Hawke government. There is a widespread perception that an emphasis on economic rationalism on the part of Hawke governments may have been good for the economy in general and certainly has been of benefit to the rich and economically powerful, but that this has been at the expense of ordinary people and especially of the less fortunate in our society, so that poverty has increased. Is this perception correct? Does an emphasis on economic rationalism lead to increasing inequality in the distribution of income?

In fact the governments led by Hawke have not had an across-the-board emphasis on economic rationalism in the narrow sense of that term. Policies relating to the labour market have been highly interventionist, but otherwise it is fair to characterise the economic policy since 1983 as strongly influenced by economic rationalism. Except in the area of labour markets, economic policy has been noted for its stress on the value of leaving markets to function with a minimum of government regulation and intervention. In financial markets, the government moved very fast and very far in the direction of deregulation; in the market for goods, it has moved much more cautiously. But, despite exceptions, there can be no doubt about the direction of movement, which is also towards deregulation and the goal of a level playing field. As noted above, in the labour market the trend has been in the other direction. The government has been highly interventionist, and has undoubtedly affected market outcomes, restraining wages growth.

Overall, the whole period in Australia since the fall of the Whitlam government in 1975 is certainly characterised by an increasing emphasis on economic efficiency and faith in free markets. In this section I will look at changes in the pattern of personal income distribution in Australia since 1975–76 and show that income distribution became progressively more unequal. This could have been due to several factors. Increased unemployment and social trends are often mentioned in this context. However, increased unemployment is not the major cause of greater inequality of income distribution. Similarly, social trends towards more single-parent families cannot, even along with increased unemployment, explain all that has happened.

Even apart from the effects of these two factors on income distribution, the dichotomy in policy philosophy noted above makes it unwise to be overly dogmatic in asserting that policies inspired by economic rationalism favour the rich at the expense of the poor. Those who support free markets could argue that any undesirable trend in the Australian economy, even one towards increasing inequality in income distribution, occurs because the labour market has not been deregulated. Some clues on the plausibility of such an argument can be obtained from international comparisons and such comparisons are made at the end of this section.

Over the last fifteen years there have been a number of household surveys in Australia which collected data on income distribution. That of 1975–76 has been extensively analysed by Kakwani[1] and that of 1984 has been analysed by Nevile, Podder, Tran-Nam and Warren.[2] These two dates also span a large part of the period of increasing emphasis on economic rationalism. Table 9.1 shows the before-tax income distribution by households in 1975–76 and 1984. A household, in simple terms, is a group of people living in the same dwelling and sharing household expenses.

The first comparison in Table 9.1 is for households without any adjustment for differing numbers of people in individual households. The Gini coefficient is used as a summary measure of income inequality. Like all single-number measures of income inequality, the Gini coefficient has limitations, but the rise from 0.35 to 0.38 in Table 9.1 does reflect an unambiguous rise in income inequality. The rise was mainly due to a significant rise in the share of the top 20 per cent of households and a substantial decline in the share of the second lowest quintile. It is important to note that there was little change in the extent of income distribution between 1968–69 and 1975–76, so that the change between 1975–76 and 1984 was not the continuation of an already-established trend.

It is possible, though very unlikely, that the change in the degree of inequality in income distribution is because of changes in the composition of households, e.g. a fall in the proportion of households containing a large number of individuals could produce this result without any change in the underlying per capita income distribution. This possibility is allowed for in the second and third comparisons in Table 9.1. The per capita measure is obtained by dividing household income by the number of people in the household without any distinction between babies, children and adults.

A more sophisticated method is to convert each household into a certain number of 'equivalent adults'. This idea goes back to Engel and can

Table 9.1 Distribution of before-tax income by households, Australia, 1975–76 and 1984

Quintile class	**Unscaled**		**Per capita**		**Equivalent**	
	1975–76	**1984**	**1975–76**	**1984**	**1975–76**	**1984**
Lowest	5.1	5.1	6.9	6.6	7.4	7.1
Second	12.2	10.5	12.1	11.3	12.6	11.5
Third	18.1	17.3	16.6	15.8	17.6	16.8
Fourth	24.7	25.0	23.2	23.1	23.9	23.8
Highest	39.8	42.2	41.2	43.2	38.5	40.9
Gini coefficient	0.35	0.38	0.34	0.36	0.31	0.34

Sources: For 1975–76, N. Kakwani: *Analysing Redistribution Policies: A Study Using Australian Data* Cambridge University Press, 1986; For 1984, J.W. Nevile, N. Podder, B. Tran-Nam and N.A. Warren 'Inflation, Anti-inflationary Policy and the Distribution of Income in Australia' Working Paper No. D1, Centre for Applied Economic Research, University of New South Wales, 1988.

be achieved by employing an equivalence scale that expresses all household types as multiples of the single-adult reference household. While all equivalence scales are to some extent arbitrary, we have used the following scale, developed by Kakwani, which at least seems intuitively reasonable:[3]

First adult in the household	1.00
Each subsequent adult	0.75
Each child aged 15 to 19 years	0.60
Each child aged 5 to 14 years	0.40
Each child under 5 years	0.20

The adult equivalent household income is then derived by dividing total household income by its adult equivalence number constructed from the above scale.

Both the per capita household distribution and the equivalent household distribution show, if anything, a greater increase in inequality than the simple household distribution. In both cases, the shares of the lowest two quintiles fall and the Gini coefficients rise by more than they do in the case of unscaled households.

To what extent has this increase in income inequality been modified by a progressive income tax? Table 9.2 shows the distribution of disposable income by households defined in the same three ways as in Table 9.1. In all three cases, the Gini coefficient increases between 1975–76 and 1984 by just as much as when before-tax income distribution was compared. Also, in all three cases the share of the top quintile, where one might have thought income tax rates would bite the most, is significantly greater in 1984 than in 1975–76.

Table 9.2 Distribution of disposable income by households, Australia, 1975–76 and 1984

Quintile class	**Unscaled**		**Per capita**		**Equivalent**	
	1975–76	**1984**	**1975–76**	**1984**	**1975–76**	**1984**
Lowest	5.6	5.7	7.5	7.1	8.0	7.8
Second	12.7	11.2	12.5	12.1	13.1	12.3
Third	18.3	17.4	16.8	16.1	17.9	17.0
Fourth	24.7	24.7	23.3	23.1	23.8	23.6
Highest	38.7	41.0	40.0	41.6	37.2	39.3
Gini coefficient	0.33	0.36	0.32	0.34	0.29	0.32

Sources: For 1975–76, N. Kakwani *Analysing Redistribution Policies: A Study Using Australian Data* Cambridge University Press, 1986; For 1984, J.W. Nevile, N. Podder, B. Tran-Nam and N.A. Warren, 'Inflation, Anti-inflationary Policy and the Distribution of Income in Australia' Working Paper No. D1, Centre for Applied Economic Research, University of New South Wales, 1988.

Table 9.3 Distribution of private income by households, Australia, 1975–76 and 1984

Quintile class	Unscaled		Per capita		Equivalent	
	1975–76	1984	1975–76	1984	1975–76	1984
Lowest	1.7	0.3	3.9	1.0	3.7	0.8
Second	11.6	7.8	11.4	9.5	12.3	10.0
Third	18.5	18.0	16.9	16.3	18.0	17.6
Fourth	26.0	27.3	23.9	24.8	25.0	25.8
Highest	42.2	46.8	43.8	48.3	41.1	45.8
Gini coefficient	0.40	0.48	0.39	0.47	0.37	0.45

Sources: For 1975–76, N. Kakwani *Analysing Redistribution Policies: A Study Using Australian Data* Cambridge University Press, 1986; For 1984, J.W. Nevile, N. Podder, B. Tran-Nam and N.A. Warren 'Inflation, Anti-inflationary Policy and the Distribution of Income in Australia' Working Paper No. D1, Centre for Applied Economic Research, University of New South Wales, 1988.

If taxation did not have a big effect on moderating the increases in income inequality, what about social benefits? Table 9.3 shows the distribution of private household income, where private income is defined as income before taxation and also before cash benefits received from the government. The increase in inequality in the distribution of private income is dramatic. For each of the three concepts of household income there was a substantial rise both in the Gini coefficient and in the share of income going to the top quintile. The fall in the share of income going to the bottom quintile is even more remarkable. When household income is not corrected for size of household, the bottom 20 per cent of household received only 0.3 per cent of income net of cash benefits in 1984. This statistic may be a little misleading, but the figures for per capita household income and equivalence household income are not. They both tell the same story. The share of private income of the bottom 20 per cent of households fell from around 4 per cent in 1975–76 to around 1 per cent in 1984. The social welfare system prevented a massive increase in poverty over this period.

It is also interesting to bring the analysis a little more up to date and to examine trends in the inequality of income distribution since Bob Hawke became prime minister. This can be done using the work of Saunders, Hobbes and Stott.[4] Unlike Kakwani and Nevile et al., Saunders and his co-workers use families as the unit of analysis rather than households. (The difference is that members of a family must be related to one another by blood or marriage.) Saunders et al. also introduce one additional sophistication. Instead of placing the lowest 20 per cent of families in the first quintile, they place in it 20 per cent of all the individuals who are in families with the lowest equivalent incomes. This is done to give each individual the same weight, rather than each family. Otherwise, less weight is given to individuals in large families. Saunders et al. use a different equivalence scale

Table 9.4 Family income distribution, Australia, 1981–82 and 1985–86

Quintile class	Before-tax unscaled		After-tax equivalent	
	1981–82	**1985–86**	**1981–82**	**1985–86**
Lowest	4.6	4.4	8.1	8.1
Second	10.0	9.4	11.4	11.2
Third	16.5	15.9	14.4	13.5
Fourth	25.2	24.7	23.0	22.9
Highest	43.7	45.6	43.1	44.3
Gini coefficient	0.40	0.42	0.31	0.32

Source: P. Saunders, G. Hobbes and H. Stott, Income Inequality in Australia and New Zealand: International Comparisons and Recent Trends, paper presented at the 21st Conference of the International Association for Research in Income and Wealth, Lahnstein, West Germany, August 1989.

to that used earlier in this chapter, but the differences are not great in practice and need not detain us. The relevant data are given in Table 9.4.

The distribution of before-tax unscaled family income and that of after-tax equivalent family income both became more unequal between 1981–82 and 1985–86. However, in the more important case, that of after-tax equivalent family income, the increase in inequality was very slight and occurred almost entirely because of a shift in income share from the middle quintile to the top quintile. This certainly bears out the popular perception that changes to the tax rates under Hawke have benefited the rich at the expense of middle-income ordinary Australians. Nevertheless, overall it appears as if the trend towards increasing income inequality slowed substantially after 1981–82.

This conclusion is reinforced by other evidence. For example, the Australian Bureau of Statistics publishes data on income distribution by income units. Multiple-person income units are either married couples plus dependent children (if any) or a single parent plus at least one dependent child. One-person income units are all other income recipients: for example, non-dependent children living with their parents are classed as one-person income units. The share of the (unscaled) income of the bottom 20 per cent of all income units fell noticeably between 1978–79 and 1981–82, but actually rose, even though very slightly, between 1981–82 and 1985–86.[5]

One reason often put forward for the increases in income inequality in Australia since the mid 1970s is increased unemployment. Perhaps surprisingly, this does not seem to be too important. The unemployment rate quadrupled without having much effect on the degree of income inequality, and then income inequality increased substantially in a period in which unemployment did not change much.

In 1968–69 the unemployment rate in Australia was 1.3 per cent. In 1973–74 it was 1.5 per cent, and in 1978–79 it was 6.3 per cent. Yet the

Table 9.5 Before-tax income distribution by income units, Australia, 1978–79 and 1981–82

Quintile class	**One person**		**Two or more person**	
	1978–79	**1981–82**	**1978–79**	**1981–82**
Lowest	6.2	5.9	6.5	6.0
Second	9.8	9.7	13.1	12.2
Third	16.4	16.6	18.4	18.1
Fourth	25.7	25.6	24.2	24.4
Highest	42.0	42.1	37.9	39.3
Gini coefficient	0.37	0.38	0.32	0.34

Source: Australian Bureau of Statistics *Income Distribution Australia*, 1978–79. Supplement to Social Indicators No. 3, 1982, Canberra: ABS, Cat. No. 4101.0; Australian Bureau of Statistics Social Indicators No. 4, 1984, Canberra: ABS, Cat. No. 4101.0.

share of the top quintile for before-tax unscaled family income declined significantly over the decade and the Gini coefficient was the same in each of the three years.

Perhaps even more convincing evidence can be obtained by comparing income distribution in 1978–79 and 1981–82—two years in which the unemployment rate was virtually the same. To do this, it is necessary again to use income units, which the Australian Bureau of Statistics has used to present income distribution data for these two years. The relevant figures are given in Table 9.5, and show a significant increase in the inequality of income distribution.

There was an increase in inequality of income distribution for single-person income units but is was not very large. However, there was a significant increase in inequality in the income distribution of multi-person income units, particularly considering that it took place over only three years. The Gini coefficient increased from 0.32 to 0.34, the share of the top quintile increased and the share of the bottom quintile fell by nearly 10 per cent. The increase in the Gini coefficient for multiple-person income units between 1978–79 and 1981–82 is the same as the increase in the coefficient for per capita household income over the period 1975–76 to 1984. That for single-person income units is less, but clearly some other factor in addition to increased unemployment was making income distribution more unequal.

A factor often blamed in popular right-wing writings for increased income inequality is a social trend leading to more single-parent families. However, this explanation is even less well supported by the evidence than the explanation which blames increases in unemployment. Single-parent families are too small a proportion of all income units (only 4 per cent) and

Table 9.6 Before-tax income distribution of married couples with dependent children, Australia, 1981–82 and 1985–86

Quintile class	**1981–82**	**1985–86**
Lowest	8.1	7.6
Second	14.2	13.9
Third	18.2	18.0
Fourth	23.1	22.7
Highest	36.5	37.8
Gini coefficient	0.28	0.30

Sources: Australian Bureau of Statistics *Social Indicators* No. 4, 1984, Cat. No. 4101.0; Australian Bureau of Statistics *1986 Income Distribution Survey, Australia, Preliminary Review* 1987, Cat. No. 6545.0.

that proportion is increasing too slowly (from 4.15 per cent in 1981–82 to 4.23 per cent in 1986) to explain much of the increase in inequality.[6] Other factors were far more important.

Probably a better way to make the same point is to look at changes in income distribution in the archetypical Australian social unit, the married couple with dependent children. Table 9.6 does this. There is an unambiguous increase in inequality, with a fall in every quintile except the highest.

At the beginning of this section, we noted that some might argue that the trend towards increasing inequality in income distribution would not have occurred if the labour market had been deregulated, so that any increase in poverty over the last decade is due not to the pursuit of 'economic rationalism' but to the fact that it has not been pursued in all markets. Implausible as this may sound, it is worth checking by making international comparisons of income distribution. It will be hard to give much credence to this claim if countries with deregulated labour markets have more poverty than countries with similar average levels of income per head but with interventionist labour markets.

For the purposes of such an exercise, comparisons should be made between countries as like as possible, apart from labour market institutions, and data from income distribution studies that were made within two or three years of each other should be used. I have used a sample of seven OECD countries for which the Luxembourg Income Distribution Study has consistent data from income distribution surveys all undertaken between 1979 and 1981–82. Apart from Australia, these countries can be placed into two groups. In the first group are the United States, Canada and, perhaps more controversially, the United Kingdom; in the second are West Germany, Sweden and Norway. Nations in the first group have labour market institutions more along the lines desired by the economic rationalists (narrowly defined) and those in the second have more interventionist (even corporatist)

Table 9.7 Poverty among families in seven countries (Poverty rate is below half median equivalent income)

Country	Year	Couples, no children	Couples, 1 child	Couples, 2 or more children	Single women with children	All families
Australia	1981–82	2.7	6.2	10.3	55.0	12.3
Canada	1981	4.0	5.1	12.0	48.5	13.2
Germany	1981	2.2	1.7	3.4	*	5.2
Norway	1979	4.1	2.1	3.1	18.3	5.1
Sweden	1981	2.6	3.1	4.7	10.6	5.4
UK	1979	1.7	1.9	6.7	28.5	11.4
US	1979	4.2	5.4	13.0	55.2	17.2

*The number in the sample in this category was too small for reliable estimates.
Source: P. Saunders, Income Inequality in Australia: Lessons from the Luxembourg Study, paper presented to the Economic and Social Policy Group, Income Distribution Seminar, Sydney, May 1989.

labour market institutions. Table 9.7 shows the extent of poverty in each of these seven countries. There is clearly very much more poverty in the first group than in the second, with Australia lying between the two groups. This is so whether one looks at social groups in which one would expect poverty to be high, such as single women with children, or at groups such as married couples without children, where poverty is usually low. Since the sample is small and many things can affect income distribution, not too much weight should be put on the data in Table 9.7. Nevertheless, they offer no support at all to the hypothesis that if only Australia's labour market were deregulated, income distribution would become more equal.

If one looks at the United States in particular and examines trends over the 1980s, this also supports the argument that the trend to increasing income inequality in Australia is not due to labour market intervention. There is a similar trend in income inequality in the United States. That country has one of the most deregulated labour markets in the OECD, and it also espoused economic rationalism in the 1980s. Table 9.8 gives the distribution of equivalent family income in the United States for three years. All are years in which the level of economic activity was high, so that cyclical effects do not influence trends in income inequality. Also, the families included in Table 9.8 are families with male heads under the age of 65, so that any trends in income inequality are not affected by such things as increasing numbers of female sole parents or changes in the proportion of retired people. The figures are for income before tax.

Table 9.8 shows that, while there was a very slight tendency to increasing income inequality between 1973 and 1979, this tendency became much more pronounced between 1979 and 1987. Indeed, although it is not

Table 9.8 Distribution of family income in the United States

Quintile class	Equivalent family Income*		
	1973	**1979**	**1987**
Lowest	6.78	6.44	5.40
Second	12.77	12.78	11.78
Third	17.36	17.73	17.14
Fourth	23.27	23.94	23.98
Highest	39.81	39.10	41.70

*Families headed by a male under 65 years old; various years.
Source: S. Danziger, P. Gottschalk and E. Smolensky 'How the Rich Have Fared, 1973–87' *American Economics Review,* May 1989, pp. 310–314.

shown in the table, income inequality actually increased between 1982 and 1987, although 1982 was a slump year and 1987 a boom year. Moreover, unlike the case in Australia under Hawke, in the United States under Reagan there was a clear-cut movement of relative income shares from the poor to the rich. The income share fell in each of the bottom three quintiles, but by a decreasing amount as one moves up the income scale. The income share of the fourth quintile was virtually the same in 1987 as in 1982 and the income share of the top quintile increased substantially between 1982 and 1987. As there were regressive tax changes in the period 1982–87, after-tax figures would show a greater increase in income inequality.[7]

To draw together the threads of this section, over the last decade or so there has been a noticeable trend towards increased inequality in income distribution. The biggest change was in the period 1978–79 to 1981–82 but the trend has continued, though at a slower rate since Hawke became prime minister. (When data become available for the period since 1985–86, we may see this trend reversed. Certainly the recent changes to social security benefits should increase the income share of the lowest quintile.) Increased unemployment is not a convincing explanation for this trend towards greater inequality, and neither can it be accounted for by a greater proportion of single-parent families. One cannot reject the hypothesis that the pursuit of policies which emphasise economic efficiency and place great faith in the free market has increased income inequality in Australia. One very strong conclusion can be drawn, namely, the importance of social security benefits in preventing a much greater increase in inequality in income distribution over the last decade or so. It is a reasonable implication that, if not for the social security system, policies inspired by economic rationalism, narrowly defined, would have caused much greater income inequality in Australia.

Notes

1. N. Kakwani, *Analysing Redistribution Policies: A Study Using Australian Data* New York: Cambridge University Press, 1986.
2. J.W. Nevile, N. Podder, B. Tran-Nam and N.A. Warren, 'Inflation, Anti-inflationary Policy and the Distribution of Income in Australia' Working Paper No. D1, Centre for Applied Economic Research, University of New South Wales, 1988.
3. Kakwani, *Analysing Redistribution Policies*.
4. P. Saunders, G. Hobbes and H. Stott, 'Income Inequality in Australia and New Zealand: International Comparisons and Recent Trends', paper presented at the 21st Conference of the International Association for Research in Income and Wealth, Lahnstein, West Germany, August 1989.
5. Australian Bureau of Statistics, *Income Distribution Australia 1978–79 Supplement to Social Indicators, No. 3*, Canberra: ABS, Cat. No. 4101.0.
6. Australian Bureau of Statistics *Social Indicators No. 4,* Canberra: ABS, Cat.No 6523.0.
7. While not relevant to the argument in this paper the United States figures suggest that income inequality is greater in the United States than in Australia. Restricting the families included to those with a male head under the age of 65 reduces the degree of income inequality shown, yet income inequality in Table 9.8 is comparable with, or greater than, that in the tables for Australia.

10
Book Review: "Ethics and Economics"

J. W. Nevile

This is a significant book, which deserves to be read widely by economists and others. A central theme in the book, the desirability of reinstating the entanglement of fact, value and theory that existed widely before the dominance of the neoclassical school, is particularly important in a world economy still struggling to cope with the global financial crisis.

The eleven chapters in the book were first published as symposia in the *Review of Political Economy* and the *Review of Social Economics*. Each symposium is not published separately but articles from each are presented in themes, beginning with broad methodological issues, progressing into theory and modelling and finishing with a discussion of policy issues. Nevertheless the two symposia were not identical in their aims. The first symposium aimed to contribute to the discussion of Sen's work, and that of ethics and economics more generally, in two ways. 'First it shifts the debate from the methodological level to the level of economic analysis. … Second, it goes beyond utilitarian means of addressing ethics in economics' (van Staveren 2008: 159–160). All the articles in this symposium reject the now traditional positive/normative dichotomy in economies, implicitly arguing that this rejection is the way forward for economics. The editorial introduction to the book makes this explicit.

> A more subtle, methodological emphasis of the book deals with the entanglement of fact, value and theory. Ethics is not outside economics, in a separate normative realm, but is part and parcel of it. Contrary to a common belief held by economists, facts and values are not mutually exclusive categories. (pp. 1–2)[1]

A review of Mark D. White and Irene van Staveren (eds) *Ethics and Economics: New Perspectives*, Routledge, New York, 2010, by J.W. Nevile. Reprinted from *The Economic and Labour Relations Review*, 22(1): 131–137, 2011, 'Ethics and Economics: New Perspectives' [Book Review] by G. C. Harcourt and P. Kerr. With kind permission from SAGE Publications. All rights reserved.

The second symposium was more limited in its aims. The editorial introduction notes that sometimes economists

> … use the language of philosophical ethics merely to lend authority to their own personal feelings about right and wrong, without exploring the philosophical foundations of these intuitions, much less admitting this to their readers. The danger here is that readers without philosophical background themselves will take the author's ethical presumptions as given. (White 2009: 1)

The symposium then offers a counter example of five articles which discuss ethics and economics with explicit references to specific philosophers or schools of philosophy. Thus, the symposium is itself a positive exercise, an example of the correct way of doing things. However, presumably White hopes that it will encourage others to avoid the dangerous habits warned against in the above quotation.

Some of the eleven chapter authors are well known to economists, notably Deidre McCloskey and Vivian Walsh. Others will be known only to those specialising in methodology or with interests in moral philosophy. The eleven authors are diverse in their interests and all are well qualified to write on their chosen topics. Nevertheless, rather than devote a paragraph or so to each, this review will comment at greater length on the chapters which bring out the underlying emphasis on the entanglement of fact, value and theory. Various others will be mentioned more briefly when appropriate.

The chapter with the most emphasis on entanglement of fact, value and theory is that of Vivian Walsh. Indeed the opening section of his chapter is entitled 'Rationality: entanglement of fact, theory and value' (p. 86).The title of the chapter itself is 'Freedom values and Sen: towards a morally enriched classical economic theory'. Walsh argues that he, Putnam and Sen share a definition of rationality which implies that the 'treatment of rational choice in neoclassical economics is in need of serious revision' (p. 87) and claims that Sen has shown this is just as much the case for social choice as it is for individual choice. Moreover, Walsh is completely dismissive of those who claim Adam Smith as the patron saint of self interest. Walsh claims that central to Sen's achievements is the demonstration that the reintroduction of ethical concerns and concepts into economic discourse is 'a *reintroduction* of something that was everywhere present in the writings of Adam Smith and that went hand-in-hand with Smith's technical analysis' (p. 88, italics in the original).

After the first section on entanglement there is a wide-ranging discussion of Sen's work. The unifying theme of this is rational choice theory (RCT) with Walsh discussing how Sen argues for changes in conventional RCT: changes that are necessary because this theory has been developed to avoid any explicit ethical content whereas entanglement is an inevitable part of any worthwhile theory. A large proportion of this discussion is based on a consideration of material in Sen (2002) but the discussion goes beyond that in three major areas. One is Sen's acknowledgement of his debt to John Rawls and his discussion of issues Rawls' work raises. A second is the somewhat surprising choice of Sraffa's work to discuss as representative of logical positivism. Walsh adds an ironic twist to this discussion by quoting (on p. 114) Signorino (2005) who argued that in his lectures of 1928–31, Sraffa maintained that historically, economic theorems are a joint product with debates on policy issues, if not sometimes a by-product of such debates. Finally, more surprising and very perceptively, Walsh discusses Pasinetti's growth theory as the best alternative to the sterility of neo-classical growth theory. Quoting himself, Walsh argues that Pasinetti's growth models are 'inspired by Adam Smith' (Walsh 2003: 372). While it can be argued that Walsh has a somewhat limited view of Pasinetti's work, he has certainly grasped an essential part of it, namely, to quote Pasinetti himself, the introduction of capital goods into Pasinetti's concept of vertical integration yields 'a series of relations of the Harrod-Domar type … [each relation] linking the sectoral rate of growth, sectoral investment and the sectoral capital output ratio [with] each relation being specific to each (vertically integrated) sector' (Pasinetti 2007: 303). Walsh argues that this is the way forward for Sen, quoting a remark Putnam made to him in 2005 in a phone conversation: 'capability theory needs to be cashed out by supplementing it with the kind of socially responsible growth theory provided by Pasinetti' (p. 117).

In her chapter entitled 'Not by P alone: A virtuous economy', Deidre McCloskey also argues for a substantial revision of neoclassical rational choice theory: 'segregating the goals or purposes of life into a ghetto of sheer unanalysed taste, as economists led by Paul Samuelson have done rigorously since the 1930s, has been a scientific mistake' (p. 47). McCloskey calls P variables (P for Profane) those variables prominent in modern economics, e.g. price, profit, property and prudence. She then contrasts these with S variables (S for Sacred) or, in traditional Christian terms, faith, hope and love. S variables can be cultural as well as religious and McCloskey instances tipping habits 'as an easy-to-observe outcome of a sacred decision' (p. 50). McCloskey finishes her classification of virtues by introducing O variables. These are virtues purely secular in origin. Concerns for justice, the secular parts of love and the self-sacrificing parts of courage, are given as examples. While McCloskey does not mention this, perhaps because she thinks it self evident, what are O variables for one person may be S variables for another. McCloskey does, however, point out that others besides economists use P-only analysis with a hard hitting attack on evolutionary biologists and psychologists.

McCloskey's chapter is a pleasure to read, but despite the attractive rhetoric her conclusion can be baldly summarised. Unlike Walsh, McCloskey thinks that the neoclassical approach has value and 'has produced a lot of good science, but there is a great deal more to be had by building into our thinking the virtues of O and S' (p. 62). Or, if one is prepared to think about the implications of a wittier summary, 'economists want the world to be P only. The world is not buying' (p. 59).

The chapter following that of McCloskey is entitled 'Virtue and behaviour'. The author, Jennifer Baker has a very different approach to the subject to that of McCloskey. The chapter has two aims. The first is to defend Sen's concept of commitment 'by placing it in an account of moral psychology (specifically the one on which traditional virtue ethics is dependent)' (p. 66). This is of course only one of many ways to explain why commitment occurs, but shows Sen's claims about the nature of commitment are supported by a respected tradition in philosophy.

The second, and I would judge the major, aim of the chapter is to demonstrate that the Stoic version of virtue ethics 'can accommodate Sen on commitment *without* requiring the alteration of the methodological assumptions [of neoclassical RCT]' (p. 67, italics in the original).This is done by utilising a distinction in Stoic thought between indifferents, or what McCloskey calls P variables, and motives based on moral considerations (O and S variables). Baker argues that a sensible division of labour is for economists to concentrate on the study of indifferents. 'Let the standards that guide the development of RCT be those of the field [of economics]' (p. 83). Ethics is the field concerned with moral issues. When, as is usually the case, choices concerning indifferents have moral and political relevance, it should be the ethicists who guide our thought. What is needed is that 'the ethicists must merely speak up' (p. 84).

It is probably unwise for one who is a professional economist but a very amateur philosopher to comment on this conclusion. Nevertheless, it seems to me that Baker denies that there is any need for economists to be concerned at all with moral issues, contradicting a point central to Sen's thought.[2] The three articles discussed form a continuum. Walsh believes entanglement always is necessary, McCloskey believes it often is necessary and Baker believes it never is necessary. The continuum covers the whole book. The remaining chapters can be placed either between Walsh and McCloskey or McCloskey and Baker.

This does not mean that the remaining chapters can be disregarded. 'Communitarism and the market: a paradox' by van Staveren and 'The efficiency of equity' by Klassen are the ones that I would particularly recommend. However, the remainder of this review is about the book as a whole, rather than individual chapters. A good place to start is the importance of the concept of entanglement, which as we saw is a central theme in the book. In my judgement the neglect of this concept has not only impoverished economics in general but does it in a way that was particularly disastrous in the onset of the global financial crisis and is likely to be equally disastrous as the world copes with the aftermath of that crisis.[3]

A Special Session of the United Nations was held in 2000 to review and appraise the implementation of the commitments and program adopted by the World Summit for Social Development held in 1995 and to re-invigorate the drive for social development. As part of the preparation for the meeting, thirty experts from around the world, including the present writer, were invited to speak at a UN seminar on how the values underlying social development and those of the market economy fit together. Although the term entanglement was not used at that seminar, the concept was. The integration of economic and social values was considered essential for a healthy society. As one participant put it 'When the logic of market transactions invades most spheres of social life, everything becomes a commodity and ultimately nothing is worthy of respect' (United Nations 2000: 9).

At the seminar I predicted that the lack of regulation in the global financial system, plus the belief that the market itself was better able to cure problems as they arose than was any intervention by Government, was a recipe for a severe crisis in the whole world economy. This was not a difficult prediction to make. The global financial crisis that occurred some seven years later had several joint causes, including excessive greed in the international financial sector, but the low level of regulation in that sector was important among these causes. The emphasis on free markets at any cost, which became the mantra of highly paid participants in the finance sector, was both self-serving and bad economics. The seminar as a whole agreed with my prediction. Though they were not debated due to lack of time, a number of recommendations about international economic institutions were made at the seminar, including 'increasing regulations particularly to hinder deliberately destabilizing speculation by hedge funds and others … [and] putting more of the costs of international financial crises on international lenders' (United Nations 2000: 14). If these and similar suggestions are ignored, and the belief that the international financial sector needs to be subject to no constraints beyond those imposed by the market again holds sway, the world economy will remain in a perilous state.

While Baker is an extreme case, other places in the book assume that, however undesirable it may or may not be, it is possible for economic analysis to be purely in terms of P variables. This is of course trivially true in the case of pure theory, though the theory may also be trivial. But the claim is also made with respect to applied economics. For example, in a chapter which otherwise has much to commend it, Klasen claims that 'the empirical case for the relevance of equity for efficiency can now be made largely staying within the tradition of positive economics, and does not need to rely on arguments coming from a normative view point' (p. 229). However, despite the belief among most economists that it is possible to separate the positive from the normative this is never possible in applied economics.[4] In economics, applied work involves an appeal to empirical studies in some shape or form. Moreover, these empirical studies are not carried out in carefully controlled conditions in a laboratory. They are facts thrown up by real world situations and judgement is important in interpreting the facts. This judgement is usually heavily influenced by the values of the person making the judgement. A common example is the desirability of regulation and other forms of government intervention in an economy. The case for reducing government regulation of, and intervention in, the economy rests on the empirical judgement that cases of market failure are uncommon, that is, if left to itself, it is very unusual for the market not to produce an efficient outcome. Those who place a high value on political and personal liberty are suspicious of government intervention and regulation, which they see as reducing personal liberty. It is perhaps not surprising that such economists generally make the professional judgement that market failure is rare.

Other economists are more concerned about the costs of the government not intervening when to do so will be beneficial to the economy. If there is market failure, the people who suffer are usually the economically weak, who may well experience very real poverty. Economists who put a high value on economic security for all, on preventing anybody falling below a certain level of income, are more likely to make the professional judgement that market failure is an important problem in an unregulated capitalist economy. Not all examples of applied economic studies involve values held so passionately as is often the case in the above example. Nevertheless, the principle about the involvement of values remains the same.

One final point about the book is the readership at which it is aimed. As discussed at the beginning of this review, the two symposia that comprise the book are somewhat different in their aims, in that the *Review of Social Economy* was designed to give examples of discussion of ethics and economics which avoid the danger of economists using the language of moral philosophy to claim authority for their own ethical positions without any indication of the extent to which these positions are supported by moral philosophers (White 2009). The chapters from this symposium in the book, those by Baker, Davis, van Staveren, White and Wight have no other unifying purpose. This diversity is not in itself undesirable, but it does mean that these chapters are likely to appeal mainly to those interested in ethics and economics who have a knowledge of the literature of moral philosophy.

The other symposium does have a unifying theme. This is provided both by the attention paid to the work of Sen and the emphasis on the importance of the concept of entanglement. Given Sen's reputation both as an economist and a philosopher the book chapters from this symposium are likely to attract a wider readership. Many economists with no professional interest in philosophy would probably enjoy, and benefit from, reading large parts of it. It is to be hoped that a large number will. But the publisher's claim that the book 'provides a comprehensive introduction to the cutting edge of interdisciplinary research between ethics and economics' (p. i) does not help. This statement, combined with an approach in much of the book summed up in the words that '[t]he chapters in this book involve a rigorous emphasis on the work of moral philosophers' (p. 2), may significantly reduce the number who do read at least parts of the book. This would be unfortunate to say the least.

Notes

1. Page references with no other reference relate to the book under review.
2. Joan Robinson (1966) commented on two Nobel-prize-winning economists 'After putting the rabbit into the hat in the full view of the audience, it does not seem necessary to make so much fuss about drawing it out again' (p. 308). Baker appears to go one better and after putting the rabbit into the hat claims that actually rabbits do not exist. Also Joan Robinson, and many others, would argue that the choice of P variables itself involves normative issues.
3. Stiglitz (2010), with the authority of a Nobel-prize-winning economist, sets out at length the arguments supporting this judgement and places them in the context of the complex collection of factors responsible for the global financial crisis. Stiglitz is an American writing for Americans and to a lesser extent Western Europeans. Nevertheless, much of the book is relevant to Australia with chapters 1, 3, 8 and 9 particularly important in this respect.
4. The rest of this paragraph and all of the following one are based on material in Nevile (1990).

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Part II
Human Rights

11

Economic Perspectives on Workers' Rights

Peter Kriesler and J. W. Nevile

It has often been argued that providing Australian workers with rights, such as those advocated by the Australian Charter of Employment Rights, would impose economic costs on the nation in terms of lost output or increased unemployment. Yet there is little theoretical or empirical evidence to support this objection, while there is indeed evidence that points to a positive relation between workers' rights and economic performance. While there are conflicting views as to the net effect of these rights on employment and output, there is an unambiguously positive relation between the rights promoted by the Charter and equity and fairness.

One of the most important objections to the implementation of workers' rights is the view that such rights impose significant economic costs on the economy in the form of reduced output and employment. This is based on neo-liberal ideology[1] drawing on neoclassical economic theory.[2] However, both internal and external theoretical criticisms of this conclusion argue that it is based on a specification of the theory which cannot describe actual economies. When the theory is modified so as to incorporate essential features of contemporary economies, the conclusion that rights impose costs is no longer sustainable, as the theory can no longer make predictions about the implications of the imposition of rights. This means that the question of economic costs must be tested empirically. Here again, the evidence does not support the contention that rights are costly. Most of the evidence suggests that granting workers' rights causes no loss of output or employment and also support a beneficial relation between legislation providing for security of employment (Employment Protection Legislation, or EPL) and the distribution of income and equity.

Modern policy is often guided by neo-liberal (economic rationalist) ideology. With respect to the labour market, it is argued that a deregulated labour

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Revised from *Australian Charter of Employment Rights*, 127–134, 2007, 'Economic Perspectives on Workers' Rights,' by Kriesler, P. and Nevile, J. W. With kind permission from Hardie Grant Publishing. All rights reserved.

market, with no employment protection, will allow the forces of supply and demand to establish a price (wage) and conditions which will ensure that all labour that is available to work at that wage can do so. According to this view, markets, when left alone, will achieve optimal outcomes, and so institutions representative of this ideology such as the World Bank and the International Monetary Fund (IMF) have pushed for labour market deregulation and increased flexibility of employment conditions and time. In other words, they argue that deregulated markets can guarantee full employment under conditions that assume competitive market conditions. A consequence of this is that regulated markets with minimum wages and employment protection interfere with the market mechanism, and so will impose costs on the economy, either in terms of job losses or in terms of higher prices.

The theory behind this result is derived from neoclassical analysis and relies on markets fulfilling certain conditions, including both perfect competition and perfect information. Perfect competition implies that all agents in the market, especially firms and employees, are so small relative to the size of the market that they cannot exert any market power. This means that they have no influence over wage outcomes, so that they are all price takers. Moreover, the information requirements of the analysis demand perfect knowledge not only of all current activity but also of the future. No reputable economist believes that the conditions for perfect competition exist in any actual economy, but many neoclassical economists consider that departures from perfect competition are not important enough to invalidate the use of the model as a tool for analysing aggregate employment and unemployment. The limitations of neoclassical theory as a guide to policy are well known in the literature and are particularly well articulated by Joseph Stiglitz, a former senior vice president and chief economist of the World Bank and Nobel Laureate in Economics.[3] Labour market analysis is widely recognised as an area where the use of neoclassical theory is likely to cause analytical problems. But in economic theory there is no credible prima facie case against intervention in labour markets to set minimum employment conditions. Accordingly, empirical analysis is necessary.

In the important case of minimum wages, theoretical ambiguity occurs in part because wages are both a cost to the employer (hence, increases are likely to reduce employment) and an income for the employee and therefore a source for their spending and demand (hence, increases are likely to increase employment). In addition, it is a standard result of microeconomic theory that when employers have market power, so that perfect competition does not hold, minimum wage legislation can increase employment. Especially in this case, the theoretical position with respect to the economic costs of employment rights is ambiguous, and reference needs to be made to the empirical evidence. This is true of labour market regulation more generally and is reflected in recent Organization for Economic Cooperation and Development (OECD) reports. Initially, the OECD unambiguously opposed

Employment Protection Legislation (EPL), arguing that labour market deregulation was a necessary condition for growth and full employment. However, after strong theoretical and empirical criticism, it has recently reversed its position.

In 2004 the OECD Employment Outlook stated that:

> The net impact of EPL on aggregate unemployment is therefore ambiguous *a priori,* and can only be resolved by empirical investigation. *However, the numerous empirical studies of this issue lead to conflicting results, and moreover their robustness has been questioned....*
>
> *The impact of EPL on overall employment and unemployment rates is ambiguous...Overall, theoretical analysis does not provide clear-cut answers as to the effect of employment protection on overall unemployment and employment... no clear association can be detected between EPL and unemployment rates.* (Emphasis in the original)[4]

When considering the economic implications of the Australian Charter of Employment Rights, the effects of the rights on the level of employment and economic efficiency and its social justice ramifications need to be highlighted. As summarised by economist Richard Freeman: "Studies of minimum wages ...of employment protection legislation ... and of diverse other social protection programs ... find little or no impact of these institutional interventions on economic efficiency".[5]

11.1 The Impact of Rising Minimum Wages

Likely effects of the Charter are to augment the role of basic minimum wages and to increase their levels. There has been a long and acrimonious debate among labour economists about any effects the raising of minimum wage levels might have on the rate of unemployment. However, the debate has been about whether there are any effects and on whether the effects may in fact reduce unemployment, not increase it. Neither side has argued that any effect is large. While the discussion looms large in the literature, and cannot be ignored given the use of the issue in political debate, in fact it is a storm in a tea cup.

As mentioned, there is no credible economic theory to support either side of the debate, so that the argument is an empirical one. The empirical evidence strongly supports the view that the effects of raising wages on the level of unemployment are negligible and can be in either direction. After reviewing a number of studies, Freeman concludes: "From the perspective of economic efficiency, all of these estimates suggest that the minimum wage at the level enacted in the US has no substantial economic cost."[6]

A similar argument applies to reducing wages by abolishing loadings and penalty rates, as long as the discussion is confined to wages and employment of relatively low paid workers. Loadings paid to those with medium to high levels of wages are another matter, and not much empirical work has been done on this. However, there is no robust evidence suggesting that high wage rates overall reduce employment, a fact admitted by the OECD who argue that: "The evidence is somewhat fragile overall and highlights the complexity of wage-setting institutions in OECD countries and their implications for economic performance."[7]

The evidence, however, strongly suggests that minimum wage legislation does significantly reduce earnings inequality by increasing earnings at the bottom end of the distribution.

11.2 Increasing Flexibility of Employment Conditions More Generally

Lack of labour market flexibility as the major cause of unemployment in Europe was the new orthodoxy of the 1990s, especially among the OECD and neo-liberal economists. However, the empirical studies supporting this orthodoxy have been shown to be so flawed that even the OECD, as an institution, was forced to back down. Again Freeman summarises very succinctly what happened: "The OECD Jobs Study came down strongly in favour of deregulation and active labour market policies, but succeeding analyses by the OECD have highlighted the weakness of that case. Countries with very different regulatory practices and policies have surprisingly similar outcomes."[8]

There is now strong agreement that deregulation of labour markets and the increased labour market flexibility that ensues are not associated to any significant extent with increased levels of employment or falling unemployment. However, they are associated with a deterioration in the distribution of income. In Freeman's words: "The bottom line is that employment protection legislation alters the distribution of work but not its volume."[9] The OECD itself has commented:

> *High union density and bargaining coverage, and the centralisation/co-ordination of wage bargaining tend to go hand-in-hand with lower overall wage inequality. There is also some, albeit weaker, evidence that these facets of collective bargaining are positively associated with the relative wages of youths, older workers and women. On the other hand, the chapter does not find much evidence that employment of these groups is adversely affected.*
>
> *No robust associations are evident between the indicators of wage bargaining developed in this chapter and either the growth rate of aggregate real wages or non-wage outcomes, including unemployment rates.*[10]

Another argument against rights for workers is the "conventional wisdom" that predicts that lower labour standards will be more attractive for foreign direct investment (FDI), which will increase domestic employment and output in the longer term. Some argue that, by increasing the cost of employing labour, workers' rights make countries less competitive and therefore less attractive to foreign investors. This view has been criticised on the basis that employment rights may increase the productivity of workers through their impact on education, skills acquisition and firm loyalty, as well as being associated with higher economic growth. There is no credible empirical evidence to support the "conventional wisdom". In fact, the empirical evidence "suggest[s] that FDI tends to be greater in countries with stronger worker rights".[11]

In short, workers' rights do not seem to have any significant negative impact on employment or efficiency, but they do have a significant impact on equality and the distribution of income.

11.3 Social Effects and Influence on Productivity

As suggested above, the evidence overwhelmingly supports the view that greater flexibility in labour markets, especially that which occurs by reducing the power of trade unions, increases earnings inequality. Again the OECD itself has pointed this out:

> *[Our] analysis confirms one robust relationship between the organisation of collective bargaining and labour market outcomes, namely, that overall earnings dispersion tends to fall as union density and bargaining coverage and centralisation/ co-ordination increase. It follows that equity effects need to be considered carefully when assessing policy guidelines related to wage-setting institutions.*[12]

Income inequality and other undesirable social effects that may flow from increased flexibility may reduce productivity. This is particularly the case as empirical evidence suggests that workers care about social justice and that their incentive to work is influenced by their perception of how they are being treated. More generally, casualisation is likely to reduce the commitment of workers to firms and hence reduce productivity. This may have serious effects on international competitiveness, so "it is likely that [freedom of] association rights would increase output and competitiveness by raising productivity"[13].

There is a large body of evidence supporting the association between stronger workers' rights and higher economic growth as well as improved distribution of income. There are many reasons for this, including improved possibilities for the development of human capital, reductions in industrial unrest, improved firm loyalty and reduced labour turnover.

Informed discussion so far has concluded that the provision of reasonable protections to workers, such as those contained in the Australian Charter of

Employment Rights, is unlikely to impose costs on the economy in the form of reduced employment, output or efficiency. Neither the theoretical nor the empirical evidence supports the case for any loss in output, efficiency or employment resulting from these rights. In fact, there is significant evidence suggesting that the reverse may be true. It is reasonable to suppose, and the empirical evidence confirms, that workers "care" about just conditions and equity, and they react adversely to perceived unfairness and inequality. In addition, there is evidence of a link between better employment rights and improving economic performance through improvements in labour productivity associated with better education and skill acquisition – and in increased foreign direct investment, among other factors. If the rights promoted by the Charter are implemented to enhance social justice and to successfully encourage a co-operative industrial environment, it is likely that there will be substantial economic returns for Australia.

Notes

1. Neo-liberalism combines a political philosophy, or ideology, which puts great stress on the freedom of the individual with the espousal of a particular type of economics which puts great stress on the benefits of a largely unregulated market.
2. This theory is fundamentally a theory of how markets allocate goods and services. It assumes that if the economy departs from full employment the market mechanism ensures a rapid return to full employment.
3. Stiglitz, J, *Whither Socialism?*, MIT Press, Cambridge Mass., 1996.
4. Organization for Economic Cooperation and Development (OECD), *OECD Employment Outlook*, OECD Paris, 2004, pp. 63 and 80 (italics in original).
5. Freeman, R, (2000) "Single peaked vs. diversified capitalism: the relation between economic institutions and outcomes", National Bureau of Economic Research Working Paper 7556, 2000, p. 18 http://www.nber.org/papers/w7556.
6. *op. cit.,* p. 21.
7. *op. cit.*, p. 165.
8. *op. cit.*, p. 22.
9. ibid.
10. *op. cit.* p. 130.
11. Kucera, D, "Core labour standards and foreign direct investment", *International Labour Review,* vol. 141, no. 1–2, 2002, p. 34.
12. *op. cit.*, p. 166.
13. Martin, W, and Maskus, K, "Core Labor Standards and Competitiveness: Implications for Global Trade Policy", *Review of International Economics* 9 (2), 2001, p. 317.

12
The Right to Work

Peter Kriesler and J. W. Nevile

The Australian Charter of Employment Rights identifies the rights and obligations that workers and employers should provide to each other. A right that stands outside the ambit of the Charter is the right to work. This is not a right that any individual employer can fulfil – although it can be hoped that, with an eye to the public interest, employers will always strive to maximise employment opportunities for the unemployed. Rather, the right to work imposes a societal obligation. While the Charter deals with the rights of employers and those in work, it would be remiss not to recognise that we, as a society, have an important obligation to provide work to those who want it but don't have it. This chapter addresses that obligation.

The costs of frequent or long-term unemployment are great, not only (and especially) to the individuals concerned but also to families and to society as a whole. Thirty to sixty years ago there was much greater awareness of these costs. The right to work and to protection against unemployment is enshrined in Article 23 of the United Nations Universal Declaration of Human Rights. Despite the widespread recognition of this right at the end of World War II, over the last thirty years in many Western countries, including Australia, the effort to reduce unemployment and keep it low has been given increasingly less importance, so that it has become subordinate to the goal of keeping the rate of inflation at negligible levels. As a matter of deliberate public policy, Australia is failing to properly address an obligation to its citizens, as well as an international obligation, to promote and fulfil the right to work for all. If this failure is not reversed, it will continue to do lasting damage to hundreds of thousands of Australians and to the structure of our society.

Revised from *Australian Charter of Employment Rights*, 135–144, 2007, 'The Right to Work,' by Kriesler, P. and Nevile, J. W. With kind permission from Hardie Grant Publishing. All rights reserved.

The leading human rights treaty of the modern era, the United Nations Universal Declaration of Human Rights, which Australia has ratified, is the source in international law for the right to work. Article 23 states:

> *Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment.... Everyone who works has the right to just and favourable remuneration ensuring for himself and his [sic]family an existence worthy of human dignity and supplemented, if necessary, by other means of social protection.*

The right to work, including protection against unemployment, was thus recognised by the international community as a fundamental human right, an essential element of human existence, part of what it means to be human. The importance of the right to work and of the responsibility of government to safeguard this right was further highlighted by the United Nations Covenant on Economic Social and Cultural Rights, which was also ratified by Australia and came into force in this country in March 1976. The right to work is enshrined in Article 6: "The State Parties to the present Covenant recognize the right to work, which includes the rights of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right."

Post-World War II, the right to work was acknowledged in most Western countries, with the consensus built on a belief in full employment. In the United Kingdom and in Australia, these beliefs were manifest in White Papers in 1944 and 1945 respectively, while the United States passed its Employment Act in 1946.

The universal recognition given to the right to work at the end of World War II was an acknowledgement of the economic and social ills of unemployment. In fact the ills of unemployment were well recognised much earlier: the threat of unemployment to world peace had been a motivating factor for the creation of the ILO by the Treaty of Versailles at the end of World War I.

The costs of unemployment to society start with the loss of output that those seeking work would have produced as workers and the loss of potential productivity, or human capital, that occurs as the skills of the jobless waste away and become redundant. The costs also include unemployment benefits, increased health costs and increased criminal activity. It is the children of the unemployed who are the group in which unemployment is most likely to lead to criminal activity. As far as minimising the costs of crime is concerned, it is important to reduce both frequent and long-term unemployment among young poorly educated workers, especially where the unemployment is concentrated geographically. In general the health and cohesion of society are most damaged where inherited unemployment creates an ongoing underclass. If current growth in inherited unemployment in Australia is not reversed, there will be lasting damage to the structure of our economy.

Unemployment also imposes costs on individuals – and it is these costs that motivate most of those concerned about unemployment. The extent of the costs depends on the family circumstances of the individual and the nature of the unemployment, especially whether it is short-term or long-term. The costs are greatest for people in families of low socio-economic status, where family income is low and the level of assets owned even lower. In such families low levels of social security benefits, the waiting periods and the disposal of assets before income support is provided impose severe financial stress on the jobless, who have great difficulty in affording the minor expenses of seeking employment let alone the larger expenses incurred in being a normal member of society. In addition, their skills may atrophy and they miss out on the increase in skill levels that occurs in many occupations with experience in the job.

Usually, the longer a person is without work, the greater the costs of each additional period of unemployment, both to the person and to society. Individuals often gradually become more financially stressed and lose skills. However, such economic costs are only the beginning of the price of frequent or prolonged unemployment. Amartya Sen, the 1998 winner of the Noble Prize for Economic Science, observed:

> *Unemployment is not merely a deficiency of income that can be made up through transfers by the state (at heavy fiscal cost that can itself be a very serious burden); it is also a source of far-reaching debilitating effects on individual freedom, initiative, and skills. Among its manifold effects unemployment contributes to the "social exclusion" of some groups, and it leads to losses of self-reliance, self confidence, and psychological and physical health.*[1]

Implicit in Sen's remarks is the most insidious effect of unemployment: the decline in self-esteem. In our society a person's public and private identity is often largely shaped by their occupation. Self-worth is often driven by the capacity to provide for oneself and one's family. The costs that Sen lists also lead to poor parenting, family breakdown and an increased suicide rate, especially among younger males.

There is another group, besides the long-term jobless, whose unemployment is particularly costly: disadvantaged youth and young adults. This group may be mostly without work but, because of short spells of casual work, they are not technically long-term unemployed. If they remain on the fringe of the labour market their children are also likely to be often without work, with unemployment passed on from one generation to the next.

Policies against unemployment must operate at two levels: the economy-wide level and the level of helping individuals. First, unemployment is inevitable if the overall level of demand for labour in an economy is not high enough to provide jobs for everyone who wants to work, no matter how skilled or attractive to employers they may be. Policies to manage demand are therefore essential. Second, many of the unemployed are in fact not particularly attractive to employers as potential workers, often through no fault of their own. For example, most employers, often correctly, believe that long-term unemployed people are less immediately valuable as employees than workers who have had only a short break between jobs or who are already employed. This disinclination to hire some categories of people without work is even stronger in the case of those with disabilities. More generally, therefore, there is a need for policies that make it more likely for unemployed people to obtain jobs from the existing pool, as well as for policies that increase the demand for labour.

In most Western economies monetary and fiscal policies are central to the task of managing overall demand for goods and services. Notwithstanding the often controversial details of these policies, the priorities given to various aspects of the health of an economy are important in the context of unemployment. In Australia, as well as in many other countries, these priorities have changed greatly in the last thirty years. While in many circumstances it is possible to devise policies that will reduce unemployment without increasing the rate of inflation and vice versa, it is certainly true that it is much easier to prevent inflation from rising, or staying high, if the policy maker has no concern about unemployment; similarly it is much easier to reduce unemployment if increasing inflationary pressure is not a concern.

Unemployment and inflation affect different groups in the economy differently. A significant rise in the inflation rate usually leads to a rise in interest rates, which will reduce profits in the finance industry; whereas unemployment due to lack of overall demand, strikes the disadvantaged and vulnerable particularly hard. With the growth in prominence and influence of the finance industry, increasing priority has been given, in Australia and many other countries, to keeping inflation low. Risking higher unemployment is seen as more acceptable than risking a rise in the inflation rate.

In the Australian case a good example of this is seen in the official target for the inflation rate. In the *Reserve Bank Act 1959* inflation and unemployment are treated even-handedly, with neither given priority as an evil to be fought. Prominent among the statutory goals of the Bank are "the stability of the currency in Australia" and "the maintenance of full employment in Australia". Despite this the Federal Government and the Reserve Bank have a formal agreement on a target rate of inflation but no target has been set for unemployment. The inflation target is now the overriding goal in determining monetary policy. Economic commentators in the media, often drawn from the finance industry, cite this as one of the major economic policy successes of the Howard Government.

However, the tendency to give greater priority to keeping inflation low is not just the result of having a conservative government and the influence of its natural supporters. In the past the Reserve Bank has had a number of successive targets as guides to monetary policy, and the trend to give more weight to inflation existed before the formal agreement with the federal government. The willingness of Australian governments to risk continuing high unemployment in order to reduce inflation was behind the disastrous monetary policy of the early 1990s when unemployment reached heights not seen in Australia since the Depression of the 1930s and remained above the previous post-Depression peak until February 1994. This previous peak of 10.4 per cent (in September 1983) represented, at the time, the highest level of unemployment in the twentieth century outside of the 1930s depression. While current world economic conditions are a far cry from those in the early 1990s, booms in economic activity do not go on forever. If the next recession is not to be sharper and longer than it need be, changing the current unwillingness to risk a rise in inflation must be changed, though this will not be an easy task.

The Reserve Bank of Australia has defended its concentration on keeping inflation at a very low rate by claiming that high rates of inflation adversely affect growth in output and employment. There is no doubt that this is true for very high rates of inflation, but there is substantial evidence that this is not the case when the rate of inflation is below 10 per cent. Those who support fighting inflation as the over-riding goal of macroeconomic policy claim the support of the current dominant school of thought in economics. Professor Robert J Barro is one of the most respected members of this school. In a study of the experience of more than a hundred countries over thirty years, Barro found that there was evidence of "causation from higher long-term inflation to reduced growth and investment" but immediately commented that "it should be stressed that the clear evidence for the adverse effects of inflation comes from the experience of high inflation".[2] The general tenor of Barro's article suggests that he had inflation rates above twenty per cent a year in mind when he used the term *high,* although anyone less sympathetic to the argument that inflation has adverse effects on growth might maintain that his empirical work shows that "high" should be taken to mean more than fifty per cent a year. Barro's general result has been supported by numerous other studies. In the decade before the fierce anti-inflationary policy of the early 1990s the rate of inflation in Australia averaged 7.3 per cent.

The desire to avoid any risk of increased inflation, coupled with the desire of neo-liberals for small government, has also led to a change in priorities in fiscal policy, with avoidance of budget deficits becoming the supreme virtue (among politicians and the public, if not among academic experts in the field). In some circumstances but by no means all, budget deficits do increase inflationary pressures and ongoing large budget deficits can lead to a very large public debt which reduces available economic policy choices. However, the Australian public debt is close to zero and the fetish for maintaining a budget surplus or at least a balanced budget will hinder policy to reduce unemployment when the next recession occurs.

Wages policy is also considered by some to affect the level of unemployment across the whole economy.

There is widespread consensus among economists about policies that increase the likelihood that those without work will obtain jobs from the existing pool of available jobs. The only serious disagreements are value-laden ones about how much should be spent on such policies relative to expenditure on other needs. These policies include those that:

- reduce very high effective marginal rates of taxation as one moves from unemployment to employment
- increase the efficiency of the job search process and the quality of labour offered by people currently seeking work (known in the profession as active labour market programs)
- improve education and training in lower socio-economic groups generally, especially (in order of importance) preschool education and primary school education among disadvantaged children.

A major feature of the Australian social security arrangements is that payments are tightly targeted to those with little income and few assets. One important consequence of this is the creation of poverty traps. If people on social security benefits move into paid employment they may receive very little additional income because of the combination of the effects of income tax on net earnings and the loss of benefits as income rises. Their "effective marginal tax rate" can be very high, even over 100 per cent. The extent to which this happens depends on both the level of formal marginal tax rates and the speed with which benefits are tapered off as income rises. There is no obvious answer to the question as to which is the best taper rate, but there is agreement that very high effective marginal tax rates discourage those receiving social security benefits from taking up employment, especially part-time employment.

Job search assistance can help a wide range of unemployed people find continuing employment. The assistance provided ranges from minimal job placement services to intensive counselling and other measures to raise the motivation and skills of unemployed people seeking jobs. Minimal job placement services are cheap, but if one is concerned to help those least likely to find employment, emphasis must be put on expensive measures, including in-depth counselling, for both disadvantaged youth and the long-term jobless of all ages.

In the OECD as a whole, the two types of active labour market assistance programs on which most resources are spent are labour market training and subsidised employment. Each is more helpful for some types of job seeker than for others. For example, training – both in the classroom and on the job – can be helpful in assisting women reentering the labour market to find jobs but it is much less effective in helping disadvantaged youths. One reason why labour market training has not worked as well as it might have is that, for political reasons, spending on it tends to be greater when unemployment is high, vacancies are low and there is no shortage of skilled workers. Training is more likely to be effective when unemployment is relatively low.

The policies discussed so far are aimed at existing workers unable to find jobs. Such policies are, of course, necessary, but in the longer run it is more effective to treat the problem of frequent and long-term joblessness at its source. There is substantial evidence that the quality of preschool, primary and secondary schooling has lifelong effects on employability, with the greatest effect per dollar spent being from preschool programs for disadvantaged children. The increasing inequality in the education received by Australian children will make the problem of joblessness much harder to solve in the future.

Finally, a solution to joblessness is not just a matter of paying our taxes and relying on the government to do the rest. The attitudes of society to unemployed people; the private, as well as government, support services provided for them; and the institutional arrangements for providing these services are all important. They help determine the psychological impact of unemployment on the unemployed and their families, which in turn influences the likelihood of social exclusion, of ill-health and of slipping into the criminal classes – even of suicide. These outcomes are clearly undesirable for many reasons, including their effect in reducing the employability of the unemployed. If the obligation on government to provide work was given the priority it deserves, these undesirable outcomes might be avoided. However, in a far from perfect world it is not enough just to advocate better government policies. Non-government institutions and individuals also can directly improve the situation and their help is needed. The worth of a society is measured by the value it places on its less privileged. Sadly, we are now in a situation where the right of rewarding and well compensated work is given little priority.

Notes

1. Sen, Amartya, *Development as Freedom*, Knopf, New York, 1999, p. 21.
2. Barro, R J, "Inflation and Growth", *Federal Reserve Bank of St. Louis Review*, May/June 1966, p. 168.

13
The Global Financial Crisis and the Right to a Decent Job

Peter Kriesler and J. W. Nevile

The United Nations, and before it the International Labour Organization, have consistently emphasised the right to employment with dignity and security. With the onset of the global crisis in the financial sector, this right is more important than ever. But paying lip service to the importance of the right is not enough. This chapter sets out the policies necessary to restore full employment as quickly as possible. It argues that it is possible to do this while still providing all employed with a 'decent' job, and that the counter argument depends more on ideology than empirical evidence. The article concludes that the country whose economy has the most influence on the rest of the world, the United States, and our own country are both currently implementing appropriate policies. In a longer-run context, the rhetoric of the Commonwealth government is not so helpful. It argues that, unlike other sectors in the economy, governments should not normally borrow to invest in assets that will produce a flow of services for years; moreover, if they do so they should repay the loan as soon as circumstances permit. This focus is likely to cut short the fall in unemployment before Australia reaches full employment.

13.1 Introduction

> *Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment.*
>
> —The Universal Declaration of Human Rights, Art 23(1)

The right to work is always an important human right; just how important is set out briefly in the next section of this chapter. Obviously, this human right should be given an even higher priority at a time like the present, when the threat of continuing high unemployment, even in 'Western'

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countries, is the greatest it has been for three-quarters of a century. However, this chapter is not only about the importance of the right to employment, but also about how to restore full employment as quickly as possible.[1] It is written with reference to the situation in Australia, though parts of it are of greater or less relevance to other Organization for Economic Cooperation and Development (OECD) countries. Full employment does not mean that no-one is unemployed. At any point in time, there are workers who have left their previous employment and are looking for another job, and others who are searching for their first paid employment. We define full employment as a situation in which all people currently unemployed can find employment within a reasonable time—say, three months. However, full employment is only one aspect of the 'right to work', which also incorporates employment at wages sufficient to generate an adequate standard of living, as well as reasonable working conditions (Balakrishnan and Elson 2008, 14):

> Work as specified in article 6 of the Covenant must be *decent* work. This is work that respects the fundamental rights of the human person as well as the rights of workers in terms of conditions of work safety and remuneration. It also provides an income allowing workers to support themselves and their families. [CESCR 2006, para 7.]

In other words, in addition to the quantitative aspect of there being sufficient jobs to employ everyone who wants to work, the quality of jobs is also an important aspect of the right to work (Branco 2009, 29).

This chapter considers both of these aspects of the right to work. It argues that not only should Australia be striving to reduce unemployment as quickly as possible, but also that while almost all jobs are better than no job, any job is not good enough. People have a right to 'decent' wages and working conditions.

The International Labour Organization (ILO) has always emphasised not just the universal right to employment, but also the right to employment with dignity and security. Included in the aims and purposes of the ILO is the statement that:

> … all human beings, irrespective of race, creed or sex, have the right to pursue both their material well-being and their spiritual development in conditions of freedom and dignity, of economic security and equal opportunity.[2]

In recent years, the ILO has emphasised what it calls its Decent Work Agenda, which directly works to achieve the goals in this quotation. This emphasis on decent work has four strategic objectives, namely 'fundamental principles and rights at work and international labour standards; employment and income opportunities; social protection and social security; and social dialogue and tripartism' (ILO 2008). This chapter focuses on the first two of these objectives.

Later in this chapter we counter the argument that increasing wages for the lowly paid and improving their working conditions have the effect of increasing unemployment. Given the effects of the global financial crisis on employment in Australia, this would be a serious problem if there were strong evidence to support the claim. Fortunately, the evidence is that any such effect will be trivial at the most and ambiguous in direction.

The article also sets out the policies we recommend to reduce unemployment as quickly as possible. We first discuss the short-run policies that should be implemented as soon as possible, and then put these into a longer-run context. The threads are drawn together in the conclusion to the article.

13.2 The Right to Employment in a Decent Job

The leading human rights document of the modern era, the United Nations Universal Declaration of Human Rights, is the source in international law for the right to work. Article 23 states:

> Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment. … Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity and supplemented, if necessary, by other means of social protection.

The right to protection against unemployment not only implies protection, such as remuneration, against the consequences of unemployment, but also implies explicit actions to ensure that everyone who wants to is able to obtain a job (Branco 2009, 28–29).

The right to work, including protection against unemployment, was thus recognised by the international community as a fundamental human right, an essential element of human existence, part of what it means to be human. The importance of the right to work and of the responsibility of government to safeguard this right was further highlighted by the International Covenant on Economic, Social and Cultural Rights (ICESCR), which was ratified by Australia and came into force in this country in March 1976. The right to work is enshrined in Article 6(1):

> The State Parties to the present Covenant recognize the right to work, which includes the rights of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right.

Article 7 states:

> The State Parties to the present Covenant recognize the right of everyone to the enjoyment of just and favourable conditions of work which ensures, in particular:
> (a) Remuneration which provides all workers, as a minimum, with: …
> (ii) A decent living for themselves and their families in accordance with the provisions of the present Covenant;
> (b) Safe and healthy working conditions;

Importantly, the ICESCR also, in Article 2(1), commits each nation to 'take steps … to the maximum of its available resources, with a view to achieving progressively the full realisation' of these rights. This concept of 'progressive realisation', while recognising that the rights cannot necessarily be realised immediately, nevertheless 'imposes an obligation to move as expeditiously and effectively as possible towards that goal' (CESCR 1990, para 10).

This suggests that, although nations clearly have some discretion in selecting the manner in which they carry out their obligations, there are certain obligations that need to be met. These include 'the requirement for progressive realization; the use of maximum available resources; the avoidance of retrogression; the satisfaction of minimum essential levels of economic and social rights; non-discrimination and equality; and participation, transparency and accountability' (Balakrishnan and Elson 2008, 3).

The implications of these obligations are that nations need to devote sufficient resources to continuously improve the position with respect to the level of employment, the conditions of employment, and wages: 'Progressive realization imposes a "specific and continuing" or "constant and continuing" duty to move as "expeditiously and effectively as possible" towards full realization of rights' (Balakrishnan and Elson 2008, 5). In addition, there should not be any retrogression, in the sense that the enjoyment of the right should not worsen as a result of government action. Clearly, external factors, such as the global financial crisis, mean that declines in employment levels, which will vary significantly over the business cycle, are not to be taken as examples of retrogression. However, there is a proviso that governments do not take actions to worsen the impact of the external factors, and, in fact, are required to implement offsetting policies. As a result, a commitment to the progressive lowering of the unemployment rate is not possible,[3] though a commitment to policies that minimise the impact of cyclical and external factors is highly desirable. However, this is not true either for employment conditions or for wages. With both of these, reasonable improvements over time should be expected. In other words, both real wages and working conditions should be expected to improve over time and, at worse, not to deteriorate.

In addition to progressive realisation, there is also a requirement that 'a minimum core obligation to ensure the satisfaction of, at the very least, minimum essential levels of each of the rights is incumbent upon every State party' (CESCR 1990, para 10). Further, 'even in times of severe resource constraints … the vulnerable members of society can and indeed must be protected' (CESCR 1990, para 12). This section has been interpreted as requiring that 'the provision of minimum essential levels is an immediate obligation. This means that it is the duty of the state to prioritise the rights of the poorest and most vulnerable people' (Balakrishnan and Elson 2008, 6).

In addition to these international treaties and covenants, after World War II the right to work was acknowledged in most Western countries, with the consensus built on a belief in full employment. In the United Kingdom and in Australia, these beliefs were manifest in White Papers in 1944 and 1945 respectively, while the United States passed the *Employment Act of 1946*.

Basically, the human rights obligations of governments with respect to the right to work impose on them a responsibility either to directly create employment, or to give incentives to the private sector to do so. In the immediate post-war period, this right was met by government expenditure on infrastructure, which led to full employment and also improved the standard of living of the general population. Since the abandonment of the commitment to full employment in the 1970s, governments have no longer taken responsibility for fulfilling this obligation. Instead, fighting inflation has become the main goal of policy. The result of this change in emphasis has been the emergence of high levels of unemployment throughout the global economy. This has clearly led to an abdication of the state's obligation with respect to the right to work. Below we argue that there needs to be a more deliberate acknowledgement of the right to work, with significant rethinking of policies in order to ensure that governments meet their responsibilities in this respect.

The universal recognition given to the right to work at the end of World War II was an acknowledgement of the economic and social ills of unemployment. In fact, the ills of unemployment were well recognised much earlier: the threat of unemployment to world peace had been a motivating factor for the creation of the ILO by the Treaty of Versailles at the end of World War I.

The right to employment is a very basic right. In many circumstances, unemployment leads to social exclusion for the unemployed and their families:

> The right to work, as guaranteed in the ICESCR, affirms the obligations of States parties to assure individuals their right to freely chosen or accepted work, including the right not to be deprived of work unfairly. This definition underlines the fact that respect for the individual and his dignity is expressed through the freedom of the individual regarding the

> choice to work, while emphasizing the importance of work for personal development as well as for social and economic inclusion. [CESCR 2006, para 4.]

This social and economic exclusion imposes costs on the unemployed and their families. The extent of the costs depends on both the family circumstances of the individual and the nature of the unemployment, especially whether it is short-term or long-term. The costs are greatest for people in families of low socio-economic status, where family income is low and the level of assets owned is even lower. In such families, low levels of social security benefits, long waiting periods, and the disposal of assets before income support is provided impose severe financial stress on the jobless, who have great difficulty in affording the minor expenses of seeking employment—let alone the larger expenses incurred in being a normal member of society. In addition, their skills may atrophy and they miss out on the increase in skill levels that occurs in many occupations with experience in the job.

Usually, the longer a person is without work, the greater the costs of each additional period of unemployment. Individuals often gradually become more financially stressed and lose skills. However, such economic costs are only the beginning of the price of frequent or prolonged unemployment. Amartya Sen, the 1998 winner of the Noble Prize for Economic Science, observed:

> Unemployment is not merely a deficiency of income that can be made up through transfers by the state (at heavy fiscal cost that can itself be a very serious burden); it is also a source of far-reaching debilitating effects on individual freedom, initiative, and skills. Among its manifold effects unemployment contributes to the 'social exclusion' of some groups, and it leads to losses of self-reliance, self confidence, and psychological and physical health. [Sen 1999, 21.]

Implicit in Sen's remarks is the most insidious effect of unemployment: the decline in self-esteem. In our society, a person's public and private identity is often shaped largely by their occupation. Self-worth is often driven by the capacity to provide for oneself and one's family. The costs that Sen lists also lead to poor health, poor parenting, family breakdown and an increased suicide rate, especially among younger males (see, for example, Saunders and Taylor 2002; McClelland 2000; Morrell, Page and Taylor 2001; Harris and Morrow 2001).

There is another group, besides the long-term jobless, whose unemployment is particularly costly: disadvantaged youth and young adults. This group may be mostly without work but, because of short spells of casual work, they are not technically long-term unemployed. If they remain on the fringe of the labour market, their children are also likely to be often without work, with unemployment passed on from one generation to the next.

Unemployment also imposes costs on society as a whole, and these costs also increase as the length of the spell of unemployment grows. They start with the loss of output that those seeking work would have produced as workers and the loss of potential productivity, or human capital, that occurs as the skills of the jobless waste away and become redundant. The costs also include unemployment benefits, increased health costs, and increased criminal activity. It is the children of the unemployed who are the group in which unemployment is most likely to lead to criminal activity (see, for example, Weatherburn 2002). As far as minimising the costs of crime is concerned, it is important to reduce both frequent and long-term unemployment among young poorly educated workers, especially where the unemployment is concentrated geographically. In general, the health and cohesion of society are most damaged where inherited unemployment creates an ongoing underclass. If the trend growth in Australia in inherited unemployment is not reversed, there will be lasting damage to the structure of our economy.

Unfortunately, despite the importance of economic rights associated with the right to work, these rights are often neglected, and are certainly not treated with the same level of intensity afforded to civil and political rights:

> As stated by the then chairperson of the Committee on Economic, Social and Cultural Rights during the Vienna Conference in 1993 the sad reality is that we continue to tolerate all too often breaches of economic, social and cultural rights which, if they occurred in relation to civil and political rights, would provoke expressions of horror and outrage and would lead to concerted calls for immediate remedial action. In effect, despite the rhetoric, violations of civil and political rights continue to be treated as though they were far more serious, and more patently intolerable, than massive and direct denials of economic, social and cultural rights. This statement is almost twenty years old, but unfortunately, its content remains pertinent today. [Albuquerque 2010, 146; see also Branco 2009, 4.]

The main reason for the relative neglect of employment rights is that it is often argued that there are costs associated with the implementation of these rights. In particular, increasing levels of employment, wage rates or working conditions are claimed to result in inefficiencies and will cause other economic problems. These issues are discussed in the next section of the article.

13.3 Must Better Working Conditions or Wages Increase Unemployment?

The claim that improvements in employment levels, working conditions and remuneration for work impose significant economic costs on the economy in the form of reduced output and reduced employment is based on neoliberal ideology drawing on neoclassical economic theory. The antagonism between neoclassical economics and human rights is well known (Balakrishnan and Elson 2008, section 1; Branco 2009). There seem to be particular issues with the 'right to work', which conventional economic theory sees as problematic. Much of this is related to the neoclassical/neoliberal idea that markets will generate a rate of unemployment which no government via macroeconomic policy can permanently influence. In fact, any attempt to reduce the rate of unemployment below this level (called either the 'natural rate of unemployment' or the 'non-inflation accelerating rate of unemployment') will simply lead to accelerating inflation. That unemployment will always tend to this natural rate in the long run is a central result of modern neoclassical theory, though it is generally rejected by heterodox alternatives—particularly Keynesian ones.[4]

As long as full employment is seen as being incompatible with low inflation, with the corollary that unemployment helps reduce inflation, sustainable low unemployment rates will not be achieved: 'The single most important obstacle to full employment is the belief held by orthodox economists, policy-makers, central bankers and the international financial community that unemployment is needed to control inflation' (Wilkinson 2000, 642).

In any case, because the main aim of neoclassical economics is to promote the economy's efficiency, with the level of employment emerging as a by-product, the 'right to work' is clearly regarded as a secondary issue:

> It seems quite natural that an economy which does not aim at full employment can only expect to reach it through the art of magic, in other words by some sort of supernatural trickle-down effect which takes full employment as the by-product of the attainment of higher ranked goals, such as perfect markets. But magic is no longer what it used to be, and therefore it seems quite clear that, in fighting unemployment, mainstream economics happens to be not only shooting in the wrong direction, but also causing excessive collateral damage. [Branco 2009, 49.]

The insight that capitalist economies have no mechanism to bring them to full employment and that the achievement of full employment is just a fluke stands counter to the conventional wisdom of neoclassical economics and neoliberal ideology. However, it was the main conclusion of Keynes's *General Theory of Employment, Interest and Money* (Keynes 1936).[5]

Importantly, then, neoclassical economics argues that any explicit attempts by states to use economic policies to achieve full employment will be self-defeating and will also cause damage to the economy. This view is extended to include other aspects of the right to work, including those associated with a right to a job with decent conditions and reasonable wages.

In all of these cases, any attempt to interfere with the market will be associated with costs to the economy. However, even if this argument is accepted, it is still unclear as to why these costs should be considered sufficient as to overcome the right to work. This is simply not discussed.

However, both internal and external theoretical criticisms of these conclusions argue that they are based on a specification of the theory which does not describe actual economies. When the theory is modified so as to incorporate essential features of contemporary economies, the conclusion is no longer sustainable. Hence, the question of economic costs must be tested empirically. Most of the evidence suggests that improvements in wages for those with low pay will have ambiguous impacts of trivial magnitude on the level of employment (Freeman 2000; 2005). Moreover, empirical evidence also supports the beneficial outcomes of employment protection legislation (EPL) on the distribution of income and equity (OECD 2004). The remainder of this section of the article will evaluate the arguments of neoclassical economists against employment rights in relation to reasonable wages and decent working conditions.

Modern policy is often guided by neoliberal (economic rationalist) ideology. With respect to the labour market, it is argued that a deregulated labour market, with no employment protection, will allow the forces of supply and demand to establish a price (wage) and conditions that will ensure that all labour wishing to work at that wage can. According to this view, markets, when left alone, will achieve optimal outcomes, and institutions representative of this ideology—such as the OECD, the World Bank and the International Monetary Fund (IMF)—have pushed for labour market deregulation and increased flexibility of employment conditions. In other words, they argue that deregulated markets can guarantee full employment if there are competitive market conditions. A consequence of this is that regulated markets with minimum wages and employment protection interfere with the market mechanism, and so will impose costs on the economy—either in terms of job losses, or in terms of higher prices.

The theory behind this result is derived from neoclassical analysis and relies on markets fulfilling certain conditions, including both perfect competition and perfect information. Perfect competition implies that all agents in the market, especially firms and employees, are so small relative to the size of the market that they cannot exert any market power. This means that they have no influence over wage or price outcomes, so that they are all price takers. Moreover, the information requirements of the analysis require perfect knowledge not only of all current activity, but also of the future. No reputable economist believes that the conditions for perfect competition exist in any actual economy, but many neoclassical economists consider that departures from perfect competition are not important enough to invalidate the use of the model as a tool for analysing aggregate employment and unemployment. The limitations of neoclassical theory as a guide to policy are well known in the literature, and an excellent starting point on this is *Whither Socialism?* by Joseph Stiglitz (1994), a former senior vice president and chief economist of the World Bank and a Nobel Laureate in economics. Labour market analysis is widely recognised as an area where the use of neoclassical theory is likely to cause problems. As there is no prima facie case against intervention in employment conditions, empirical analysis is necessary.

In the important case of minimum wages, theoretical ambiguity occurs in part because wages are both a cost to the employer (and so increases are likely to reduce employment) and an income for the employee—and, therefore, a source for their spending and demand (and so increases are likely to increase employment). In addition, it is a standard result of micro-economic theory that when employers have market power, so that perfect competition does not hold, minimum wage legislation can increase employment. Especially in this case, the theoretical position with respect to the economic costs of employment rights is ambiguous, and reference needs to be made to the empirical evidence. This is true of labour market regulation more generally and is reflected in recent OECD reports. Initially, the OECD unambiguously opposed EPL, arguing that labour market deregulation was a necessary condition for growth and full employment. However, after strong theoretical and empirical criticism, it has recently reversed its position.

In 2004, the OECD *Employment Outlook* stated that:

> The impact of EPL on overall employment and unemployment rates is ambiguous … Overall, theoretical analysis does not provide clear-cut answers as to the effect of employment protection on overall unemployment and employment. … no clear association can be detected between EPL and unemployment rates. [OECD 2004, 80.]

There has been a long and acrimonious debate among labour economists about the effects on the rate of unemployment of raising the minimum level of wages. However, the debate has been about whether there are any effects, and on whether the effects may in fact reduce unemployment, not increase it. Neither side has argued that any effect is large. While the discussion ranks large in the literature and cannot be ignored, given the use of the issue in political debate, in fact it is a storm in a tea cup.

As indicated above, there is economic theory to support both sides of the debate, so that the argument is an empirical one. The empirical evidence strongly supports the view that the effects of raising wages on the level of unemployment are negligible and can be in either direction. After reviewing a number of studies, Freeman concludes: ‘From the perspective of economic efficiency, all of these estimates suggest that the minimum wage at the level enacted in the US has no substantial economic cost’ (Freeman 1998, 21). Nevile (2001) comes to the same conclusion in the case of Australia.

A similar argument applies to reducing wages by abolishing loadings and penalty rates, as long as the discussion is confined to the wages and employment of relatively low paid workers. Loadings paid to those with medium to high levels of wages are another matter, and not much empirical work has been done on this. However, there is no robust evidence suggesting that high wage rates overall reduce employment—a fact admitted by the OECD, which argues that: 'The evidence is somewhat fragile overall and highlights the complexity of wage-setting institutions in OECD countries and their implications for economic performance' (OECD 2004, 165).

Another important mechanism whereby weaker employment rights have been argued to influence employment and output has been via the 'conventional wisdom' that argues that lower labour standards will be more attractive for foreign direct investment (FDI), which will increase domestic employment and output in the longer term. This, in turn, it is contended, will lead to a 'race to the bottom' as each country lowers standards in order to attract international capital. The main mechanism through which this happens is via the effect of workers' rights on labour costs. By increasing the cost of employing labour, it is argued, workers' rights make countries less competitive—and, therefore, less attractive to foreign investors. This view has been criticised on the basis that employment rights may increase the productivity of workers through their impact on education, skill acquisition and firm loyalty, as well as being associated with higher economic growth. The empirical evidence suggests that 'FDI tends to be greater in countries with stronger worker rights' (Kucera 2002, 34).

Moreover, empirical evidence strongly suggests that minimum wage legislation does significantly reduce earnings inequality by increasing earnings at the bottom end of the distribution (World Bank news release of 2003, quoted in Freeman 2005; OECD 2004). Lack of labour market flexibility as the major cause of unemployment in Europe was the new orthodoxy of the 1990s, especially among the OECD and neoliberal economists. However, the empirical studies supporting this orthodoxy have been shown to be so flawed that even the OECD, as an institution, was forced to back down. Again, Freeman summarises very succinctly what happened:

> The OECD Jobs Study came down strongly in favour of deregulation and active labour market policies, but succeeding analyses by the OECD have highlighted the weakness of that case. Countries with very different regulatory practices and policies have surprisingly similar outcomes. [Freeman 1998, 22.]

There is now strong agreement that deregulation of labour markets and the related increased labour market flexibility are not associated to any significant extent with increased levels of employment or falling unemployment.

However, they are associated with a deterioration in the distribution of income. The OECD itself has commented:

> *High union density and bargaining coverage, and the centralisation/co-ordination of wage bargaining tend to go hand-in-hand with lower overall wage inequality.* There is also some, albeit weaker, evidence that these facets of collective bargaining are positively associated with the relative wages of youths, older workers and women. On the other hand, there is not much evidence that employment of these groups is adversely affected. *No robust associations are evident between the indicators of wage bargaining developed .... and either the growth rate of aggregate real wages or non-wage outcomes, including unemployment rates.* [OECD 2004, 130; emphasis in original.]

In short, workers' rights do not seem to have any significant negative impact on employment or efficiency, but they do have a significant impact on equality and the distribution of income.

As suggested above, the evidence overwhelmingly supports the view that greater flexibility in labour markets, especially that which occurs by reducing the power of trade unions, increases earnings inequality. Again, the OECD itself has pointed this out.

> [A]analysis confirms one robust relationship between the organisation of collective bargaining and labour market outcomes, namely, that overall earnings dispersion tends to fall as union density and bargaining coverage and centralisation/co-ordination increase. It follows that equity effects need to be considered carefully when assessing policy guidelines related to wage-setting institutions. [OECD 2004, 166.]

These and other undesirable social effects that may flow from increased flexibility may reduce productivity. This is particularly the case as empirical evidence suggests that workers care about social justice, and their incentive to work is influenced by their perception of how they are being treated (Martin and Maskus 2001). More generally, casualisation is likely to reduce the commitment of workers to firms and hence reduce productivity. There is a large body of evidence supporting the association between stronger employment rights and higher economic growth, as well as improved distribution of income. There are many reasons for this, including the improved possibilities for the development of human capital, reductions in industrial unrest, improved firm loyalty, and reduced labour turnover.

The discussion so far has concluded that the implementation of employment rights is unlikely to lead to costs to the economy in the form of reduced employment, output or efficiency. Neither the theoretical nor the empirical evidence supports the case for any loss in output, efficiency or employment resulting from these rights. In fact, there is significant evidence suggesting that the reverse may be true. It has been argued that employees 'care' about just conditions and equity, and react adversely to perceived unfairness and inequality. In addition, there is evidence of a link between better employment rights and increased economic performance through improvements in labour productivity associated with better education and skills acquisition, and in increased FDI, among other factors. In this case, it is likely that the improved conditions and an environment of social justice may further increase labour productivity, and there will be substantial economic returns from the implementation of employment rights (see Kitson, Martin and Wilkinson 2000; Martin and Maskus 2001; Kucera 2002).

This section of the article has evaluated the neoclassical objections to the right to work associated with decent working conditions and reasonable wages. These objections have been in terms of the cost to the economy, usually as a result of lower levels of employment and output. However, empirical evidence shows the weakness of this position, as no negative links between employment rights and the level of either employment or output have been found. This position has been admitted by the OECD, which, during the 1980s, was a harsh critic of these rights and a strong advocate of deregulation of labour markets. On the basis of the evidence, it changed its advocacy significantly and reversed its position. In fact, employment rights may be associated with increased output and employment as workers have a strong sense of social justice, and productivity may rise as a result of the implementation of decent working conditions and reasonable wages.

13.4 The Global Financial Crisis, Economic Management and Fiscal Policy in the Short Run

The previous section of the article considered the arguments for those qualitative aspects of the right to work associated with improved working conditions and decent wages. This section and the one that follows extend this to the quantitative aspect associated with the right to a job, in the sense of the pursuit of full employment. It is argued that, despite the high levels of uncertainty associated with the global financial crisis, full employment is achievable in both the long and short run, with little cost, and should be made a policy imperative. The policies required to achieve this are also examined.

While Australia may well have had a recession in any case, the initial severity of the downturn in Australia was due to the worldwide financial crisis. Currently, our economy is much healthier than that of almost any other economy in the OECD. In Australia, prompt policy action led to economic activity being supported by strongly expansionary fiscal policy, with the immediate and appropriate stimulus package. This does not mean, however, that unemployment in Australia will continue to fall. If the support is cut back too quickly, there will be significant increases in unemployment, which also depends very strongly on the outlook for the global economy. While Australia has an easier task than most countries, the implementation of the policies recommended in this section is still urgently needed. In the case of Australia, the downside risk is less and depends more on indirect factors, such as the effects of flat or declining economic activity in many OECD countries on the economies of China and India. Nevertheless, in our judgment there is still a significant downside risk. Australian policy makers must be prepared for the possibility that things will go wrong. In Australia, there are signs that, as in Europe, support will be withdrawn too quickly in the name of conservative 'sound finance', as witnessed in the 2010 federal election campaign. This is encouraged by an unfortunate, even tragic, vision of overall possibilities by key economic policy agencies. We maintain that both the Reserve Bank of Australia and the Treasury have set their sights too low with respect to what can and should be achieved over the cycle in economic activity, and the resultant policy has led to the unemployment rate being higher than it should be.

Typically, monetary policy can be used to expand the economy, though its role in this respect would be a limited one. However, rather than being concerned with the right to work and setting policies to continue generating employment, policy makers, once again, have indicated an overriding concern with inflation and are using monetary policy to contract the economy due to their unnecessary worries that the economy is being overheated. As a result, the Reserve Bank has been increasing interest, causing reduced demand and reduced employment—and also reducing the standard of living of consumers, who now are faced with increased payments on their debt.

Other things being equal, increasing interest rates in Australia compared to international interest rates will increase the value of our currency. This makes imports into Australia cheaper in terms of our domestic currency, and either makes exports more expensive abroad or decreases the income of exporters. All these effects work to decrease the demand for goods and services produced in Australia and increase the demand for those produced overseas, compared with what would have occurred if there had been no change in the exchange rate. The value of the Australian dollar has risen since interest rates started to increase.

In addition, increases in interest rates may hinder business. Profits, of course, are the difference between revenues and costs. Interest rates enter into the calculation as part of the cost (actual or opportunity) of financing the project. This means that unless there is an expected revenue gain from a new investment project, it does not take place—no matter how low interest rates are. In a recovery, on the other hand, increases in interest rates increase the cost of borrowing and, therefore, hinder investment.

The extent to which fiscal policy was used in many OECD economies in 2008 to stimulate the economy was unprecedented in recent decades, but it did not involve any break with current economic orthodoxy. For at least the last 20 years, economists from a wide spectrum of schools of thought have held that fiscal policy can be a helpful tool in increasing output and employment when there is unused capacity in an economy. In a symposium at the 1997 Annual Meeting of the American Economic Association, five eminent but diverse economists, who between them had considerable experience on bodies concerned with official policy making or advising, discussed whether there is a core of practical macroeconomics that could be confidently used, especially to underpin macroeconomic policy. Their papers were published (Blanchard 1997; Blinder 1997; Eichenbaum 1997; Solow 1997; Taylor 1997). Given the diversity of the five, there is a remarkable degree of agreement between them.

All five economists agree that in the short run, due to wage and price rigidities, knowledge deficiencies, and perhaps expectation factors, fiscal policy, as well as monetary policy, can influence output, employment and unemployment, though their detailed theoretical reasons for this differ. This belief in the ability of fiscal policy to have the traditional effect on macroeconomic variables in the short run is not confined to academics. It has been affirmed in an official publication of even such a conservative institution as the IMF, which stated: ‘Most economists argue that in the right circumstances, fiscal expansion can be an effective tool to stimulate aggregate demand and revive a stagnant economy’ (Gupta and Clements 2005, 10).

All of the above assume that using fiscal policy to increase aggregate demand in a recession will result in a budget deficit. In the media and among politicians, there is still undue attention paid to whether expansionary fiscal policy will result in a budget deficit and what should be done if it does. For example, the federal leader of the opposition has stated that if there is a deficit, the government should outline its plans for repaying the money borrowed. In current circumstances, any deficit should be financed by a loan from the Reserve Bank, not by borrowing from the public at all. The only reason to borrow from the public is to prevent an increase in the money supply from increasing inflation. Inflation is not a current problem. A loan from the Reserve Bank need never be repaid. Whether or not it should be depends on the economic circumstances of the time. Often, it should never be repaid, though in some circumstances there may be political advantages in doing so. This is not a short-run issue and will be taken up again in the next section of this chapter.

It is true that since the 1997 American Economic Association Symposium, a so-called ‘new consensus on monetary policy’ received some prominence in the academic literature and even among central banks. The new consensus on monetary policy has rather dubious theoretic foundations (Kriesler and Lavoie 2005; 2007) and shows a remarkable ignorance of the history of economic thought and recent US economic history (Galbraith 2008). However, all that matters in this context is its primary policy recommendation—inflation targeting as the major guide to implementing monetary policy—and its claim that targeting inflation makes actual output conform to potential output, 'as an operational matter a central bank can make the economy conform to its underlying core' (Goodfriend 2007, 61). Goodfriend (2007) was published in the issue of a journal dated Fall 2007. Whether one regards this as an example of hubris or merely ironic, there is no doubt that the events in the US in (its) autumn of 2007 effectively ended any claims to real world relevance by the new monetary consensus.

There is one more point to be made in the discussion of issues in the short run—and one of considerable importance. It does matter what government expenditure is spent upon. In many countries, including Australia, spending on infrastructure is a very valuable way to increase government spending and, less obviously, this includes spending on human capital (that is, education and training, making the unemployed more 'job ready', and even such things as health) as well as physical capital. The increase in productivity resulting from this increased infrastructure expenditure will increase future growth rates, employment and incomes, increasing net government revenue and reducing the burden of any debt.

For humane, social and economic reasons, as well as from concern with basic human rights, spending on human capital should include measures to help the most vulnerable, such as the long-term unemployed and those who drift in and out of employment. The latter, while not technically long-term unemployed, share many of the same characteristics of the long-term unemployed and are just as vulnerable as members of the labour force. It is also important to help those who hitherto have had continuous, but casual, employment, and help them avoid joining the ranks of the long-term unemployed or of those who drift in and out of employment.

If one gives a high weight to concern for the less well off in our community, spending on human capital is clearly of prime importance. There are strong arguments as well that it also may be at least as important in raising productivity as investment in physical infrastructure. Vocational training can help overcome skill bottlenecks. From a longer-term point of view, Heckman has shown the importance of early intervention programs for disadvantaged children (Heckman and Kreuger 2003).

It is also worth noting that the increase in productivity resulting from this increased infrastructure expenditure will increase future growth rates. It will also increase net government revenue and hence reduce the burden of any debt.

13.5 The Global Financial Crisis, Economic Management and Fiscal Policy in the Long Run

With the context shifting to longer-run issues, the analysis in this chapter departs more significantly from the view of the dominant (neoclassical) school of economists. Therefore, the arguments are spelled out more fully. The neoclassical school holds that trend movements in real variables such as output, employment and unemployment are determined by the supply side. Thus, fiscal policy and other tools for managing aggregate demand have little place in long-run analysis. As Solow put it, 'the appropriate vehicle for analysing the trend motion is some sort of growth model, preferably mine' (1997, 230). In other words, neoclassical economists argue that the market will deliver the best outcome for employment, and that policy should not attempt to intervene—even if the market result does not guarantee everyone a job.

In the case of fiscal policy, the argument that it cannot affect long-run output and employment has been put at two levels. There is analysis that specifically relates to fiscal policy and argues that the stimulus it provides will, in the longer run, crowd out an equivalent amount of private sector economic activity. In addition, there is the more general belief that the longer-run growth path of an economy is determined by supply-side factors. Hence, fiscal policy, like any other policy instrument designed to influence aggregate demand, has no effect on real variables in the longer run, unless it has side effects which affect supply-side variables.

This is not the place for a discussion of the technicalities of crowding-out theory. Readers interested in this are referred to Kriesler and Nevile (2002). Suffice to say, regardless of whether or not one is convinced of the arguments in that paper, empirical evidence in Australia does not support the crowding-out thesis. If one examines changes in the size of the deficit and changes in short-term interest rates in Australia, it is hard to find a relationship—but, if anything, the relationship is inverse (Nevile 1997, 101–03). This is also the case overseas. Heilbroner and Bernstein carried out a cross-sectional analysis of the G7 countries. Pressman summarised their findings as follows:

> … those countries whose public debt increased most during the 1980s did *not* also experience the largest increases on real interest rates. In fact, if anything the actual relationship seemed to be the reverse. Canada, whose public debt increased the most among G7 countries between 1980 and 1986 experienced the smallest increase in real interest rates among the G7 countries over the same time period. Conversely the United Kingdom experienced the smallest increase in government debt and the largest increase in real interest rates. [Pressman 1995, 215.]

Once crowding-out theory is rejected, there is no reason not to return to something like a previous orthodoxy in which the goal of monetary and fiscal policy was to keep economic activity at the rate which produced full employment without inflation. This orthodoxy had no concern about whether any single or short series of budgets were in surplus or deficit.

However, the possibility of problems generated by a rising public debt over a longer period was acknowledged.

If a country's public debt is held by its own citizens, the liability (to taxpayers) is balanced by the assets of those citizens who hold the debt. Nevertheless, the consequences for income distribution of a continually growing public debt may be important. In theory, these consequences could be overcome through taxation and other fiscal measures for redistribution—but, if the interest bill is large, this may not be feasible for political reasons. Even so, the widely cited rule that the budget should be balanced, not over a year but over the business cycle, is too strict, as it ignores the effects of inflation and economic growth. If nominal gross domestic product is growing, there can be a positive budget deficit on average over the business cycle without any upward trend in the ratio of public debt to gross domestic product. However, in the case of Australia, this discussion is purely academic, since our public debt, net of debt between different levels of government, is close to zero.

However, most academics and even many bureaucrats probably have long-run macro neoclassical theory (growth theory) in mind when asserting that, in the long run, output, employment and unemployment are determined by supply-side factors, not due to a deficiency in demand, and cannot be reduced given the institutional structures of society. It is not possible to analyse the economic theory supporting this conclusion, since there is not any. Neoclassical growth theory just assumes full capacity of physical equipment and full employment. Solow states this unambiguously. Neoclassical growth theory, he says, supposes:

> … the available supply of labour always to be fully employed and the existing stock of productive capital goods always to be fully utilized … This assumption of full utilization could better be made explicit by introducing a government that makes (useless) expenditure and levies (lump-sum) taxes in order to preserve full utilization but this is rarely done … Full employment/utilization is usually just assumed. [Solow 2000, 350.]

Moreover, in the following paragraph Solow makes an even more damaging statement as far as the conventional view of neoclassical growth theory is concerned:

> The neoclassical model allows in one important effect for the interaction between fluctuations and growth: fluctuations will surely perturb the rate of investment and that will necessarily affect the path of potential output. [Solow 2000, 350.]

As Solow discusses later in his article, this is true of investment in human capital as well as investment in physical capital. In other words, if there is such a thing as a NAIRU, or a non-accelerating inflation rate of unemployment, it is path determined and is smaller the greater the amount of government expenditure on physical and human capital.

This raises the issue of the relationship between unemployment and inflation, or the Phillips curve. There is general agreement that at very high levels of unemployment, such as there are now, small to moderate changes in unemployment have no effect on inflation. According to neoclassical economists, decreases in unemployment usually increase the rate of inflation in the short run.[6] They hold that in the long run, the self-adjusting forces of a market economy will lead to market clearing in all markets, including the labour market. In other words, the market will determine an 'optimal' level of employment at NAIRU. As a result, while the short-run Phillips curve is upwards sloping, the long-run Phillips curve is vertical at the NAIRU. If unemployment is kept below the NAIRU for any length of time, this will lead to accelerating inflation. Related to this is the belief in the neutrality of money, so that monetary policy can have no long-run effect on the level of employment.

The rationale for the neoclassical view of the Phillips curve is that at the macro level employment and wages are determined in the labour market, where the wage rate is seen as the price which equates the demand and supply for labour. Assuming that demand and supply schedules behave in the conventional ways, a market clearing wage will be established, so that there would be no involuntary unemployment at that wage. Unemployment can only be the result of an impediment to the market mechanism, which prevented the wage rate from adjusting to the equilibrium level. Such rigidities or wage stickiness are assumed to be only short-run phenomena, so that the labour market will always clear in the long run.

However, we deny the ability of markets always to clear so that there is no underutilisation of resources, and we assert that this is particularly the case in the labour market. It is not the wage rate which determines employment but, rather, the level of aggregate demand in the economy. There is nothing inherent in capitalist economies that inevitably pushes demand to the full employment level.[7]

Nevertheless, over the last 25 years, as the importance of the financial sector has grown, more emphasis has been put on keeping inflation low compared to keeping unemployment low. In a speech to the National Press Club, just before his retirement as Governor of the Reserve Bank, Bernie Fraser said that monetary policy was becoming the hostage of influential financial markets with a vested interest in making the Reserve Bank give greater weight to inflation than employment. He was quite explicit about the reason for this:

> Most financial market participants rate low inflation ahead of the Reserve Bank's other objectives. This reflects a number of factors but the financial harm that is done to the holders of bonds when inflation and interest rates rise is the main one. [Cleary 1996.]

In Australia, and in many other countries, governments have defended a concentration on keeping inflation at a very low rate with the claim that high rates of inflation adversely affect longer-run growth in output and employment. There is no doubt that this is true for very high rates of inflation, but there is substantial evidence that this is not the case when the rate of inflation is below, say, 10 per cent. Those who support fighting inflation as the overriding goal of macroeconomic policy claim the support of the current dominant neoclassical school of thought in economics. Professor Robert Barro is one of the most respected members of this school. In a study of the experience of more than 100 countries over 30 years, Barro found that there was evidence of 'causation from higher long-term inflation to reduced growth and investment', but immediately commented that 'it should be stressed that the clear evidence for the adverse effects of inflation comes from the experience of high inflation' (Barro 1996, 168). The general tenor of Barro's article suggests that he had inflation rates above 20 per cent a year in mind when he used the term 'high', although anyone less sympathetic to the argument that inflation has adverse effects on growth might maintain that his empirical work shows that 'high' should be taken to mean more than 50 per cent a year. Barro's general result has been supported by numerous other studies.

Many media commentators and some academics have countered the argument for a reduction in the priority given to fighting inflation with the claim that such a reduction runs the risk of making inflation harder to contain, whereas pre-emptive interest rate rises add credibility to policy which lessens the risk of an increase in inflation. This is true, but the argument is completely symmetrical with respect to unemployment. Pre-emptive expansionary policy to increase employment equally lessens the risk of an increase in unemployment. In the Australian case, this is illustrated by the experience of the 25 years following the Second World War. No one doubted the commitment of successive governments to maintaining full employment. Both monetary and fiscal policy reacted quickly to the first signs of any looming decline in the rate of economic growth and minimised departures from full employment growth. The most spectacular example was the 1952 recession precipitated by the virtual halving of the price of wool that occurred as a result of the cessation of hostilities in the Korean War. The value of wool exports fell by about a half, while that of all other exports increased slightly. Real gross national product declined by over 10 per cent in 1951/52, but aggressive monetary and fiscal policy halted the fall after that one year. Unemployment rose in 1952/53, but by a relatively small amount and the rise did not last long.

13.6 Conclusion

The right 'to free choice of employment, to just and favourable conditions of work and to protection against unemployment' is one of the most basic human rights. As Sen (2009) points out, unemployment that is not short run has debilitating effects on many aspects of people's lives, including both psychological and physical health. As the effects of the global financial crisis initially increased unemployment in Australia, and most other countries are still faced with very high levels of unemployment, the right to employment is more important than ever.

We have argued that even in current economic circumstances, the right to 'just and favourable conditions of work' is also important. The thesis that improvements in working conditions will lead to significant increases in unemployment has been shown to depend more on ideology than empirical evidence. It is true that, if the global financial crisis produces a worldwide depression as severe as that in the first half of the 1930s, this empirical evidence may not be relevant, since it depends on data gathered in the post-World War II period, when there were severe recessions but no full-scale depression. However, we argue that if OECD countries pursue appropriate policies, the current crisis will not slide into a genuine depression. In a longer-run context, the rhetoric of the Commonwealth government is not so helpful. In seeking to maintain a reputation as a sound economic manager, our government suggests that in the longer run it will follow a course of action that is counterproductive. It argues that, unlike other sectors in the economy, governments should not borrow to invest in assets which will produce a flow of services, or income, for years to come. The government's focus on repaying in the future money borrowed now is likely to cut short the fall in unemployment before Australia reaches full employment as we have defined it and as is clearly implied in the Universal Declaration of Human Rights.

What we advocate is not pie in the sky. It has been achieved in the past—for example, in the first 30 years after World War II. Australians have the right to live in an economy that achieves this again. There will still be involuntary unemployment from time to time. Modern capitalism has had recessions throughout its history, and this is unlikely to change. However, appropriate policies can make involuntary unemployment short-lived. Anything else is a denial of a fundamental human right to hundreds of thousands of Australians.

Notes

1. The article began as a study in much greater depth of the issues explored in the authors' chapters in Bromberg and Irving (2007), after Hancock pointed out the need for this in his review of that book in the April 2008 issue of this journal (Hancock 2008, 232). However, those chapters were written before September 2007, and the need became apparent to give much more emphasis to the policies required to restore full employment.
2. Quoted in Bamber and Russell 2007.
3. That is, unless the state is committed to act as an employer of the last resort; see, for example, Burgess and Mitchell 1998.

4 See, for example, Kriesler and Lavoie 2005; 2007.
5 See also Kalecki 1939.
6. The short-run trade-offs between unemployment and inflation, which underlie this view of the Phillips curve, often do not work for a number of reasons. In particular, if prices are set on a cost-plus-mark-up model and there are constant or decreasing costs, there is no need for increased output to be associated with increased prices up to the level of full employment or full capacity utilisation.
7. These insights are associated with the work of Keynes and Kalecki. Many economists reject the vertical long-run Phillips curve, some even arguing that it may be horizontal. See, for example, Kriesler and Lavoie 2005; 2007.

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14
Minimum Wages, Unions, the Economy and Society

J. W. Nevile and Peter Kriesler

One of the characteristics of the WorkChoices *legislation introduced by the Howard government was the anti-union bias that permeated it. Some argue that this is appropriate because unions increase minimum wages, and economic theory shows that this will decrease employment and hence output. The Rudd government has signalled that it intends changing this anti-union bias, while at the same time restoring the role and coverage of minimum wages. This paper examines the arguments around these issues and concludes that neither side of the economic theory debate has delivered a knockout blow. The theoretical analysis is followed by a section looking at empirical evidence on the effects of deregulating labour markets. Again there is not complete consensus among the economics profession. However, both sides of the debate on the effects of labour market deregulation agree that strong minimum wage legislation does significantly reduce earnings inequality by increasing earnings at the bottom end of the distribution. The paper concludes that the increase in inequality consequent on labour market deregulation has adverse effects on the economy in the short run and disturbing longer run effects on society.*

14.1 Introduction

One of the most obvious characteristics of the *WorkChoices* legislation enacted by the Howard government, but an aspect underplayed in the media and in the 2007 election debate between political leaders, was its profoundly anti-union bias. A few of the more thoughtful journalists commented on it (for example, Ross Gittins, *Sydney Morning Herald*, 21 November 2005). The ALP and even the ACTU preferred to highlight the effects of *WorkChoices* on individuals, often through stories about actual individuals who had been treated particularly harshly by employers. After the election, the Rudd government signalled important changes to the *WorkChoices* legislation,

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under the label of *Forward with Fairness*.[1] The foreshadowed legislation includes provisions restoring the importance of collective bargaining, as well as restoring minimum protections in the form of National Employment Standards over a wider range of employment conditions than those covered by *WorkChoices*. Importantly, the proposed legislation will extend both the coverage of minimum wages, and also widen the range of factors which the new Minimum Wages Panel can consider in reaching wage decisions.

This Chapter maintains that while there may be some room for argument, though not much, about the effect of anti-union bias on the economy, which almost certainly will be adverse, there is no room at all for argument about the longer run effect on society which will be seriously detrimental due to the increasing inequality in income and wealth.

Another major change discussed by the Rudd government, as a departure from *WorkChoices*, is the role of collective bargaining. Under *WorkChoices* there was no requirement for employers to bargain collectively. Employers were free to bargain collectively with unions or other representatives of workers and many did. However, an employer was free to decline to bargain collectively with his or her employees. Such legal provisions 'effectively deny workers on AWAs the choice of participating in collective bargaining, thus undermining their fundamental right of freedom of association' (McCallum, Chin and Gooley 2007: 102). Perhaps the best insight into the Howard government's attitude towards unions was given by the disparate treatment accorded to small businesses and unions. The Coalition recognised that small business may have little or no bargaining power and little influence on prices and other conditions of supply of goods and services. It therefore legislated to allow small businesses to notify the Australian Competition and Consumer Commission (ACCC) that they wish to bargain collectively, and even hold a collective boycott if appropriate, and the ACCC was allowed to assess such notification (Australian Competition and Consumer Commission 2007). The Trade Practices Act does not deal with employer/employee collective bargaining as this is regulated under industrial and workplace relations legislation. However, employees have had no legal way of bargaining collectively if their employer has declined to do so. The Coalition accepted, for example, that experienced farmers should be able to bargain collectively with buyers of their produce, but denied a supermarket employee, even a teenager from a non-English speaking background, any similar right with respect to wages.[2]

The new workplace relations system which the Rudd government is hoping to implement restores the role of collective bargaining, particularly at the enterprise level. Employees will have a right to appoint a bargaining representative, which includes unions. In other words, employers will no longer have the right to refuse to bargain collectively with their employees.[3]

In order to evaluate the proposed changes to the workplace relations system, it is important to realise that *WorkChoices* has been defended with the argument that economic theory shows that if it is successful in keeping down wage rates at least at the lower end of the scale, then this will increase employment there and hence output. However, economic theory does no such thing. The following section of the paper examines this claim in detail and concludes that neither side of the economic theory debate has delivered a knockout blow on the role of minimum wage legislation, though many economists, including the present authors, award a victory on points to those who argue that the effects of the proposed Rudd government changes, on the total number of persons employed and on aggregate output, are less likely to be adverse than the effects of *WorkChoices*. The theoretical analysis is followed by a section looking at empirical evidence on the effects of deregulating labour markets, drawing on both Australian and overseas experience. Again there is not complete consensus among the profession, though many labour market analysts would agree that this is not surprising as the result of labour market deregulation depends on institutional and wider cultural factors. However, both sides of the debate over the effects of labour market deregulation agree that strong minimum wage legislation, of the kind the Rudd government wishes to implement, does significantly reduce earnings inequality by increasing earnings at the bottom end of the distribution. In our conclusion we argue that the increase in inequality consequent on labour market deregulation has adverse effects on the economy in the short run and disturbing longer run effects on society.

14.2 Theoretical Arguments

Typically, in the literature, unions are seen as keeping wages from falling while maintaining them at levels higher than they otherwise would be at, as well as being concerned with working conditions which may raise labour costs as well as productivity. In this section we evaluate the theoretical case for and against wage flexibility and lower wages as an effect of labour market deregulation.

The main rationale for the link between flexible wages and employment comes from the analysis of a firm in a perfectly competitive industry. Under these conditions, firms will produce a profit maximising output by equating marginal cost and marginal revenue. As perfectly competitive firms face an infinitely elastic labour supply curve, the marginal cost of hiring an extra worker is simply the wage, while the marginal revenue is the value of the worker's marginal product.

This assumes that firms can simply hire as much labour as they want without affecting the price of labour. However, firms which are large relative to the size of the labour market for the types of workers they hire may not be price takers with respect to labour. These firms have market power in the labour market. Under these conditions, they face an upward sloping supply curve for labour, and so must increase the wage offer in order to hire additional labour. Unless the firm discriminates, this higher wage must be paid to all workers, not just the last one employed. As a result, it follows that the marginal cost which these firms face for each extra unit of labour is greater than the wage rate. That cost, the marginal factor cost, is defined as the variation in the firm's total cost of labour of employing an extra unit. The marginal factor cost curve lies above the supply curve for labour because the cost of hiring an extra worker is higher than the wage paid to the marginal worker, as it includes the increase in the wage bill due to the higher wage paid to all the previously employed workers.

The profit maximising output occurs when the firm equates marginal factor cost with marginal revenue product, ie, the cost of hiring an extra worker with the addition to total revenue which that worker brings to the firm. The demand curve for labour slopes downward due to the assumption that the marginal product of labour decreases with increased output. In Figure 14.1, this generates a level of employment 0L*. The wage rate corresponding to that level of employment is derived from the supply of labour curve, and is W*. This can be compared with the competitive level of employment, Lc and wage rate Wc obtained from the intersection of the supply and demand curve.

In this particular situation, a minimum wage set between the competitive wage (Wc) and the monopolistic wage (W*) will both increase wages AND increase employment.

In other words, what we have seen is that, even at the microeconomic level, neoclassical theory accepts that, once we are outside the world of

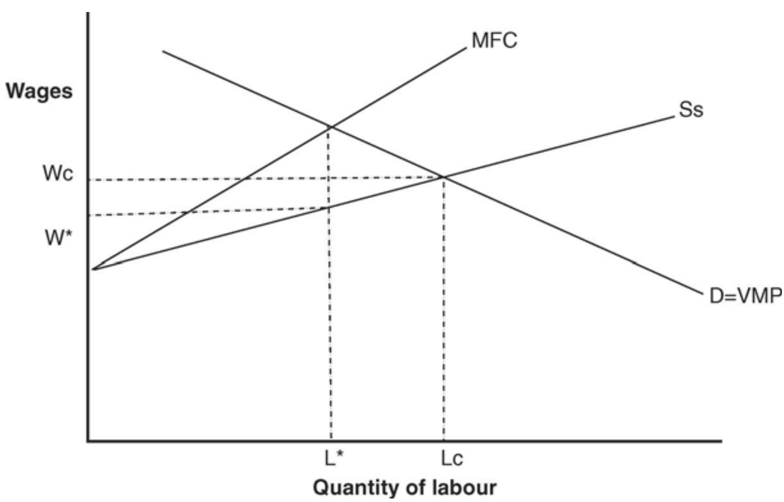

Figure 14.1 The profit maximising wage and employment levels for a firm with market power

perfect competition, minimum wages can increase employment. So, once we leave the world of perfect competition, the argument that a reduction in wages will always be employment creating needs to be modified.

At the macro level, according to the conventional wisdom, employment and wages are determined in the economy wide labour market, where the wage rate is seen as the price which equates the demand and supply for labour. Assuming that demand and supply schedules behave in the conventional ways, a market clearing wage will be established, so that there would be no involuntary unemployment at that wage.[4] Unemployment can only be the result of an impediment to the market mechanism, which prevented the wage rate from adjusting to the equilibrium level. This is represented in Figure 14.2.

In Figure 14.2, W is the wage rate, and N the number of workers. SS, the supply of labour is represented as an increasing function of the wage rate, while DD, its demand, is a decreasing one. At the equilibrium wage rate of W_e, N_e is the quantity of labour both supplied and demanded, so that the labour market clears and there is no unemployment. If, for some reason

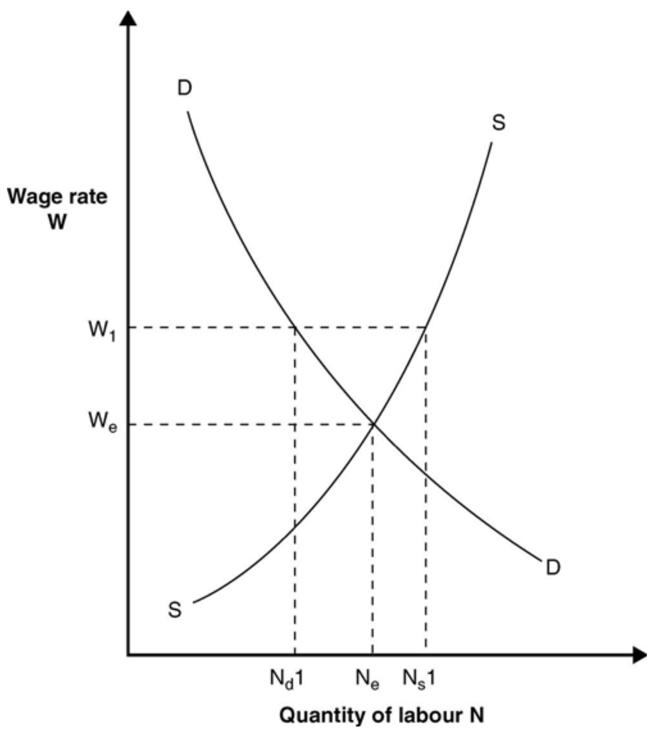

Figure 14.2 Employment, wages and the labour market

such as minimum wage legislation or union activity, the wage rate is not allowed to adjust, so that it cannot fall below W_1, then the demand for labour will be N_d1 while its supply will be N_s1 The difference between these represents an excess supply of labour, or, in other words, unemployment. The labour market is seen as guaranteeing full employment, unless there are rigidities in the wage rate. Only in that event is there a role for government. For neoclassical economists, the role of government is limited to trying to eliminate the rigidity, although, especially after the work of Keynes there were alternate suggestions that the government may attempt to increase the demand for labour.

Keynes, in 1936, published *The General Theory of Employment, Interest and Money,* in which he was extremely critical of this explanation, and proposed an alternative account of the determinates of employment. Keynes' main criticism was in terms of the fallacy of composition. In other words, he argued that the neoclassical macro story incorrectly extended results to the economy as a whole which were only true for individual firms or industries. In particular, with respect to the labour market, Keynes argued that, while it was true that a reduction in the wage rate would increase an individual firm's demand for labour, this was not true of a general reduction in wage rates. The reason for this is that when we are considering an individual firm, it is reasonable to assume that it can reduce wages while the level of aggregate demand in the economy as a whole, and hence demand for their product, remains unchanged. However, if all wages fall, then the level of aggregate demand will also fall, and this will reduce employment or, at best, leave it unchanged. Keynes also argued that neoclassical theory is incorrect in portraying labour as bargaining for a real wage. Rather, the labour market bargain only determines the money wage. In other words, Keynes denied the quantity theory of money, maintaining that real wages are determined in the goods market where prices are determined.

It is not the wage rate, according to Keynes, which determines the level of employment, but rather the level of effective demand. Effective demand is determined by the sum of consumption demand, investment demand, net government demand and net international demand.

Keynes' central message was that there was no mechanism in a capitalist economy which could guarantee full employment. He explicitly rejected flexible wages as a solution, because he believed that the main cause of unemployment was insufficient effective demand, and a reduction in wages would not increase that demand.

Heterodox economists have developed Keynes' insights[5] and shown that wage flexibility is not an important factor in the determination of employment. They stress the dual role of wages as both a cost to the employer (and so increases are likely to reduce employment) and an income for the employee, and, therefore a source for their spending and demand (and so increases are likely to increase employment). As a result, there is no determinate relation between wage rates and the level of employment, as this will depend on a number of factors, including the state of the economy (Seccareccia 1991).

14.3 Empirical Evidence

Those wishing to restrict the influence of unions usually justify this stance by two claims: first that by raising wage costs unions reduce employment; and second that employment is also reduced by union support for security of employment.[6] Empirical evidence, both overseas and in Australia, provides little support for the proposition that unions by raising minimum wage rates above the market clearing level (where demand equals supply) increase unemployment and reduce output. There has been a long and acrimonious debate among labour economists about the effects of raising the minimum level of wages on employment. In the thirty years to 1980 a substantial number of studies were made of the effects of changes in wage rates, especially minimum wage rates, on the level of employment. A survey in the *Journal of Economic Literature* by Brown, Gilroy and Kohen (1982) concluded that:

> Time series studies typically find that a 10 per cent increase in the minimum wage reduces teenage employment by one to three per cent. … We believe that the lower half of that range is to be preferred; to the extent that differences in results can be attributed to differences in the specifications chosen, the better choices seem to produce estimates at the lower end of the range. … Cross-section studies of the effect on teenage employment produce a wider range of estimated impacts … but estimates of 0 to .76 percentage points are most plausible.
>
> The effect of the minimum wage on young adult (20–24 years) employment is negative and smaller than that for teenage employment. This conclusion rests on much less evidence than is available for those 16–19 years. The direction of the effect on adult employment is uncertain in the empirical work, as it is in the theory. (p. 524)

Various studies suggest that when minimum wages are increased, one effect is that adult employment increases at the expense of teenage employment.[7] To the extent that this is the case, the studies of teenager employment will overstate the elasticity of demand for labour as a whole.

In the 1980s there were fewer studies, but the pattern was for estimated effects of a rise in the minimum wage to be the same or smaller than those summarised by Brown, Gilroy and Kohen in the above quotation.[8]

The 1990s saw an increase in the number of studies published, most of which suggested that, if anything, the Brown, Gilroy and Kohen summary overestimated the effects on employment of a rise in the minimum wage.

The most influential studies occurred in the context of a controversy between Neumark and Wascher, and Card and Kreuger. Neumark and Wascher (1992) used panel data on US state minimum wage laws and found that the effects of these laws on employment depend heavily on the exact specification of the estimating equation. In their preferred specification a 10 per cent increase in the minimum wage caused a decline of one to two per cent in employment of teenagers and young adults.

A whole series of United States studies by Card and Kreuger found that raising the minimum wage increased employment rather than reducing it, although in only two studies out of seven was the increase in employment statistically significant at the 5 per cent level.[9] However, to quote Card and Kreuger themselves,

> the results are uniformly positive and relatively precisely estimated. We find zero or positive employment effects for different groups of low-wage workers in different time periods, and in a variety of regions of the country. The weight of this evidence suggests that it is very unlikely that the minimum wage has a large negative employment effect. (1995: 390)

This provoked a counter study by Neumark and Wascher using data supplied by a quasi lobby group—the Employment Policies Institute. They found that employment had fallen in New Jersey fast food restaurants, although the fall was only weakly significant by the usual statistical criteria. However, Neumark and Wascher (1995) acknowledged that the Employment Policies Institute had 'a stake in the outcome of the debate' (p. 5). They undertook another study collecting additional data of their own. When they combined the two sets of data the rise in the minimum wage was followed by a fall in employment which was significant at the 5 per cent level. Their own data gave results which were not statistically significantly different from those of Card and Kreuger. Arguments for and against Card and Kreuger's position were not confined to the original participants and became very acrimonious, to say the least,[10] but those arguing that the elasticity was negative not positive never argued that it was large. The passion was over the sign of the elasticity.

A similar argument applies to reducing wages by abolishing loadings and penalty rates, as long as the discussion is confined to wages and employment of relatively low paid workers as occurred under *WorkChoices*. Loadings paid to those with medium to high levels of wages are another matter, and not much empirical work has been done on this.

The studies so far discussed were mostly undertaken at the firm or industry level. Another set of studies was prompted by the OECD (1994) study called Jobs Study. This study made ten recommendations about changes in institutions and policies in order to reduce unemployment. Six were easy for economists of a wide range of persuasions to accept. Three of the others—increased flexibility of working hours, reforming (i.e. reducing) employment security provisions and allowing more flexibility in wages and other labour costs (so that they could be reduced overall)—are things that unions would normally oppose. The final one related to unemployment benefits. Studies supporting or opposing these OECD recommendations look at the issue at a macro level and by and large used cross country comparisons. The evidence from some of the studies supports the view that the effects of raising wage costs on the level of unemployment are significant but other studies suggest the opposite. Freeman (2005) suggests two reasons for this inconclusive result:

> The first reason is that many adherents to the claim [that unions and other labour market institutions reduce employment] hold strong priors that labour markets operate nearly perfectly in the absence of institutions and let their priors dictate their modelling choices and interpretation of empirical results. The second reason is that the cross-country aggregate data at issue is weak — too weak to decisively reject strong prior views or to convince those with weaker priors. (p. 2)

Notice that Freeman judges that it is 'priors', or ideology, that underpin the conclusions supporting the OECD view, not the empirical evidence taken by itself.

Before leaving the effects of wage rates on employment it is perhaps appropriate to look at an Australian study made in response to the OECD *Jobs Study*. Debelle and Vickery (1998) provided the basis for the elasticity of demand used in a high profile policy proposal made by five economists to the former Prime Minister[11] made in 1998. This proposal used an elasticity of demand for labour of around –1. However, a careful reading of Debelle and Vickery shows that their empirical work does not lead to this conclusion. Debelle and Vickery argue that reducing real wage rates may increase employment, and reduce unemployment, in two ways. The first is through the substitution of labour for capital (with no change in output). The second they call the scale effect. It is a further possible effect which occurs if reducing real wages increases output. All the empirical research of Debelle and Vickery is into the first of these effects. They explicitly state that they do not know the size of the scale effect or even if it is positive. They make two assumptions. One is that there is no effect on output; an assumption they think is at the bottom end of the range. The second is one at the other end of the range, that output increases by so much that the final increase in employment is 2.4 times as large as that occurring just through the substitution of labour for capital with no change in output. It is results based on the second of these assumptions that the five economists use. They completely ignore results based on the first. Since Debelle and Vickery put in the too hard basket the task of estimating the effect of economy-wide wage changes on employment and output—a decision that may well have been wise—their study does not add to the empirical evidence on this issue despite the appeal to it by the five economists.

Freeman's conclusion that there is no robust evidence suggesting that high wage rates overall reduce employment remains, a fact admitted by the OECD (2004) who state that: 'The evidence is somewhat fragile overall and highlights the complexity of wage-setting institutions in OECD countries and their implications for economic performance' (p. 165).

As we saw above, the OECD *Jobs Study* also opposed Employment Protection Legislation (EPL) in general. However, after strong theoretical and empirical criticism, it has recently reversed its position. In 2004 the OECD *Employment Outlook* stated that:

> *The net impact of EPL on aggregate unemployment is therefore ambiguous* a priori*, and can only be resolved by empirical investigation*. However, the numerous empirical studies of this issue lead to conflicting results, and moreover their robustness has been questioned. (OECD 2004: 63, italics in original)

and:

> The impact of EPL on overall employment and unemployment rates is ambiguous .... Overall, theoretical analysis does not provide clear-cut answers as to the effect of employment protection on overall unemployment and employment. … no clear association can be detected between EPL and unemployment rates. (OECD 2004: 80)

Freeman (2000) summarises very succinctly the reasons for this retraction:

> The OECD Jobs Study came down strongly in favour of deregulation and active labour market policies, but succeeding analyses by the OECD have highlighted the weakness of that case. Countries with very different regulatory practices and policies have surprisingly similar outcomes. (p. 8)

There is now strong evidence suggesting that deregulation of labour markets and the related increased labour market flexibility is not associated to any significant extent with increased levels of employment or falling unemployment. The OECD (2004) itself has commented:

> *High union density and bargaining coverage, and the centralisation/co-ordination of wage bargaining tend to go hand-in-hand with lower overall wage inequality.* There is also some, albeit weaker, evidence that these facets of collective bargaining are positively associated with the relative wages of youths, older workers and women. On the other hand … [our study] does not

> find much evidence that employment of these groups is adversely affected. *No robust associations are evident between the indicators of wage bargaining developed in this chapter and either the growth rate of aggregate real wages or non-wage outcomes, including unemployment rates*. (p. 130, italics in original).

and:

> The .... analysis confirms one robust relationship between the organisation of collective bargaining and labour market outcomes, namely, that overall earnings dispersion tends to fall as union density and bargaining coverage and centralisation/co-ordination increase. It follows that equity effects need to be considered carefully when assessing policy guidelines related to wage-setting institutions. (p. 166).

The World Bank, traditionally a member of the Washington consensus, has gone much further not only confirming the effects of unions in reducing inequality but also affirming that they can improve macro economic outcomes. 'At the macroeconomic level, high unionisation rates lead to lower inequality of earnings and can improve economic performance (in the form of lower unemployment and inflation, higher productivity and speedier adjustment to shocks)' (World Bank 2003). The reduction in inequality itself plays a large part in bringing these and other benefits to the economy. It is reasonable to suppose, and the empirical evidence confirms, that workers 'care' about just conditions and equity, and they react adversely to perceived unfairness and inequality. In addition, there is evidence of a link between better employment rights and improving economic performance through improvements in labour productivity associated with better education and skill acquisition—and in increased FDI, among other factors.

14.4 Conclusion

The anti-union bias of *WorkChoices* was rationalised on the grounds that unionism is inimical to growth in employment and output. This paper has shown that, not only are there no rigorous theoretical justifications for the ideas underpinning that view but that the evidence supports the opposite position—that unions are associated with improvements in working conditions, which both are important in their own right, and also have a positive impact on productivity. There is no robust theoretical or empirical evidence to support the claims of supporters of the anti-union bias, suggesting that the support for this view is strongly ideological. We consider one of the main results of union activity to be higher minimum wages. There is considerable empirical evidence showing that higher minimum wage rates, in the range experienced in Western economies, only have a very small effect on employment. In any case, there is no consensus about the direction of any change in employment following a rise in minimum wage rates. What there is consensus about is that reducing minimum wages will increase inequity of earnings, which may have further undesirable social effects. This suggest that there will be positive effects on the economy from the Rudd government's proposed modifications to the industrial relations laws.

Concerns about the effect of inequality on individuals usually concentrate on those at the bottom end of the range. The same is often true with the effects of inequality on society more generally. Low income people may turn to crime if their income is inadequate to enable meaningful participation in society. Increases in income inequality may reduce productivity. This is particularly the case as empirical evidence suggests that workers care about social justice and that their incentive to work is influenced by their perception of how they are being treated. Also, casualisation is likely to reduce the commitment of workers to firms and hence reduce motivation and productivity. Very rapid increases in inequality, such as have occurred in Australia and the United States over the last decade or so, may reduce social capital more generally. In the extreme case financial inequality can greatly reduce democracy if that is defined as one person one vote and the concept of voting includes having significant power in choosing governments. Voting is not done in a vacuum. Voters are influenced by advertising but also by arguments. The richer one is, the more one can spend on advertising and on placing one's arguments before thoughtful voters who want more rigorous arguments than those incorporated into advertisements. But the problem goes even deeper than this. Those who are very rich can sometimes ensure that the generally accepted beliefs in the community are those which further their particular interests.

To sum up, above a certain level as inequality grows the inequality itself acts against economic efficiency and a healthy society. The size of the gap between the rich and the poor is important as well as the absolute level of the income of the poor. In the longer run and in the bigger picture the most important contribution of unions may well be moderating the size of this gap. As a result, the paper supports the view that the changes proposed by the Rudd government under the head of *Forward with Fairness* are likely to lead, at the very least to increased equality with no impact on employment and output, though it is likely that these will also improve.

Notes

1. Some of the key elements of the government's plans are documented at the *Forward with Fairness* website: http://www.workplace.gov.au/workplace/Publications/PolicyReviews/ForwardwithFairness/.

2. This issue is discussed in by Joe Isaac in a symposium 'Collective bargaining under trade practices law'.
3. The importance of collective bargaining in any new industrial relations legislation is supported by Hancock (2008) and McCallum (2008).
4. This required that, for both schedules, if the income effect was of the opposite sign to the substitution effect, its absolute value was smaller.
5. These were simultaneously 'discovered' by Kalecki, who has also been an important influence in the heterodox tradition. See Kriesler (1997, 2002).
6. See for example Business Council of Australia (2007).
7. See for example Bureau of Labour Market Research (1983).
8. See for example Solon (1985), Swidinsky (1980) and Kaufman (1989).
9. Some of these studies were done separately and some together. Laurence Katz was co-author of two of the articles describing them. They are all set out in detail in Card and Krueger (1995).
10. See Blinder 1996 for a description and evaluation of the controversy between Card and Kreuger and Neumark and Wascher.
11. For details of the proposal see Dawkins (1999).

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15
Full Employment, a Neglected, but Indispensable and Feasible Human Right

J. W. Nevile and Peter Kriesler

Human rights are the foundation of human existence and coexistence. Human rights are universal, indivisible and interdependent. Human rights are what make us human. They are the principles by which we create the sacred home for human dignity. [Message by Kofi Annan, Secretary-General of the United Nations, on the fiftieth anniversary year of the Universal Declaration of Human Rights 10 December 1997]

15.1 Introduction

December 10 1998 was the fiftieth anniversary of the Universal Declaration of Human Rights. This Covenant of the United Nations was a direct result of the atrocities committed during the two world wars. It has provided the starting point for most discussion of human rights issues for this century.

Within this context, it is appropriate to be discussing the issue of the right to employment, as, despite the fact that a later Covenant specifically dealt with economic rights, it was deemed sufficiently important to be incorporated in that original covenant, alongside an important right to economic well being:

> Article 23: Everyone has the right to work, to free choice of employment, to just and favourable conditions of work and to protection against unemployment. .... Everyone who works has the right to just and favourable remuneration ensuring for himself and his family an existence worthy of human dignity and supplemented, if necessary, by other means of social protection.

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> Article 25: Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family.

In other words, the right to work was seen as one of the fundamental rights, incorporated into the document which defined the Human Rights Agenda for the Twentieth Century. As such, as indicated in the quote at the beginning of this chapter, it was seen, by the international community, as an essential element of human existence and coexistence, part of what it means to be human.

The importance of these rights was further highlighted by the United Nations Covenant on Economic Social and Cultural Rights which was ratified by Australia in December 1975, and came into force generally the following month, and in Australia on 10 March 1976. The Covenant articulated specific rights, the most fundamental of which are argued to be the right to a basic standard of living and the right to freedom from hunger. It includes recognition of economic rights such as the right to "the highest attainable standard of physical and mental health" [Article 12]; "the right of everyone to education" [Article 13]. The right to work is enshrined in Article 6:

> The State Parties to the present Covenant recognize the right to work, which includes the rights of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right.

In other words, the right to work in the form of some commitment to full employment is regarded as one of the most fundamental human and economic rights. This, of course, was acknowledged in most Western countries with the post war consensus built on a belief in full employment. In the United Kingdom and in Australia, these beliefs were manifest in White Papers in 1944 and 1945 respectively, while the United States passed the Employment Act in 1946.

In any case, given Australia's legal commitment to both of these United Nations Covenants, the importance of a commitment to full employment is obvious.

This commitment to full employment lasted until the early 1970s. Then, as the result of inflationary and international pressures governments changed the focus of their policies to concentrate on fighting inflation first. Full employment ceased to be the major aim of economic policy, replaced by the perceived need to fight inflation and current account problems. In a very real sense, jobs were sacrificed on the altar of anti-inflation policy.

This state of affairs has continued up to the present day. The elimination of unemployment has ceased to be the major imperative of governments, as a result of which unemployment has remained at unacceptably high levels for well over two decades, and indications are that it will continue to do so.

Without question the existence of unemployment indicates a denial of the rights of the unemployed, not just the right to employment, but also to a variety of other rights which depend of employment. As mentioned above, both the Universal Declaration of Human Rights, and the Covenant on Economic Social and Cultural Rights proclaimed other fundamental rights, which are closely linked to unemployment. In particular, the right of people to live in safe environments, and the right to high levels of mental and physical health are both threatened by the existence of unemployment. As is argued in the next section, there are strong links between unemployment and crime; and between unemployment and poor mental and physical health. In other words, when people's right to full employment is not fulfilled, then other fundamental rights are also severely constrained.[1]

A fundamental question which needs to be addressed is why this situation is tolerated. Given that government economic policy could significantly reduce unemployment, the question is, why don't they do so? There are, we believe, two main reasons which are used to justify this neglect.[2] Firstly, the benefits of reducing unemployment are underestimated because the costs to the individual and to society of violation of this fundamental right are severely underestimated. This is because economists concentrate on the opportunity cost mainly in terms of lost output and social security payments. However, this ignores all the other costs associated with unemployment, many of which are only just being uncovered.[3] The next section will consider the additional costs of unemployment by examining the impact of unemployment on social relations and health. Secondly, the costs and difficulty of reducing unemployment are severely overestimated. It is often argued that higher unemployment is the price which must be paid to prevent either higher inflation or worsening current account deficits. It should be noted that neither of these provide binding long-term constraints, and, in any case, it is not clear that the costs of higher inflation are worse than those of higher unemployment. The third section of the chapter will evaluate the feasibility of achieving full employment, considering both inflation and the current account as constraints on employment creation. Those economists who believe in the "natural rate of unemployment" would argue that attempts to reduce unemployment below the natural rate are self-defeating. Some would add, that since we do not know, at any point of time, what the natural rate is, then it is best to learn to live with whatever level of unemployment we happen to have. These propositions are also considered in section 3. Finally, the feasibility of full employment in Australia will be analysed by way of a suggested policy package in section 4.

15.2 Employment as a Human Right

It is important to realize that the significance of employment in modern societies is not limited, as most economists suggest, simply to its role in the derivation of income. In most cases, economics treats work as a disutility necessary to generate income. However, this loses sight of the role that a person's job gives them in defining their place in society as well as giving access to resources which influence not only their immediate needs, but also that of their families. In other words, a person's job and the entitlements associated with it help define the range of most choices open to them and to their family. Of vital importance is the link between a large array of socio-economic factors, such as crime, health and education with employment and reasonable income levels. This relates to stress and feelings of social exclusion associated with the state of unemployment. Indeed many other human rights are profoundly influenced by employment considerations.

Employment is a "human right" in the sense identified by Secretary-General Annan at the beginning of the chapter, it defines people and is an essential part of their dignity:

> It is also the case that work establishes a right to respect, to a feeling of self-worth and some argue to an identity. ..... The question 'What do you do?' is often asked when people meet for the first time as is well understood in our culture to refer to work – to an occupation. From the answer we learn what level of income they are likely to earn. What kind of house they live in, what type of school their children attend and so on .... Work is central to our material existence, to our place in the world and in fact to every aspect of human life. [Allen 1997: 54–55,64]

As well as being an important right, per se, employment has profound effects on other rights. In other words, where people's rights to employment have been infringed, it is likely that some other basic right is also being transgressed. Two human rights which are particularly closely linked to employment are the right to adequate health and well being, and the right to live in a safe environment. Both of these are threatened by the existence of unemployment, which is associated with increases in health problems and with increased criminal activity; both crimes against the person and against property.

The relationship between employment and the income streams it generates and health problems has been well documented:

> The mounting scientific evidence ... all points to a better health status for those who earn more, know more, or have more power. [Gunning-Schepers quoted in Whitehead 1993: 3]

> [F]indings indicate that wealthier people not only live longer but also spend a significantly smaller proportion of their life disabled. [Whitehead 1993:3]

Whitehead (1993) gives strong evidence to demonstrate that a range of physical and mental conditions are strongly related to differences in income and wealth, and that "the chance of achieving and maintaining good health" is unevenly distributed in the population, basically being determined by socio-economic factors.

Further research by Wilkinson, on cross country analysis indicates that the relationship between GDP per capita and indicators of health such as life expectancy is strongest when considering "poorer third world countries". For these, there is a strong relationship between the two. However, for the richer developed countries, the relationship appears to be much weaker. Increased GDP per capita has little influence on average life expectancy. "The correlation between them is almost non-existent." [Wilkinson 1993: 7] Instead, what seems to be a more important determinant of health status in developed countries is relative income. Evidence suggests a strong relationship between health indicators, including life expectancy and income distribution. There is a "clear tendency for life expectancy to be better when income distribution is more egalitarian. ... [T]he income share going to the whole of the bottom half of the population .. seems to be the most closely related to the population's average life expectancy" [Wilkinson 1993 pp. 7, 9]. The evidence suggests that, for developed countries, although the absolute level of income and hence standard of living do matter, there are also important "psychosocial channels" which mean that health is affected by "your sense of yourself and your subjective quality of life. What matters is the depression, isolation, insecurity and anxiety caused by low incomes ... [T]he sense of insecurity and worry is central to the casual process." [Wilkinson 1993: 9]. Of course, all this is just as true of the problems associated with the psychosocial effects of unemployment.

> [T]he lack of an adequate income and the sense of relative deprivation associated with poverty can lead to a situation of psychological stress, which results in a loss of self-esteem and adversely affects the nature of people's social relations. [Saunders 1998:12]

Although it is obviously difficult to disentangle the effects of poverty from those of unemployment, two observations should be made. Where attempts have been made to analyses the contributions of these as separate factors, it has been noted that both have major separable influences on health problems. In any case, since unemployment is a major casual factor of poverty, the debate may be purely academic.

There is, however, a strong body of evidence which supports the view that unemployment, per se, has an important causal link with illness, particularly mental illness.[4]

> The underlying rationale for unemployment leading to increased mental and physical illness is that employment not only provides an income but also a set of social relationships which provide structure and meaning to life. [Junankar 1987: 5]

In other words, in additions to the impact caused by any loss of income, unemployment has a separate impact on health due to its effect particularly on mental well being.[5] Not surprisingly, the risk of health problems is strongly linked to the length of unemployment.[6]

As well as the link between unemployment and health, there is also a link between unemployment and crime. A report by leading criminologists suggests that there is "an overwhelming link" between unemployment and certain types of crime, particularly crime against person and property.[7]

Recent work from the NSW Bureau of Crime Statistics and Research, suggests that the nature of the link is more complex than was previously believed. The evidence suggests that there is not a simple linear relationship, where an increase in unemployment leads to a proportional increase in crime. Nevertheless, there does appear to be a strong positive relation. However, the exact impact of an increase of unemployment on crime depends is multifactoral, depending on, inter alia, age and gender. In addition, there is an important intergenerational effect from an initial increase in unemployment. Initially, the unemployed are more likely to commit crimes, for pretty much the same types of reasons that they are likely to have increased health problems. However, there is also an important second generational effect. The unemployed lose parenting skills. Living in areas with high unemployment and crime, youth loses hope and motivation. Hence, the children of unemployed are also much more likely to have serious social and health problems, and commit crimes.[8]

This preliminary discussion of the wider ramifications of unemployment has helped highlight the reason why employment is regarded as a fundamental human right. Employment has profound impacts on the individual way beyond that of the income it generates. It defines the person and their place in society, and it grants access to a range of resources which, themselves, are associated with fundamental rights. So, unemployment conflicts not only with the right to full employment, but, due to its consequences with other rights; particularly those associated with adequate health and with living in safe environments.[9]

Given this vital role, we need to examine carefully the question of why full employment is not currently being achieved in any major economy.

15.3 Full Employment is Feasible

This chapter argues that full employment is feasible. How strong a claim this is depends on how that concept is defined. We define it as a situation in which there is only frictional unemployment. In operational terms full employment could be said to exist when virtually everyone who is actively searching for a job can find one within three months. It may not be possible to prevent relatively small levels of cyclical unemployment occurring from time to time, but this chapter argues that the Australian economy can return to a situation in which both full employment is the norm, and this is achieved without unduly low wage rates at the bottom end. The chapter finishes with a policy package to achieve this, not in a year or two, but over 5 to 10 years. First, however, the arguments that this result is not feasible are examined.

There is a strong body of opinion in the profession that the economy tends towards a high a level of employment, and the government is powerless to reduce unemployment, except perhaps temporarily.[10] The reasons for adopting this position fall into three categories: ideology, fear of inflation and fear of a balance of payments crisis.

15.3.1 Ideology

Most disciplines have their own characteristic ideology and many modern economists tend to be seduced by the Arrow-Debreu general equilibrium model. It is elegant and appears to be a powerful tool to analyse how the market works. Moreover, its conclusion that the market produces a Pareto optimum market clearing situation sits comfortably with the libertarian social philosophy so fashionable in the North American graduate schools where many Australian economists studied. Whatever the reason a large number of Australian economists assume that the economy will tend to a general equilibrium situation in which unemployment is at the "natural rate", as Friedman christened "the level that would be ground out by a Walrasian system of general equilibrium equations, provided there is embedded in them the structural characteristics of the labor and commodity markets" (1968: 8). However, as any competent economist knows, the conditions necessary for a Walrasian general equilibrium model to hold are so far from anything in any actual economy that it is a matter of judgement whether it is appropriate to use the model to analyse any particular problem. The best practitioners in the area do not regard any attempt to identify the model as a description of reality as legitimate.[11] It is hard to find any empirical evidence to support the view that the natural rate concept gives useful insights about the major determinants of aggregate unemployment. Hence, we have classified as ideology this reason for rejecting macroeconomic policy moves to reduce unemployment.

The purest form of "natural rate" economics is the new classical model which maintains that, even in the short run the government cannot affect the level of unemployment through macro-economics unless policy moves take people by surprise, so that they do not take them into account in their decision making and act on incorrect information. In this model, any departure from the natural rate of unemployment can only be over a period of time short enough for government policy actions to be unexpected and unnoticed.[12]

For many the market clearing assumption, on which the whole edifice of new classical economics rests, is so absurd that little further discussion is needed.[13] However, a simple empirical test also leads to the rejection of new classical economics. A prediction at the core of new classical economics can be shown not to hold. New classical economics holds that economic policy can affect the general price level and the rate of inflation but that, except in the short period when people are taken by surprise by policy changes, variables such as output, employment and unemployment cannot be changed through economic policy actions. If this is so, tight monetary policy, well heralded in advance so that it surprises no one, will stop inflation immediately without affecting output and employment. This has not happened and experienced central bankers believe that it is most unlikely to happen in the future. On his retirement, as Governor of the Reserve Bank of Australia R.A. Johnston said "To deal with inflation in a permanent way is to accept a fairly great deal of pain" (*Sydney Morning Herald*, 19/6/1988). In more formal language Max Corden, in summing up the conclusions of a Reserve Bank conference stated "Consensus did exist on three crucial matters ... [of which the first was] you cannot disinflate without some cost" (1992: 341). In its pure, new classical economics form the natural rate hypothesis is not a valid argument against the power of macroeconomic policy to restore full employment.

In any case, the Arrow-Debreu model is mainly concerned with the existence of an equilibrium, from which the natural rate is derived. Two theoretical problems also suggest that this rate has no operational significance. Firstly, the solution to a general equilibrium system is highly unlikely to be unique. This means that there will not be one natural rate, but a number, each one corresponding to an equilibrium solution of the system. In addition, it must be noted that existence says nothing about stability. In other words, just because an equilibrium solution to a general equilibrium system may exist, this does not mean that there are any forces within the economy that will push the economy towards equilibrium. There is no a priori reason to believe that the equilibrium is stable. In fact, the reverse is true. Work on the stability of equilibrium suggest that once the assumption of tatonnement (or recontracting) is dropped so that trading is allowed outside equilibrium at what is know as "false prices", then equilibrium must be path-determined. This means that the actual equilibrium to which the economy is tending, if there is one, is determined by the path which the economy takes when it is not in equilibrium.[14] In this case, the natural rate could not exist independent of the path taken by the economy, and so is susceptible to influence by government policy.

15.3.2 Fear of Inflation

An apparently similar, but potentially different, concept to the natural rate is the NAIRU. While the NAIRU also implies an expectation adjusted Phillips curve, it does not necessarily rest on a Walrasian general equilibrium system of equations. It can be derived from a simple model of the labour market in which lower unemployment increases the bargaining power of workers and reduces that of employers.

The NAIRU is not a number set in stone. It has clearly changed over time and its exact value at any point in time is often not clear. It is rational for those whose first priority is to avoid inflation to argue that while policies to reduce unemployment in the depths of recession may be acceptable, policies which aim to reduce the average level of unemployment over the trade cycle run the risk of re-igniting inflation and must be used very cautiously if at all.

In fact this type of argument has been common and, unfortunately, influential in Australia over the last decade if not over the last year.

In a speech the former Governor of the Reserve Bank of Australia Bernie Fraser commented that "monetary policy was becoming the hostage of influential financial markets with a vested interest in making the Reserve Bank give greater weight to inflation than unemployment" (quotation from the *Sydney Morning Herald* report 16/6/1996). Financial institutions have a vested interest in keeping inflation low because a rise in interest rates reduces the value of the fixed interest securities that they held. Also, and perhaps of more importance to foreigners investing in financial assets in Australia, a rate of inflation that is consistently above that in most other countries is a reliable sign that sooner or later the currency will be devalued.

There is convincing evidence that, over the last decade, reducing inflation has been given greater priority than reducing unemployment in Australian macroeconomic policy.[15] If hysteresis exists in Australia this fear of inflation has increased the NAIRU, making it harder to restore full employment. It is not just that the concept of the NAIRU has necessarily passed its use-by date. It is that the wrong lesson has been drawn from it. The correct lesson is that monetary and fiscal policy to reduce unemployment substantially must be accompanied by labour market policies, including incomes policies, that reduce the NAIRU.

15.3.3 Fear of a Current Account Crisis

The third argument against macroeconomic policies to reduce unemployment is that they will soon cause balance of payments problems. Macroeconomic policies reduce unemployment by increasing the rate of economic growth. In the past 25 years in Australia, whenever output and employment have grown fast enough to significantly reduce unemployment, and this rate of growth is sustained, the leakage of aggregate demand into imports causes uncomfortably high current account deficits on the balance of payments. If consequent market forces, or even government policy, result in a depreciation of the value of the Australian dollar against foreign currencies, imports will become more expensive adding to inflationary pressure. A rising rate of inflation will put further pressure on the foreign exchange rate and it is easy to slip into an inflation-depreciation vicious circle. This vicious circle can be prevented if wages are not allowed to rise to offset the increased cost of living caused by higher import prices, but the demand and supply elasticities of imports and exports may be such that the current account deficit remains too large for a long time.

Some academic economists argue that since the borrowing from foreigners, which is represented by the current account deficit, is largely done by firms in the private sector, who presumably believe that it is profitable to do so, it is not something to be concerned about.[16] The majority of economists disagree. Whilst there are many complex technical conditions, the basic argument for concern about the size of the current account deficit is simple. Australia already has a large foreign debt, and the amount we are already borrowing from abroad is a high proportion of our output (or GDP). If we continue to borrow increasing amounts from abroad (i.e. if the current account deficit increases as a proportion of GDP) sooner or later foreigners will wonder if we will be able to service the debt and cease lending to Australia. This will precipitate a massive depreciation of the Australian dollar on foreign exchange markets, large falls in imports and hence falls in real consumption and a rapid, painful adjustment in our economy. Moreover, the depreciation may be precipitated by currency speculators before it would occur if foreign investors were left to make the judgement themselves. If currency speculators have reason to think that signs of weakness will cause investors to stop lending, a speculative attack is likely to be successful. Although the circumstances are different, the East Asian crisis of 1997–98 is an outstanding example of what can happen when financial markets take fright. It is, at the least, only prudent to have policies that address current account deficit problems.

If rapid growth in the Australian economy is significantly faster than that in the rest of the world there will be a surge in imports not matched by increased exports. While trade credit will initially finance the increased current account deficit, the increase in foreign capital inflow is unlikely to continue. Assuming it does not, the value of the Australian dollar will fall on the foreign exchange market. If, for fear of inflationary consequences or some other reason, the government wishes to avoid this depreciation, the usual response is to raise interest rates enough to sustain the flow of foreign lending. Policy induced rises in interest rates will encourage foreign lenders not only because of the higher interest returns, but also because it may reassure them that the government is determined to avoid a substantial depreciation which would cause losses on loans denominated in Australian dollars. However, the higher interest rates will discourage investment by private firms. This will reduce imports, but it will also reduce growth of output and any fall in unemployment.

If interest rates do not rise and the Australian dollar's value falls on foreign exchange markets this will encourage exports and import-competing industries, but only in the very short run unless real wages fall. Otherwise an inflation-depreciation vicious circle will be set up. Even if this does not occur, a substantial depreciation may make foreign investors more nervous than is necessary, leading to a further depreciation. While a small depreciation can be helpful, it is not likely to be enough by itself and it is hard to make a large one successful. It requires a strong incomes policy and perhaps other policies also, which reassure foreigners that the Australian dollar has underlying strength. Rather than relying on depreciation of the Australian dollar, it is almost always easier to tackle the savings gap, which is the other side of the current account deficit. This should be done, not by reducing investment, but by increasing savings in Australia. To some extent savings increase automatically as output and income rises, but in the absence of policies to increase the savings ratio this is not enough to match the rise in imports. Although increasing savings is only part of the solution it is probably a necessary condition for policies to increase growth in output and employment in the long run, in a country like Australia.

This conclusion is made much stronger when account is taken of the effects of the financial deregulation and globalisation that have occurred over the last two decades. Although the integration of financial markets around the world may not be the most important manifestation of globalisation, it is the aspect that is important in the present context. The globalisation of financial markets has given these markets considerable influence on government policy. Financial markets now have great power in determining the exchange rate for an economy, and the exchange rate has such a widespread influence on the economy that, in many countries, governments must be constantly looking over their shoulder with concern about the effects of policy actions on financial markets (Nevile, 1996: 323).

The practical effect of this is not necessarily that national sovereignty in policy making has been superseded by tailoring policies to please financial markets. While there have been assertions that this is the case, careful empirical studies suggest that "governments still have policy choices and fiscal policy may be the most important instrument for choice" (Keohane and Milner, 1996: 248), to quote from the conclusion of a major book on the extent to which domestic policy making has been constrained by globalization. Keohane and Milner certainly agree that choices in macroeconomic policy making have been reduced, but not to zero. The quotation is largely based on the study, in the volume they edited, that was written by Garrett. After a careful cross country study of 15 countries, Garrett (1996) concludes that monetary policy is constrained by increasing capital mobility, but that the evidence that there are important constraints on fiscal policy is weak. Moreover, Moore (1998) has shown that much of the evidence found to support the loss of national autonomy in policy making is based on the experience of members of the European Economic Community who have gone much further along the road of integration of their economies than is generally the case. Nevertheless, the problems with current account deficits, which always were important, when Australia tried to grow faster than its trading partners, are now even more important.

Financial markets have, no doubt, always been concerned about inflation and the current account deficit. Globalisation gives them much more power to make their wishes prevail in that it makes a disastrous outcome much more likely if they decide that the exchange rate for a country's currency is unsustainable. While governments do not have to make the desires of financial markets their first priority in economic policy making, at least those in countries with a large foreign debt have to convince financial markets that their actual (or potential) policies will prevent a large depreciation. While avoiding a rigidly fixed exchange rate is of prime importance, experience suggests that avoiding continual large government deficits is also important.

15.4 Policies to Restore Full Employment

The previous section has indicated that, if Keynesian policies to raise the rate of growth of output and employment are to be successful in restoring full employment, more than expansionary monetary and fiscal policies are required. A package of policies is briefly outlined in this section.

The starting point is an increase in government expenditure to stimulate growth in aggregate demand and private investment. For reasons to be explained later, the increase in expenditure will have to be matched by increases in taxation. Hence, the expansion will be a balanced budget multiplier expansion. A large part of the increases in expenditure should be carefully targeted to increase productivity. Expenditure on economic infrastructure, education, training and labour market programs will increase aggregate demand and also increase both labour and capital productivity helping to offset to some extent the fall in the real value of take home pay caused by the rise in taxation rates. There is mounting evidence that in many countries increased public investment in economic infrastructure increases the productivity of private sector investment. Otto and Voss (1994) documents this for Australia. Education, training and labour market programs obviously increase labour productivity, but indirectly can also contribute to increasing capital productivity. Making private investment more productive will normally increase the rate of private investment which will help increase aggregate demand. Also taxation laws should be changed in ways that encourage high technological investment and, more generally, entrepreneurship in the goods market rather than in takeovers and financial deals.

If this type of government expenditure and the increase in private investment does not cause unemployment to fall at the desired rate, there must also be government expenditure on labour intensive socially useful community services (including improvements to the environment). Expenditure on community services is valuable in its own right and is a suitable vehicle through which the government can act as employer of the last resort.

However, those so employed should be paid the appropriate award wage rate not a few dollars a week more than the unemployment benefit.

As the unemployment rate steadily falls there may be renewed inflationary pressure. Expanded and better designed labour market programs will help counter this by increasing the effective supply of labour but they will probably need to be buttressed by an explicit incomes policy.[17] The incomes policy will have to be strong enough to withstand the strain put on it by increases in tax rates as well as falling unemployment. Successful incomes policy and labour market programs are needed to reduce the NAIRU, not only to reduce short-run inflationary pressures, but also because while the exact level of the NAIRU in Australia at present is not clear, it certainly is above anything that could correspond to a full employment rate of unemployment.[18]

Given the prospects for the world economy, the Australian economy will be growing significantly faster than that of most OECD countries and the current account deficit may rise as a proportion of GDP. This may make financial markets nervous and taxation revenue will have to rise enough to ensure that, despite increases in government expenditure, the budget deficit does not become large enough to alarm financial markets. In the short to medium term it is essential that financial markets do not have undue concern about the Australian dollar. This rules out budget deficits that are large and increasing. There is scope to increase taxes because Australia has one of the lowest ratios of taxes to income and output in the OECD.

The rise in taxation revenue will almost certainly involve some new taxes and these would have to be introduced with careful consideration of both equity issues and effects on private sector saving. This is not the place for a detailed discussion of tax reform but a couple of unusual suggestions can be put forward for consideration. The first is the imposition of a uniform tariff, say at 5 per cent on all imported goods, and on as many imported services as it is reasonably convenient to catch in the tax net. Revenue tariffs are not meant to be part of a policy of protection and are allowed under World Trade Organization rules when a country faces current account deficit problems. Any effect on the price of imports would be smaller than those of acceptable fluctuations in the exchange rate, partly because, in the longer run, the exchange' rate will be a little higher than it would be in the absence of a revenue tariff. The revenue raised would be about five billion dollars.

The second suggestion relates to the debate about the merits of a goods and services tax versus Australia's present wholesale sales tax. It is desirable to tax consumption of services as well as consumption of goods. The equity problems involved in the introduction of a goods and services tax could be overcome by zero rating food, housing and health expenditures and by retaining the wholesale sales tax on luxury items, for example expensive cars. It will also be necessary to increase direct taxes to some extent. Increasing the medicare levy on higher incomes, reducing tax expenditures in the personal income tax area and reducing the ability to artificially split income are obvious places to start.

The higher taxation rates will help to moderate any rise in the current account deficit. In the longer term solving the current account deficit problem will be eased by measures that increase private saving without reducing private sector investment or public sector saving. One possibility is to increase the superannuation levy, but thought should be given to other measures.

Increasing net exports will also ease current account problems. There are numerous examples where Australian governments have not proved good at picking winners. Nevertheless, policies that encourage export and import competing industries across the board can be devised. Tax laws can provide direct incentives for exporters, and measures such as the suggested general revenue tax can drive a wedge between international and domestic prices of imports. While the real exchange rate might eventually adjust to offset this, it could be decades before the process is complete.

These policies to steadily reduce unemployment can be successful, but they do not provide a free lunch. Even in the short-term they are likely to increase income per head as the unemployed are drawn back into productive activity. However, at least in the short-term, the increased taxation required will reduce a little the incomes of those already in steady full-time employment and those with comfortable incomes from rent, interest and dividends or profits. How big is the required rise in tax revenue? It is impossible to be precise. It will depend in part on what is happening in the rest of the world. The faster economies overseas are growing the faster the volume and value of Australian exports will grow. Thus, fast growth in the rest of the world will both stimulate output and employment growth in Australia and help prevent the current account deficit growing too rapidly.

The size of the required increase in taxation will also depend on how rapidly unemployment is to be reduced. Over the eight years to June 1998 the unemployment rate in Australia averaged 9.3 per cent. This period roughly covers one complete business cycle of boom and slump. An ambitious, but not completely unrealistic, target would be to reduce unemployment by half in five years so that after that five year period the average level of unemployment over boom and slump is 4.7 per cent. In the following 5 years all but frictional unemployment could be eliminated.

Given this target, and assuming that the world economy will grow relatively slowly over the next five years, a ball park figure for the increase in the ratio of tax revenue to GDP is 10 per cent. Current government revenue, which includes dividends from government business enterprises and fees and fines as well as taxation, would have to rise from a little over 34 per cent of GDP to around 38 per cent of GDP. This rise will be needed to cover the increase in government expenditure. The low rate of growth of the world economy will make it unlikely that the current account deficit will fall as a proportion of GDP. To reassure financial markets it will be necessary to finance increases in both current and capital expenditure by increases in current revenue. At least on average over boom and slump, all government expenditure must be balanced by current government revenue.

The rise in government expenditure and current revenue should be sustained, as a percentage of GDP, over the whole 5 years. Obviously, those who move from unemployment, or underemployment, to full employment will have a rise in real income. On average other Australians will suffer a short-run decline in real personal disposable income because of the increase in taxation. This will be greatest (3 to 4 per cent) at the beginning of the period, but will become progressively smaller because of the more rapid rate of growth of GDP. By the end of five years the higher rate of growth will have completely offset the increased tax rates so that the real incomes of these already fully employed will be just as high as they would have been if the policy package had not been implemented.

15.5 Conclusion

This chapter starts with Article 23 of the Universal Declaration of Human Rights with its emphasis on "the right to work ... to protection against unemployment ... and to just and favourable remuneration." It argues that in our type of society the right to work with just and favourable remuneration undergirds other human rights, especially the right to adequate health and well being. Unemployment leads to poverty and poverty to ill health, and unemployment, *per se*, has an important causal link with illness particularly mental illness. Also, unemployment causes other ills in society, in addition to those borne by the unemployed and their families. These range from loss of output to an increase in juvenile delinquency and crime.

Although most "Western" societies have acquiesced in substantial unemployment, this is not inevitable. There will always be some frictional unemployment as people move from one job to another, but apart from that full employment is feasible, even if it cannot be produced overnight. The biggest constraint on the government's ability to increase employment, and reduce unemployment, is in the area of international trade and finance. There are two interrelated aspects of this. One is maintaining a viable long run balance between imports, exports and foreign investment. The current account deficit, which measures net foreign investment, cannot grow indefinitely as a percentage of Australia's gross domestic product. The second aspect is that, given the size of Australia's foreign debt and the proportion of this that is short-term debt, it is important to avoid policy actions which will lead financial markets to expect an unduly large depreciation of the Australian dollar on foreign exchange markets. Because of these constraints, policy to restore full employment cannot rely on one or two major measures, but must be multifaceted. It will take time, perhaps as long as a decade, before the goal of full employment can be completely realised. Most importantly, it will require higher levels of taxation so that in the short to medium run it will not be costless to those already employed in secure jobs. The real question is not can Australia achieve full employment, but how much are those already employed prepared to reduce temporarily their own consumption to bring this about.

Notes

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1. See Jones and Kriesler (1998) and Watts (2000).
2. Of course, there are also unmentioned reasons for unemployment being tolerated, in particular, the desire of capital to exert control and political power over labour. See, eg. Kalecki (1943) and Balogh (1982).
3. See Burgess and Mitchell (1998) and Watts (2000).
4. See, for example, Agerbo et al., and Clark and Oswald (1994).
5. For a detailed analysis of the precise impact of unemployment on psychological well being, see Darity and Goldsmith (1996).
6. Christoffersen quoted in Jensen. See also Carmichael and Ward.
7. Impact (1994).
8. Weatherburn and Lind (1997).
9. See also Burgess and Mitchell (1998), Dabscheck (1998) and Nyland and Castle (1998).
10. This is, of course, the basic neoclassical position reiterated in most first year text books. See, for example, McTaggart, Findlay and Parkin (1999) pp. 22.13–22.14.
11. See, for example Kirman (1989) and Hahn (1984).
12. Nevile (1981) pp. 83–84.
13. See, for example, Lipsey (1979) p. 292.
14. See Halevi and Kriesler (1992).
15. With respect to the recession that started in 1990–91 Fred Argy (1998) has commented "The evidence suggests that ... both the RBA [Reserve Bank of Australia] and the Treasury (with the tacit acceptance of the Treasurer and his personal advisers) decided it was worth taking a risk with unemployment in order to entrench low inflation in the medium term" (p.41).

    Argy goes on to quote Ian Macfarlane as saying that, in order greatly to reduce the inflation rate "we had to run monetary policy somewhat tighter than in earlier recessions and take the risk that the fall in output would be greater than forecast".
16. See Pitchford, 1995.
17. See Martin (1998) for a discussion of the experience of labour market programs in OECD countries. In the case of Australia, the most important policy change is to reverse the cuts in labour market programs which nearly halved expenditure in the first three Howard Budgets.
18. This is not the place for a discussion of incomes policies. Nevile (1974) describes the characteristics that successful incomes policies must possess. Harcourt (1997) and Nevile (1983) discuss the place of incomes policies in Australian economic policy. See also Stegman et al (1987) and Bell (2000).

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16
Human Rights: Issues in the Welfare State

J. W. Nevile

16.1 Introduction

This Chapter is concerned with a restricted range of human rights, those that are affected by the nature of the economic system. Most of the things that are usually accepted as human rights in the second half of the twentieth century take the same form irrespective of the structure of the economy. Rights such as freedom of religion or freedom from arbitrary imprisonment do not depend on what sort of economic system is prevalent in the society in which one lives. Other rights, like freedom from hunger, take quite different forms depending on the nature of the economy, and may not exist at all in some economic systems. Given its title, it is the second sort on which this Chapter focuses; but statements like "the fundamental human right in the welfare state is such and such", does not mean that the right to practise one's religion is any less fundamental, just that it is not something that distinguishes the welfare state from some other economic system.

Human rights are about features in people's lives that everyone should enjoy just because they are humans and not because of anything they do or possess. Statements about human rights, therefore, reflect a philosophy (a vision if you like) of what it means to be human. This is true of human rights in the economic sphere, just as much as in any other area of life. The main rival of the welfare state in OECD countries is the liberal market economy, and it is fascinating to speculate on the implications about the nature of humanity made by those whose writings form the intellectual basis of market liberalism. For example what does the

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following statement by Milton Friedman imply about the essential nature of human beings?

> The ethical principle that would directly justify the distribution of income in a free market society is, "To each according to what he and the instruments he owns produces".[1]

This quotation was not introduced to make a debating point about a vision of society, which is not sympathetic to the welfare state, but to make a substantial point. This is that although the welfare state still seems the natural form of society to most Australians, there is a revival of support for a different way of organizing the economy.[2] The issues discussed in this Chapter will only be of interest to those who share the vision of the essential nature of being human that underlies the welfare state. Since the welfare state developed in countries dominated by the Judeo-Christian world view it is not surprising that it rests on two major parts of that world view. The first is the assertion of the dignity and worth of every individual human being. The second is that the nature and ethos of society is important as well as the moral codes of individuals and that societies in which humans live should reflect the first principle and ensure that everyone has the economic resources necessary to live in dignity.

16.2 The Meaning of the Term Welfare State

Various definitions of the welfare state exist in the literature. One is given in the next paragraph.[3] However, more important than this definition, are the principles that follow the definition. These give more insight into the nature of the Australian welfare state than can any definition.

A welfare state can be defined as one in which the economy is basically a capitalist economy, but the government intervenes extensively in order to ensure that the economic welfare of all citizens is at least at a minimum standard, and, if possible, to increase the economic welfare of all. In the Australian version the cornerstone of the welfare state was that in every family income unit at least one person had the right to full time employment at a wage which was at least big enough to enable the breadwinner and his family to live in frugal comfort. (It was tacitly assumed that the breadwinner was a male, so "his" is the correct pronoun.) However, despite this commitment to full employment, it was recognised that there would always be frictional unemployment as people changed jobs, that there would still be occasional small recessions, and that some people could not work due to illness, disability or old age (though interestingly not until the time of the Whitlam Government was being a single parent with young children recognised as a reason for not being able to work). Because of these things, the commitment to maintain full employment was supported by a further principle: that money raised through the taxation system should be used to provide a very modest income to those who otherwise would be destitute, to provide a safety net in the shorthand of the time.

In its heyday, say from 1945 to 1975, the cornerstone of the welfare state in Australia was not the safety net but full employment. For example, the 1945 White Paper on Full Employment in Australia states quite categorically that "the maintenance of conditions which will make full employment possible is an obligation owed to the people of Australia by Commonwealth and State Governments" (p 3). The safety net was necessary, partly because we do not live in an ideal world and partly because it was thought appropriate that the whole community should take on some functions, such as provision for the elderly, which were previously a family responsibility. The following sections look first at issues arising from the commitment to full employment and then to those raised by the safety net.

16.3 Full Employment Issues

Full employment can be defined as a situation in which everyone who wants a job is able to find one within a reasonable length of time. The first issue that arises is what do we mean by everyone. Although the 1945 White Paper talked about full employment, in practice, it was assumed that the norm would be one breadwinner per family. The question that arises is whether the right to a job should be a right for each family to have a breadwinner or the right for everyone who wants it to have a full-time job (or a part-time one is that is what they prefer). Perhaps some would like to make it a right to one equivalent full-time job in each family, whether that be one full-time job or two part-time jobs. This issue is linked to the general issue of the desirability of distributing employment more equitably by, in some manner, rationing employment. In the last 10 to 15 years the average number of hours worked per week (and per year) by full-time employees has been increasing and now 40 per cent of full-time male employees work more than 40 hours a week. Even more startling is the fact that 25 per cent work 49 hours a week or more. For females the percentages are 15 and 8 respectively. Not surprisingly, the trend of an increasing number of hours worked per week by full-time workers coupled with high levels of unemployment has led to calls for a shorter working week (with corresponding reductions in weekly wages).[4] Moves to encourage a voluntary reduction of the number of hours worked per week are beneficial to both individuals and society. Much can be done to facilitate permanent part-time work and job sharing, to change community attitudes so that they are against overly long hours of work and directly to discourage excessive overtime. But any compulsory reduction in the number of hours worked (and the corresponding weekly wage rate) raises a host of equity issues.[5] These are very much more acute if rationing employment is extended, implicitly or explicitly to a rationing by families rather than individuals. Any suggestion that the unemployment problem should be solved by allowing only one (equivalent full-time) worker per family would mean in practice forbidding married women to engage in paid employment and would be immediately condemned by most Australians.

But even those willing to consider the proposition would soon find that it raises more problems than it solves. Is the level of income earned by the husband relevant? What if the husband's wage is not enough to provide a standard of living above the poverty line? If full-time workers are allowed to work overtime can a family have two part-time workers who together work 50 hours a week? Or 60 hours a week? And so on. In contemporary Australian society any commitment to full employment must be a commitment to universal full employment so that anyone who wants a job can find one.[6]

This raises the issue: is full employment still possible? The question is made more pointed once it is remembered that in the welfare state the right to a job is not to a job at any wage however low, but to one which pays enough to support the breadwinner and his family "in a state of health and reasonable comfort" to quote the first bill providing for a minimum wage introduced in an Australian Parliament.[7]

The concept of a minimum wage predates the welfare state in Australia. It was firmly in place in Commonwealth legislation within a decade of Federation. The Commonwealth Parliament imposed an excise from which employers would be exempted if they were paying "fair and reasonable" wages in the view of the Commonwealth Court of Conciliation and Arbitration. This led to the famous Sunshine Harvester case and the institution of the basic wage. As this and the subsequent development of the concept is well known, there is no need to dwell on it. For a full account see Ploughman's 1995 study, the full details of which are listed in end note 7. However, the point is that up to the early seventies, there was very widespread agreement in Australia that full employment means employment at a wage sufficient to keep a family in at least frugal comfort and even since then it is assumed to mean full employment at a minimum wage that is high compared to that which might be set by the unfettered workings of the market. The imposition of a relatively high minimum wage is the cornerstone of the income distribution aspect of welfare in Australia.[8]

However, it has been argued that full employment and a relatively high minimum wage are incompatible. Conventional wisdom is that OECD countries have gone one of two ways. At one end are countries like America whose unemployment (at least as measured statistically) has not got out of hand, but where wages at the bottom end are so low that many people who have full-time jobs live in severe poverty. At the other end are countries like Germany where the minimum wage is high but so is unemployment. Nevertheless, this conventional wisdom can, and should, be challenged. There is increasing evidence that measured low unemployment rates in the US are not the result of low minimum wages leading to much less unemployment among unskilled workers.

The argument is not really about total employment, or non-employment, but about whether low wage rates at the bottom end of the distribution cause more unskilled workers to be employed. Although it focuses on relative wage rates and relative employment rates, it is important since the less skilled are the workers most vulnerable to unemployment.[9]

Nickell and Bell[10] point out that, although there was not a large fall in the relative wages of the unskilled in continental Europe, there was in the United Kingdom, but the "unemployment record of the unskilled [there] has been worse than in countries like Germany and the Netherlands" (p 303). Moreover, in continental Europe high wages and rising relative wages at the bottom end of the distribution do not appear to have affected the employment of low skilled workers. In the Netherlands relative wages at the bottom end have risen substantially, but unemployment of unskilled workers has fallen. In Germany real wages (for males) in the bottom decile are rising rapidly whereas in the US they are falling both absolutely and relatively. Yet the unemployment rate for unskilled male workers is higher in the US than it is for Germany. This is true although "the real wage of an individual in the bottom decile of the male earnings distribution in Germany is over twice that of his equivalent in the US on a purchasing-power-parity basis" (Nickell and Bell, 1996, p 305).

In a more elaborate study, Card, Kramuz and Lemieux[11] compared changes in wage and employment rates over the 1980s for different age and education groups in France, Canada and the US. They found that, in response to changes in relative demand, relative wages of less-skilled workers fell substantially in the US, somewhat less in Canada and not at all in France. However, in the last two mentioned countries "the patterns of relative employment growth over the 1980s are virtually identical to those in the US" (p 29). The big fall in wages at the bottom end of the distribution appeared to have no effect in increasing employment among the unskilled in the US.

These studies make more convincing an alternative explanation of low recorded unemployment rates in the US compared to Europe. Mishra[12] focuses attention on non-employment, which includes hidden unemployment, rather than on recorded unemployment, which does not. The non-employment percentage is just 100 minus the percentage employed, that is it is a percentage of the population in the age group, not a percentage of the labour force. When the focus is on non-employment rather than unemployment, it becomes clear that the big difference between the US and Europe is not that low minimum wages lead American firms to hire more unskilled workers, so much as poor and short-lived social security benefits lead more of the unemployed in America to drop out of the labour force altogether. If we look at males only (to avoid any possible cultural differences in the desire for paid work by married women) and look at males between the ages of 25 and 54 (to avoid any possible difference in things like school and university retention rates, retirement patterns and so on), then in continental European 15 per cent of prime age males are not employed, compared to 14 per cent in the US. Incidentally in the United Kingdom, whose labour market is more like that in the US than are those in continental Europe, the figure is 18 per cent. In Australia the figure is 14 per cent, the same as in the US despite very different labour markets.

Thus, at the very least a strong case can be made that it is not high minimum wages that are preventing a movement towards full employment in Australia but something else. The most plausible candidate is that successful measures to reduce unemployment require raising the level of taxation. The Australian community appears to be very resistant to increases in taxes and certainly Australian politicians are unwilling to ask the community to pay higher taxes as part of a program to reduce unemployment. This may be because even a well-designed program to reduce unemployment will not have any noticeable effect overnight, or even over the first year that it is introduced. Yet unemployment could be very substantially reduced over a five to ten year period if the community is prepared to pay the cost in higher taxes.

There are two reasons why increased taxation is necessary to restore full employment in Australia. The first is that a great deal will have to be spent on labour market programs if the majority of the long-term unemployed are ever to get a job again. The measures outlined in the White Paper Working Nation were along the right lines, but even the Labor Government was not prepared to spend an adequate amount on labour market programs. The Coalition Government has cut expenditure on labour market programs so that they are now very inadequate.

However, labour market programs do not themselves create additional jobs. What they do is fit unemployed to fill jobs that are created by other means, and help unemployed find appropriate jobs when they exist. While this gives the long-term unemployed a much larger chance of obtaining a job and reduces the inflationary pressures caused by falling unemployment, it does not cause unemployment to fall. Additional jobs are created by raising the rate of economic growth and a sustained rise on the rate of economic growth large enough to significantly reduce unemployment will itself require a rise in the level of taxation.

The major constraint in Australia on a rate of economic growth large enough to reduce unemployment substantially is the current account deficit of the balance of payments. The current account deficit arises because we import too much compared to our exports. The ultimate reason for imports is consumption. If unemployed people become employed their incomes will go up, they will spend more on consumption and this will increase the demand for imports in Australia. With the increase in imports the current account will get worse. The rest of us will have to spend just a little bit less on consumption so that our demand for imports goes down a little. The sure way to reduce our consumption is to increase taxes, and, after all, Australia is one of the three OECD countries with levels of taxation much below that of the others. Also, as I previously suggested, if we want to help the unemployed, especially the long-term unemployed, find jobs, through labour market programs, these will have to be financed through additional taxation. Such programs will be needed for years to come. Raising taxes to pay for these is a smaller "ask" than raising taxes enough to remove the current account deficit (as the constraint preventing an adequate growth rate) but the two "asks" are cumulative. We need extra tax revenue for one and additional extra tax revenue for the other.

Many may accept the argument so far, but would argue that any increase in taxation will reduce economic growth and instead government expenditure should be cut. However, generally this proposition is asserted, not argued, and no convincing evidence has been proffered to support it. It is true that there seems to be a widespread feeling in the community that taxes should not be increased, and, of course, there is constant self-interested comment along these lines in the media by some of those who are very well off. But Australia is a very lightly taxed country. We could increase our tax revenue as a proportion of GDP by 30 per cent (about a third) and still be only taxed at around the same level as Canada and well below countries like France, Germany and the Netherlands, let alone the Scandinavian economies. Yet an increase of this size is more than is required.

Moreover, by international standards, just as Australia is a low tax country it is a low government expenditure country. Among the OECD countries, for which we have reliable statistics, only in Japan is government expenditure a smaller proportion of GDP. There may be some small pockets of fat in government spending where cuts could be made without widespread cost to our society and electoral backlash. But only very minor expenditure cuts are possible without doing great damage to the fabric of our society.

To sum up this section: if we believe that the right to employment is very important we have to be advocates of higher taxation, at least in the transition period while we move from where we are now to full employment. The biggest single issue arising out of human rights in the welfare state is how much are we prepared to increase taxation in order to achieve full employment.

16.4 Safety Net Issues

It is convenient to start with a safety net issue that relates directly to full employment, namely to what extent the government should supplement incomes of those, perhaps full-time, workers whose wages are not sufficient to support themselves and their families in "frugal comfort". We have gone a little way towards this in Australia with family assistance payments. There are both equity and economic growth issues involved. The equity question is well summed up in the following quotation from Julia Perry:

> extending eligibility for income support to those in paid work is important in terms of equity and incentives to take up paid work, but may require a strong mechanism to maintain wage levels to ensure that employers do not cost-shift to taxpayers.[13]

The problem with what may be in effect substantial wage subsidies is not just the employers can "cost-shift" to tax payers, but also that subsidising the wages of low income workers not only subsidises the workers it also subsidises their employers. Firms that pay very low wages are often inefficient firms or firms that use largely obsolete capital equipment. Subsidies that keep such firms in business will reduce the rate of economic growth.

Perhaps the most discussed safety net issue is the question of targeted versus universal social welfare systems. The arguments for and against each have been well surveyed in an article by Mitchell, Harding and Gruen.[14] A very brief summary will be given here.

Australia traditionally has had a social welfare system that is both targeted on the basis of need (ie, income and means tested) and targeted to categories of people (ie, to have the right to cash social welfare payments you have to belong to this or that category). The major argument for targeting is the problem of economic and budget constraints. (These are not two words for the same thing, as budget constraints may be political as well as economic) Indeed some in favour of targeting argue that universal systems will not be viable in the long run. Other arguments for targeting include the fact that transfers have transaction costs, giving money to people and then getting it back through the tax system does involve real costs. Also the characteristics of those targeted on a needs basis may reveal information that is very helpful in designing programs to combat the causes of poverty.

The major arguments against targeting revolve around what Mitchell et al call "intrusion, stigma and social cohesion". Targeting involves inquiring into people's lives, often even their very intimate lives such as who is sleeping with whom. Targeting may stigmatise people; in Australia this seems often to be the case with unemployment benefits but not with old age pensions. On the other hand, universal systems are claimed to promote social cohesion and widespread support for the welfare system making it more generous and less vulnerable to cost-cutting politicians. Other universalists' arguments include the problem of high effective marginal tax rates and poverty traps. Since benefits are withdrawn as income rises in an income range where income is subject to tax, the effective marginal tax rate can even be over 100 per cent in Australia, and rates of 70 or 80 per cent are common. There is also the problem of take up in the targeted approach. Some people in need and eligible for benefits do not claim them.

While all the above arguments for and against targeting are important, the first one seems to be the winning one. A move towards anything like a universal system would require a very large increase in taxation. Increasing taxation as part of a program to reduce unemployment has a higher priority. It may be feasible, in economic terms, for taxation to be at a level that would finance a universal social security system and adequate labour market programs as well as reducing consumption per head among the employed to allow the unemployed to become employed and increase their consumption without creating balance of payments problems. Nevertheless the required increase in taxation is very large and politically out of the question.

If we accept that the present targeted system will continue in Australia, another major issue is whether entitlements should be on an individual basis or a family basis. Again Julia Perry (1995) has summed up well what is involved.

Individual entitlement for members of couples would be fairer to individuals but does not redistribute between couples on the basis of need (its desirability depends on whether it is valid to assume that couples share income and whether it is appropriate to expect them to do so).[15]

To that must be added the fact that it is not just the position of a low income spouse, which is of concern, but also the position of dependent young adults. Should the children of millionaires be entitled to Austudy when they attend university?

A final targeting issue is whether targeting should be by categories of people or just by low income and assets. The arguments for and against distinguishing between the deserving and undeserving poor can be quickly stated. On the other hand there is the argument that paying benefits to those whom the majority of taxpayers feel are undeserving destroys respect and support for the welfare system as a whole. On the other hand, there is the difficulty of distinguishing between the deserving and the undeserving.

Finally, two brief comments on other issues. The first arises with the provision of services in kind, for example through Medicare or relatively free education. Should, as some argue, all support be given in the form of untied cash payments. The argument in favour of doing this is simple. The recipient knows far better than any legislature or government department what are his or her needs and wants. Giving support in cash enables the recipient to use the support where it will do the most to reduce the perceived deficiencies in living standards. This is often called the consumer sovereignty argument. The argument against is equally simple and more convincing to most people. Although giving all support in the form of cash payments may enable recipients to tailor their expenditure patterns to meet their individual needs and desires, we should also pay heed to donor (or taxpayers) sovereignty just as much as to consumer sovereignty. For example, if tax payers are happy to pay extra taxes to house the poor but not to give them more cash incomes, why should this desire not to be respected?

If it is accepted that it is valid to earmark support for particular purposes is it better to give vouchers, rather than support in kind, to maximise the choice of the recipient within the type of service in question? In most cases the answer is clearly no, largely because of the expensive transaction costs of a voucher schemes if they are truly providing support for a particular form of consumption and not disguised general cash grants. For example the Experimental Housing Allowance Program in the US had program administration costs of 23 per cent.[16]

16.5 Conclusion

More space has been devoted to full employment issues than to safety net issues and more often answers have been given to the questions raised under the first category of issues than under the second. This is entirely appropriate, just because full employment was the cornerstone of the Australian welfare state. The welfare state in Australia has fallen on hard times but not because of failures on the part of government to maintain the safety net efficiently and compassionately. No doubt these sorts of failures have occurred from time-to-time. But the basic reason for the decline of the welfare state in Australia is market failure, the failure of markets to produce anything like full employment.

Notes

1. Friedman M *Capitalism and Freedom*, (University of Chicago Press, Chicago, 1962) p 162.
2. Incidentally, a third contender, the communitarian state, is also gaining support. See eg, Daly H E and Cobb Jr J B *For the Common Good*, 2nd ed, (Beacon Press, Boston 1994).
3. For a different type of definition, see Saunders P *Welfare and Inequality: National and International Perspectives on the Australian Welfare State*, (Cambridge University Press, Melbourne, 1994) p 1.
4. See eg, Jamieson House Employment Group (1996), "Redistributing Work: Solutions to the Paradox of Overwork and Underemployment in Australia", Discussion Paper No 7, Australia Institute, Canberra.
5. Given that already 20 per cent of those working overtime do so without extra pay one immediate issue is whether it would in many cases translate into a pay cut with the same amount of work done at a lower salary.
6. There is a related issue, the question of whether people have the right to employment at hours that suit them. Consider for example the case in England in which a married female train driver successfully appealed against her dismissal which was because she refused to work night shifts.
7. The Bill was introduced into the Queensland Parliament in 1890. See Plowman D (1995), "Protecting the Low Income Earner: Minimum Wage Determination in Australia", *Economic and Labour Relations Review*, 6(2), p. 253.
8. It should be remembered that the Federal Government and all the Liberal/ National Party State Governments argued for an increase of $8 in the 1996 "Living Wage" case.
9. Empirical studies show that unskilled workers are substitutes for capital equipment whereas skilled workers are complements. See Hamermesh D S *Labour Demand* (Princeton University Press, Princeton, 1993) p 135.
10. Nickell S and Bell B (1996) "Changes in the Distribution of Wages and Unemployment in OECD Countries" *American Economic Review*; 86(2), pp 302–08.
11. Card D Kramarz F and Lemieux T (1996) "Changes in the Relative Structure of Wages and Employment: A Comparison of the United States, Canada, and France", National Bureau of Economic Research.
12. Mishra R (1995) "Social Policy and the Challenges of Globalisation" in Saunders P and Shaver S (eds) *Social Policy and the Challenges of Social Change: Proceedings on*

the National Social Policy Conference Sydney, 5–7 July Social Policy Research Centre, Reports and Proceedings, No. 122.

13. Perry J "Managing the Distribution of Living Standards Over the Life Course Better" in *Proceedings of the Future of Work and Access to Incomes Seminar, Commission for the Future of Work* (ACOSS, Sydney, 1995) p 81.
14. Mitchell D, Harding A and Gruen F, 1994, "Targeting Welfare", *Economic Record*, September.
15. *Op cit*, p 81.
16. *Industry Commission Public Housing Volume 1*, Report No 34 (Canberra, Australian Government Publishing Service, 1993) p 62.

Part III
Economics with a Human Face

17
Writing Biographies of Economists

Peter Kriesler

Geography is about maps
Biography is about chaps
E. C. Bentley

My brief is to discuss the art and process of writing the biographies of economists. Before I start, I should establish my credentials. Like most historians of economics and some economists, I have been an avid consumer of biographies. From my time as a student, particularly inspired by history of thought courses, I have read some of the few biographies of economists[1]. In addition, as a general reader, I have read biographies of favorite writers, of contemporary political figures and of historical figures as well as of the odd football hero, musician and comedian.

In addition to being a consumer, I am at present cast in the role of producer of a biography. Bruce MacFarlane, Jan Toporowski and myself have been working on a biography of Michał Kalecki for a number of years. This paper reflects my experience in this role as well as some reflections on the nature of biography. This was a novel experience, because, though I have read many biographies, and was in the process of writing one, I had not previously thought about the process and nature of writing biography.

Let me start by considering the question of "what is biography?" The Oxford dictionary defines it as "the story of a person's life written by someone other than [them]self". This is reinforced by the rhyme at the beginning of the paper. The paper looks at the nature and significance of such "stories", and in particular addresses three issues. Firstly, it canvasses some of the controversies about the usefulness of telling these sorts of stories. There has been some debate amongst economists as to whether there is an appropriate role for biographies within the history of economic thought. The history of economic

Revised from *History of Economic Ideas*, 3(2): 73–88, 1995, 'On Writing the Biography of Economists,' by Kriesler, P. With kind permission from Fabrizio Serra (ed.) Pisa-Roma. All rights reserved.

thought has been called the "poor relation" of economics[2]. Biography, being a specialized area within the history of economics is a poor relation of a poor relation. Some economists (most notably Stigler) see no role for biography either in economics or in the history of economic thought. Rather than provide a comprehensive discussion of all the arguments, I will briefly review some of the issues. Secondly, some of the issues flowing from the actual writing of biographies are examined. Finally, the paper relates some of my personal experiences in attempting to write the biography of a great economist.

17.1 Why Biography?

Modern debate on the merits of biography in economics was initiated by William Jaffé, the famous editor and 'would-be' biographer of Walras, in an excellent paper published in 1965 "Biography and economic analysis". In a comment which has come back to haunt us, he wrote: "With increasing frequency, distinguished economists of our day insist that the only proper study of economics consists in analysis firmly established on econometric foundations: and they recoil from the very idea of associating analysis with anything else, even its own history". (Jaffé, 1965, 223).

Jaffé raised many interesting issues in defense of biography. Perhaps the most important was his view that the great innovations in economics, "must be understood as a work of art, and, that, like all works of art, [they are] marked with the personality of [their] creator". (Jaffé, 1965, 226).

Jaffé stressed the importance of the individual as making a breakthrough or original discovery, and, as a result, leaving their marks indelibly on the subject.

> The discoverer is something more than a catalytic agent. He enters into the theory he formulates, not as a stereotype, but as an individual possessing an individuality of his own. If we consider carefully a truly original concept, even one couched in austere mathematical symbols, we find that it is inevitably composed of an intricate combination of elements which are derived not only from the discoverer's social, intellectual, and physical environment, but also from his own personal traits, attitudes and endowments. (Jaffé, 1965, 224).

For Jaffé, the link between economics and art[3] allows a creative role for the individual economist who, as a result, will leave their imprint on the subject. It follows, then, that by understanding the motivations and biographical influences on that person, we will improve our understanding of the development of our subject.

> Jaffé's conclusions were challenged in an influential (and cranky) paper by Stigler, in which he argued that for economic *science* there was no role for biography.
>
> Science is a social enterprise, and those parts of a man's life which do not affect the relationships between that man and his fellow scientists

> are simply extra-scientific. When we are told that we must study a man's life to understand what he really meant, we are being invited to abandon science. What Mill's contemporaries did not know about his personal life ... could not affect their interpretation of his words, and if we are to understand nineteenth-century economics, the details of his personal life should not affect our interpretation of his words. The recipients of a scientific message are people who determine what the message is, and no flight of genius which does not reach the recipients will ever reach and affect the science, detailed biographical knowledge is irrelevant to the interpretation of an individual's scientific work. (Stigler, 1982, 91, 93).

According to Stigler (1982, 92), the role of biography in understanding ideas is limited to the case of ambiguities caused by changes in the meaning of words. Stigler does, however, admit a role for biography, but only for either the sociology of science, that is for the study of "why some discoveries are absorbed quickly and others never" or to clear up ambiguities about the meaning of words.

Stigler failed to answer the question of "what is the criteria for scientificity?". In this context, the criteria implicit in his discussion seems totally at odds with that employed by most philosophers of science and economic methodologists. Few people would accept, as Stigler does, that there is objective scientific truth which is knowable independent of the community of scientists and individual practitioners. Indeed, modern philosophy of science stresses the role played by subjective norms in the scientific process[4]. Stigler's argument would be correct if there was some Platonic creature corresponding to "absolute truth" in economic science. In other words, we could accept Stigler's point of view if the economy could, for all time, be completely described by some unambiguous general theory. If, to paraphrase the plot of a famous book and film, this Oz-like object existed, then no matter which Yellow Brick Road the scientist traveled down, the end destination would always be the same. If there is one correct economic theory, then, eventually, it could be discovered, and the history of economic thought would have no relevance[5]. However, this is simply an assumption on Stigler's part. From it comes Stigler's claim of uniformity in scientific communities, and the suppression of alternate views. If Stigler's premise of a single method for economics is rejected, and the validity of different frameworks accepted, then the way is open for different interpretations of "great works" in the history of economics, and the role of biography as a guide to the validity of these interpretations is established. That this position, rather than Stigler's, represents the status quo in economics is apparent from the milliard different interpretations of the works of the major figures in economic thought such as Smith, Ricardo, Marx and Keynes, to name just a few.

For many economists there is no such thing as economic theory "in abstract". For them, economics is necessarily problem orientated, so that, in order to understand the development of the subject we need to understand the circumstances which threw up the relevant problem[6]. This is particularly true of classical economists as well as for some contemporary economists outside the mainstream[7]. For these economists, the role of economic theory is to provide insight into particular economic problems and for the related policy debate. Let me take two examples. We know that the economic work of Ricardo was explicitly aimed at providing insight into some of the contemporary policy debates of his time, particularly those associated with the corn laws and with the bullion controversies. A further example, one with which I am particularly familiar, (and is discussed in greater detail below) is that of Kalecki, whose approach to economics was that of a problem solver. His analytical framework was developed to throw light on the specific problems he was analyzing. For both of these economists, it is impossible to understand the significance, the development or even the meaning of their work independently of the circumstances in which they were writing. Their biography informs the message of their works.

True political economists never write in a vacuum! They attempt to throw light on the economies in which they live, in the manner in which they perceive them. Biography has a role, in elucidating this process both in reconstructing the objective environment in which they were working, and in trying to illuminate their perceptions of that environment. In other words, biography has an important role in understanding the conditions of production of both the economist who is the subject of the work, and of the environment in which they operated[8].

Biography, then, is important not only for its own sake, in that it can give us utility to know something about the "greats", and to humanize economics by making the great economists more human. It also serves the further purpose of clarifying the mindset and environment of the subject, and so can cast important light on the nature of their contributions to economics. In other words, because economics is the product of history and society, as well as of an individual, biography plays an important role in uncovering the link between these factors.

17.2 The Art of Biography

> By telling us the true facts, by sifting the little from the big, and shaping the whole so that we perceive the outline, the biographer does more to stimulate the imagination than any poet or novelist save the very greatest ... almost any biographer, if he respects facts, can give us much more than another fact to add to our collection. He can give us the creative fact; the fertile fact; the fact that suggests and engenders. (Woolf, 1967, 227–9)[9]

There are as many different types of biographies as there are writers of them, and as many different motives for reading them as there are readers. Consumers of biographies are a heterogeneous lot, with a large and diverse range of demands. The readers of biographies of the royal family, the rich, pop stars, sport heroes, movie stars and so on, can have many motives. Some may be purely prurient or vicarious, interested in gossip, others may have a curiosity as to "how the other half live", while some may have an interest in trying to understand the motivations and influences which have shaped the subject of the study, and, in particular, in understanding what it was that made them famous.

Even then, there are many types of stories that could be told, and many ways of telling them. In looking for some essence common to biographies, I sat down, for the first time, and tried to think of what had motivated me to read them. Why read biography? The answer, for me, was that I had some interest in the person and wanted to know more. In particular, I wanted to learn what made them "tick"? What had inspired them to produce whatever it was that had attracted my interest in the first place? Biographies are about people who have, in some sense, achieved something. This proposition is left intentionally vague because achievement is a subjective judgment, based on "the eye of the beholder". However, it is important to note that, for the vast majority of all biographies, either the subjects or their circumstances are inherently interesting. It is this type of interest which shapes the biography. It is the reason why the biography has been written and the reason why it is read. Biographies are read because there are people interested in the subject. This means that the biographical subject should be well known, as it is this which generally attracts reader's interest. An important part of any biography, is therefore to explain how this achievement came about.

This brings me to what I see as the main functions of biography in economics[10]. Firstly, by telling 'stories' of the great economists, biography restores the human element to the subject. With the aid of biography, economics and the history of economic thought need no longer continue to be dry analysis only. Rather, we can read of the developers of that theory, their motivations, their trials and tribulations. The intellectual battleground of ideas is made more interesting and humane. Related to this, one function of biography is to enable us to "get into the head" of the subject, to understand the forces which motivated them, so bringing a personal element into the story.

Associated with these considerations, (but in my opinion, more important) is the role of biography in exploring the circumstances which led to the production of the ideas. By circumstances I am referring to both the objective/material factors which shaped the environment in which the economist developed, and allowed the dispersion of ideas; as well as the more subjective circumstances relating to the development of ideas and the forces shaping the intellectual development of the subject. This would require the biographer to try to recreate in the minds of their readers the society in which their subject lived, including its social norms, culture, knowledge, beliefs and so on. All of this helps the reader "get into" the subject's head, and helps us understand "what makes them tick". It makes us especially aware of the creative aspect in theoretical and applied labour.

Of course, this opinion of biographical endeavor is extremely subjective. It arises from the "facts" as we know them. Of course, this raises important questions as to what is meant by "facts", and whether they are, themselves objective. It is known, for example, that people experiencing the "same" phenomena will «see» quite different things. As well, there is likely to be an extremely large number of facts, which may themselves be subject to varied interpretations. This means that the necessity for some selectivity of "facts" cannot be avoided. Otherwise a biography may take at least as long to read as the person's life was to live. So the biographer selects what they consider to be the pertinent facts (cf. Moggridge, 1989, 182). This is, has to be a subjective process, as is the use that is made of the facts and their interpretation. As our knowledge of human motivation increases, so will our selection of which facts are important, and our explanation of those facts change. As a result, in a sense, just as each generation retells history in its own light, so each generation can reinterpret the life and works of the famous.

17.3 Personal Thoughts on Writing Biographies

As mentioned above, I am currently engaged, with two other authors in writing an analytical biography of Michał Kalecki. Kalecki was born in Poland in 1899 and died there in 1970. His ideas have not had the impact on economics that many believe they should have had.

The first problem faced by any biographer is to decide what sort of biography to aim at. Amongst economists, there appears to be at least three different genres of biography. The first is the biography of the "well known" economist. As their accomplishments are well known, the biographer has no need to introduce the reader to them. Rather the sorts of issues raised above can be immediately embarked on. By looking at the story of the economist's life, understanding of the circumstances which led to the production of new ideas can emerge. Examples of this type of biography of economists are those of Wicksell, Hayek, Ricardo, Smith, and Malthus. Originally I was going to limit discussion of the second genre of biography to those about Keynes, because there seems to be almost a separate industry devoted to writing biographies of Keynes. Two biographical volumes on Keynes were published in 1992 alone. However, to be fair, I would have to include at least Marx and J.S. Mill under this head, as both seem to have been the subject of several biographies. In other words, there is a group of economists who are overly represented in the biographical stakes. Why is this so, and do we need yet another biography? To answer this, we should note that all three of these figures transcend economics. Keynes was a key economic advisor and an important figure in the history of the first half of the twentieth century, while the contributions of Marx and Mill covered many areas. Because their talents are so multi-faceted, their lives are of interest to a wide and heterogeneous audience. The biography that an economist may write will vary from that of a philosopher or that of a political historian. So, to some extent, it is the large range of their contributions which may explain the biography industry, and the controversial nature of their interpretations. As well, there are more prosaic matters such as the emergence of new material, which is of particular relevance to the case of Keynes. To an extent the multiplicity of biographies devoted to these men, who are seen as pivotal thinkers, demonstrates the idea (discussed above) that each generation reinterprets the lives and ideas of its predecessors. An important distinction between this type of biography and the others is the need for the author(s) to differentiate their product. Anyone who has read Skidelsky's biography of Keynes will know of the great stress (almost obsessive) on differentiating his book from Harrod's well known biography. Finally, we come to the case of the biography of an economist who is not well known, but whose works have attracted a small group of dedicated followers, usually outside the mainstream of economics. In such cases the biographer's task is rather different. In addition to the normal functions of a biography, the individual needs to be introduced, with claims for their importance or relevance incorporated in the study. The emphasis is not so much the discovery of new facts, rather on introducing the economist to a wider audience.

It is this last type of biography that we are currently engaged in compiling. This is one reason why we are not attempting the definitive word on Kalecki's life and achievement; some additional reasons are discussed later.

In many ways, the nature of Kalecki's life makes writing his biography more difficult than is the case with many other biographies. Most involve substantial detective work. A good biographer of economics needs to be one part Sherlock Holmes, one part economic historian, one part social historian, one part historian of economics, one part psychologist and one part writer. The qualities of historian are needed to help understand the economic and social environment as well as the analytical nature of the contribution; the psychologist is needed to try to understand motivation, the writer to make sure that the final product is something that people will want to read, so that the subject of the biography lives again through the biography, while the detective's role is to uncover the important missing facts. Most of the influences that shape the life of any individual are out of the public eye. This is especially true of the early formative years, before fame has been achieved. In some cases, parts of the past may be intentionally hidden from future biographers by the subject or their family. There are many famous economists and public figures who gave instruction for their papers to be destroyed when they died. A good biographer needs, like Sherlock Holmes, to follow the faintest clues doggedly, often following dead ends in the hope that some important clue to previously hidden aspects of the biography unfolds. An excellent example of this is Peter Groenewegen's work on

Marshall (Groenewegen, 1995), which has uncovered aspects of Marshall's life which were previously hidden, partly because Marshall himself hid them and partly because false clues were left, intended to mislead. The reward is a more complete version of the life and influences of one of the most important economists in the development of the discipline. That so much of this could be uncovered in Marshall's case was mainly due to Groenewegen's own detective work and that of others, aided by the fact that Marshall had spent most of his life in England. As a consequence, much important information had not been destroyed, it had only been hidden, waiting to be uncovered. This is in sharp contrast with our experience of Kalecki. To explain this more clearly, some important watersheds of his life need to be briefly summarized.

After spending his early years in Poland, Kalecki moved to England just before the outbreak of the second world war. He stayed there until the end of the war, when he moved to North America, mainly working for the United Nations secretariat. In 1955, under tremendous pressure from McCarthyist persecution, he resigned his position and returned to Poland, where he spent the rest of his life.

The problem this presents for Kalecki's biographers is that as a result of war and major upheavals in his life, most of the records have been destroyed. During the war, his home in Poland as well as his parent's home were destroyed. Warsaw and Gdansk, where he completed his early studies and apprenticeship in economic journalism before starting his career in the Polish Institute of Research in Business Cycles and Prices, were places severely damaged during the war. As a result, we have been unable to obtain any record of his early years. At each of the milestones of their lives, the Kaleckis destroyed most of their records. Most importantly, before they returned to Poland, they destroyed much of their written records and correspondence. As a result, the possibility of obtaining further information, particularly about Kalecki's early years seems remote.

Although much of what is available is in Polish, this is not a serious problem. Jan Toporowski is fluent in Polish, and has already translated some of Kalecki's works for Cambridge University Press. However, problems do arise from the publication of the Collected Works. Kalecki's collected works were published in a six-volume set in Poland (in Polish) between 1979 and 1988. However, due to the political climate of the time, not everything available was published. The editor of that collection, a former student of Kalecki's, has promised to make amends in the English edition, of which the first two volumes – collecting Kalecki's major writings on the dynamics of capitalist economies – were published in 1990 and 1991. These two volumes include much which has been translated into English for the first time as well as some previously unpublished material. There are five further volumes to be published, including much archival material which is extremely difficult to access. Unfortunately for us, the editor of the works has played, and continues to play, a prominent role in Polish politics. As a result of this, there is little chance of these volumes being published in the near future, or, if they are, it is unlikely that he will have been able to devote as much editorial time to the later volumes as bestowed on the earlier ones. This is why I argued earlier that we could not produce a definitive biography. That task awaits the completion of the publication of the collected works into English.

This does not, of course, mean that we have no interesting material to work from. There is a fair amount of correspondence between Kalecki and other economists in archives in England and North America. In addition, we are in the fortunate position of still being able to talk to many of Kalecki's contemporaries. Indeed, Bruce MacFarlane worked with Kalecki in India. However, this leads to further complications. By relying on interviews, we are. mainly relying on the memory of people who were close to Kalecki, either in their work or in their personal lives. Memory, in any case, is itself a very subjective thing, but this is even more true of memories of someone you are close to, and who died over twenty years ago. Many of these people are now old, and the accuracy of their memory, even after allowing for its subjectivity, must be questioned. Over the period of December 1990 to January 1991, I taped a series of interviews in England, Poland and the United States with many of Kalecki's former colleagues and students as well as with his widow. Most of the interviewees were extremely emotional, and often I got the impression that their memories consisted of a mixture of what they believed had happened and what they wished to have happened. In some cases, they could no longer remember the actual events, but could only remember what they had told others. This proved particularly tricky when I asked something that had not been asked before. Often I was told that, as they had not talked about the event recently, they could not remember it. However, despite these difficulties in obtaining detailed information about Kalecki's life, the interviews and archives have enabled the discovery of many important details.

This raises another important issue of particular relevance for biographies where the subject or their contemporaries are still alive, namely, the many ethical and moral dilemmas, in using views and opinions expressed in interviews, or information obtained from archives and letters. Individuals may choose to keep part of their lives outside the public domain, and the biographer has a difficult decision as to how much of that information to reproduce. Clearly there is a balance between the right to know important facts about the subject, and an individual's right to privacy. This is particularly important when controversial claims cannot be verified, and are only the opinion of one of the actors. There is no right or wrong, in these situations, each case must be judged on its own merits, and we must trust to the sensitivity of the biographer, and the accuracy with which such detail is reported.

The role of biography is particularly important in understanding Kalecki's work. He was, in many senses, always an applied economist. His excursions into theory were motivated by the need to understand particular problems. His life-long concerns with the distribution of income and with the determinants of employment were the direct results of his experiences in the 1920s. As a result of the depression, Kalecki's father's business went bankrupt. This forced the abandonment of his studies in engineering and saw the beginning of his career as an economic journalist. During his term working at the Polish Institute of Research in Business Cycles and Prices, he attempted to develop an explanation of the causes of economic depressions and unemployment. It was as a result of this research that the claim is advanced for Kalecki's simultaneous discovery of the principle of effective demand with Keynes. Subsequently, at the United Nations and in the role of economic consultant for developing economies, his interest changed, and he began work on understanding these types of economies. Similarly, his return to Poland rekindled his enthusiasm for the understanding of socialist economies. With Kalecki, we see the important role of biography in understanding his work: his theorizing was aimed at solving specific problems, and the significance of these problems can best be understood in biographical, historical and social context.

One of the more interesting questions facing historians of economic thought is an explanation of why Keynes and Kalecki, two economists from such different backgrounds, both discovered the principle of effective demand at about the same time, as well as explaining the differences in their formulations. Before making any concluding comments, I would like to propose that the clue both to the simultaneity of discovery and to the difference in form lies in biographical details, both responding to depressed economies, but from very different backgrounds. Keynes, brought up in the Marshallian tradition, realizing the possibility of unemployment, and the importance of effective demand, extended the Marshallian framework to incorporate a theory of output. His earlier interests in probability manifested itself in the role which uncertainty played in the analysis of investment and money. Keynes explicitly built on the Marshallian framework which was part of his intellectual environment, and modified it to incorporate the changes to the economy. Kalecki, on the other hand, had not been formally trained in economics. His early engineering studies had been interrupted by a recession, as a result of which his father became bankrupt. Forced to terminate his studies, Kalecki became an economic journalist, before obtaining employment in the Polish Institute. Here he engaged in applied studies of the Polish economy. The legacy of this early period of his professional life left Kalecki with a desire to understand the causes of unemployment, as well as an applied statistician's understanding of the economic system.

As both Keynes and Kalecki were reacting to depressed economies, it is not surprising that they both concentrated on the determination of a theory of output and employment, though similarities in their analysis of effective demand is interesting. Given their different backgrounds, both in terms of material circumstances and in terms of their education in economics, the reasons for the differences in their approaches is apparent.

17.4 Some Conclusions

This paper has canvassed some of the issues relevant to the writing of biographies. After briefly surveying the Jaffé/Stigler debate as to whether biography serves any useful role, either for economists or for historians of economic thought, the conclusion that biography is important for both was reached. A number of reasons for this conclusion were discussed, including the ability of biography to "humanize" economics and to help in the understanding of the purposes of economists. However, the most important justification for biography's role in economics results from the nature of the subject. Economics is the creation of people who are part of society and history. It is, therefore, an artificial construct with a social and historical dimension. As a result, biography has a role in helping us understand the circumstances which led to important developments in the subject, and, by doing so, throws light on those developments.

Biography requires many and varied skills, depending on the nature of the subject. For some subjects, the main difficulties will be in digging up information, or in disentangling fiction from nonfiction. In other cases the problem will be of interpretation, where the information is known, but motivation is unclear. In addition, there may be ethical and moral problems with which the biographer needs to come to terms.

In the final section, the paper outlined the way in which some of these problems have been experienced in the proposed biography of Kalecki, as well as briefly indicating ways in which biography may shed some light on the question of the simultaneous discovery of the principle of effective demand by Kalecki and Keynes.

Notes

I would like to thank, but not to implicate, Teresa Brosky, Peter Groenewegen, Mike White and Bruce McFarlane for their helpful comments.

1. According to Moggridge (1989,176), "there is really remarkably little".
2. Or, as Mike White has eloquently expressed it, a "low rent area".
3. For an illuminating and entertaining discussion of the relation between economics and art see Szostak (1992).
4. For a very useful survey of the philosophy of science, which makes this point, see Chalmers (1982).
5. See Walker (1983) for an attempt to reach a compromise between the views of Jaffé and Stigler by identifying semantic differences associated with taxonomy.
6. But not for Stigler, see Stigler (1965) chapter 2.
7. Of course this is also true for some mainstream economists, as well as for some, (Marshall and Keynes spring to mind) whom it is harder to categorize.

8. Of course, sometimes biographies can intentionally deceive, for example Keynes' biography of Marshall in which he invented details about Marshall's father in order to explain his turning against tertiary education for women, and Harrod's official biography of Keynes which clearly attempted to "sanitize" details of Keynes' life.
9. I was inspired to read this article through Moggridge (1989).
10. This may be compared to Moggridge's discussion of motivations for writing biographies, Moggridge (1989, 176–8), which include the fact that "nobody has ever written" it, that the subject is an interesting person living in interesting times, that understanding the background is indispensable to understanding the conclusions, the record needs to be set straight. Moggridge summarizes these in the view, shared in this paper, that "the creation of the biography will add something to our knowledge not only of the subject, but often also of economics".

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18

Post-Keynesian Theory, Direct Action and Political Involvement

G. C. Harcourt

In this paper I analyse how I became an economist and at the same time a democratic socialist and a Christian. I also explain how I became politically involved after my graduate studies at Cambridge in the late 1950s and started lecturing at Adelaide. When back in Cambridge in the 1960s, teaching this time, the war in Vietnam persuaded me to support direct action through the anti-war movement in South Australia when I returned to Adelaide in 1967. The 1960s and the events of the time did influence my approach to teaching and research. More concretely, I was persuaded that ideology and analysis were indissolubly mixed and that one's stance should always be made explicit. How these influenced what I did in my years in Adelaide, and then from 1982 back in Cambridge, along with my earlier experiences, are all described in the paper.

18.1 Introduction

The aim of the paper is to analyse how my decision to become an economist intertwined with my search as an undergraduate for a political philosophy and religious belief. By the end of my undergraduate course at Melbourne University in 1953 I had become both a democratic socialist and a Christian, the latter decision taking much longer to reach than the former due to my social and religious origins. Once I had finished graduate studies at Cambridge in the late 1950s and started lecturing at Adelaide, I also became politically involved in a number of areas but always through the ›usual channels‹. It was not until I was teaching in Cambridge in the 1960s and becoming more and more upset by Australia's involvement in the Vietnam War that I decided when I returned to Adelaide in 1967 to support direct action through the anti-war movement in South Australia. This decision also much influenced my approach to teaching and research as,

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greatly influenced by the writings of Chomsky, Dobb and Stretton, I became convinced that ideology and analysis were indissolubly mixed and that your own stance must always be made explicit. How this influenced what I did in my years in Adelaide from then on, and then in Cambridge from 1982 on, is described in the later parts of the paper.

18.2 Early years

To provide the background to my topic, I set out some autobiographical facts. I was born in Melbourne in June 1931, one of twin boys. (My brother became a most distinguished and respected academic dentist which would have pleased Keynes.) My parents were middle class; my father was a leather merchant, my mother before marriage, Head Mistress of the infant school of a posh Melbourne girls' school. They were right wing, agnostic, assimilationist Jews. In the 1930s Melbourne was a stuffy, snobby, sectarian city with great hostility between the Roman Catholic and Protestant communities who, nevertheless, happily formed a united front when ganging up on the Jews. There was (is) a considerable Jewish population in Melbourne. It was (is) split between pro- and anti-Zionist factions, left-wing and right-wing political beliefs and orthodox and liberal religious views. In recent years, the split takes in support for, as opposed to (distressed) opposition to, Israel's behaviour towards the Palestinians.

We were educated at private schools (where people went to school was very important in Melbourne social values) and experienced first hand what I would call ›thoughtless British Anti-Semitism‹ which served to scar my childhood. As part of my parents' assimilationist stance we were entered as C of E (Church of England) at our primary and secondary schools (one of which was C of E, the other, Methodist) so we went to the whole of morning assemblies including prayers, and to chapel and divinity classes. (Most Jewish boys – they were boys only schools – did not.) I absorbed uncritically both my parents' agnosticism about religion and their very right-wing political views allied with simplistic patriotism taking in the British Empire and all it allegedly stood for. I did early on have a burning dislike of injustice and intolerance, especially concerning some of my relatives' attitudes to Australia's indigenous people.

Though I now do not agree with my parents' stance, I cannot criticise them for it – they were doing what they considered best in the very unsettled and worrying situations of the 1930s and 1940s. My mother tried hard to be a good parent but she was insecure and possessive. Whereas my father understood well the two roles of parents: supportive and protective when children are young, supportive but letting go when children are grown up. He was an especially fine man; he exhibited all the ancient verities and he was much respected and loved by many, many people. My parents were devoted to one another and a good team. For various reasons my mother was, as I noted, a rather insecure person and it was only after she had a severe stroke in 1972 that she realised that people did care for and about her.

Though I always wanted to be a vet (and took three years to get the natural science prerequisites at university entrance examinations to allow me to do so), I had also done economics as a ›fill in‹ subject for four years at school and liked it. So when I went to Melbourne University in 1950, I decided to do a B.Com degree and become an economics schoolteacher. (This allowed me to have a generous scholarship while at university in return for several years teaching in the state system afterwards.)

I had always been in the shadow of my very bright twin brother, John. We had been moved up ahead of our age as a result of his high marks – a disaster for both of us socially and for me intellectually. But when I went to university I came into my own, as it were, and topped the first year of the B.Com degree, not least because of the encouragement and tutoring of my first mentor, Joe Isaac (who, after a distinguished academic career, was the first economist to serve on the then Australian central wage-fixing institution, the Commonwealth Conciliation and Arbitration Commission). Joe persuaded me to leave the Victorian secondary education department, which paid my scholarship and to try to become a university teacher.

As a result of the subjects I took in my first year, especially Economic Geography I (really comparative economic systems), I soon became a democratic socialist in my politics. I found out that societies organised their economic and social affairs mostly in an irrational and unjust manner, especially with regard to the use of essential resources that would be needed by future as well as by present generations. Making up my mind about belief in God (the two pressing issues for thoughtful students in those days were stances on politics and belief or not in God) took much longer because of a perceived gap between the actual behaviour and professed beliefs of Christian groups. (I knew little about Jewish ones but my father, having been orthodox until his early twenties, then decided that all religion was bunkum and religious people, hypocrites!)

I spent my university years at Melbourne after 1950 in Queen's College, a Methodist institution, which had a theological school where would-be Methodist ministers were trained. Many of them became firm friends with whom I discussed the nature of religious belief. The upshot was that in my fourth year as an undergraduate I made a Popperian-type decision: Suppose that there is a God (all three, with the Christian community a natural step on, or perhaps a takeover of, its Jewish forebears), and see how we go from there. That is to say, would subsequent experiences falsify the hypothesis? (They have not yet.) I had no trouble reconciling the precepts of Christianity with democratic socialist principles. So I coupled my Christian beliefs with them. I argued that the only difference between Humanists, who also wanted to create just and equitable societies, and believers, who wished to do the same, was that the Humanists thought they could do it unaided, whereas the Christians thought that the Holy Spirit would help them to work in mostly secular institutions to attain these ends: first, by taking on the dead weight of personal failings which so drag people down – think of poor Wittgenstein – and, secondly, by emphasising the nature and importance of the community – the people of God – rather than of the individual. So I was baptised in Queen's College chapel in 1953 and joined the Australian Labour Party (ALP) soon after. And when I took up my first teaching post in Adelaide in 1958, I began to call myself the only Jewish Methodist in that fair city.

18.3 Economics Education

The economics course I did at Melbourne was very Cambridge (England) orientated but it also took in Hicks and Kalecki as well as Samuelson, Schumpeter and Chamberlin. I also studied the classical economists and Marx in a third year history of economic thought (HET) course. Obviously Keynes was a major influence – I encountered the great man in my first year when intending Honours students read and went to lectures on *A Tract on Monetary Reform* (1923) (and Philip Wicksteed's *Common Sense of Political Economy* (1910), still two of my favourite books). We were lectured on the themes of *The General Theory* in the second year by Donald Cochrane (of Cochrane and Orcutt fame) and Joe Isaac. I had read *The General Theory* over the preceding long vacation but, needless to say, I found it extremely hard going, not least because I tried to read it in bed! In later years we were introduced to Michał Kalecki's writings on income distribution by Joe Isaac, to Maurice Dobb's writings on the transition from Feudalism to Capitalism and to his classic *Political Economy and Capitalism* (1937 and 1940). (When I subsequently took an Honours Class at Adelaide on Radical Economics in the 1970s, I told the students that they should read Dobb's book and Milton Friedman's *Capitalism and Freedom* (1962) before they could make an informed choice on where they stood politically and on their approach to economic analysis.)

The most influential article I read as an undergraduate was Kurt Rothschild's 'Price theory and oligopoly' (1947). It has influenced my thinking ever since. He argues that oligopolists are as interested in secure as in maximum profits and that Clausewitz's principles of war are the appropriate framework with which to analyse oligopolistic behaviour. In my fourth year honours dissertation I tried to introduce Rothschild's oligopolists as the principal decision-makers in the economy into the model of *The General Theory,* to see if this affected the analysis of the systemic behaviour of capitalism. These themes run through much of my work ever since.

Philip Arestis once asked: Why this approach and not some other? I suppose historical reasons dominated – it was the early 1950s and in Australian universities, the economics of British universities and especially of Cambridge dominated both syllabuses and to some extent the background of the staff. *The General Theory* had been published in 1936 and Keynes had only died four years before. Tom Asimakopulos, who was my contemporary as a Ph.D student at King's, Cambridge in the 1950s, had a not dissimilar training at McGill before coming to Cambridge. When he was asked by Philip Arestis and Malcolm Sawyer to write an autobiographical essay for the first edition of their splendid volume, *A Biographical Dictionary of Dissenting Economists* (Arestis/Sawyer 1992), he refused because he did not view his approach to economics as a dissenting one, but rather as firmly placed within the then mainstream developments of economic theory especially associated with Marshall and Keynes. His mentor, Jack Weldon, had taught him within this framework (after a thorough grounding in the writings of the classical political economists). Perhaps Paul Samuelson's *Foundations* (1947) figured more prominently in his training than in mine, but otherwise we had a very similar background. In his later years, from the mid 1960s on, our views became even closer as he adopted more and more the approaches of Joan Robinson and Kalecki, so that he became post-Keynesian in his approach.

In my case, Marx was also very important though, as I have written before, I never really understood him until I had in the 1970s and 1980s three wonderful scholars of Marx as my Ph.D students – Prue Kerr, Allen Oakley and Claudio Sardoni. Of course, with hindsight, I can now see more clearly how all these influences and others – the classicals, Sraffa, Kaldor, Dobb – come together in my approach and in my evaluation of the approaches of other economists.

18.4 A Research Student at Cambridge in the Mid 1950s

In 1955 I went to King's College, Cambridge to do a Ph.D, first, with Nicky Kaldor (a disaster) and then with Ronald Henderson as supervisors, and, as I wrote, I was appointed to my first lectureship at Adelaide in early 1958. Initially the topic of my Ph.D dissertation was the implications for the theory of the firm and of the trade cycle of secure profits being as important as maximum profits for oligopolists. In the event it was on the systemic implications of the use of historical cost accounting procedures for setting prices and measuring income for dividend and taxation purposes in a period of inflation, not completely unrelated!

While a research student I also made a special study of Joan Robinson's *The Accumulation of Capital* (1956) – this was the start of our friendship – and I subsequently lectured on the book to the Honours students in Adelaide. (It did, of course, greatly influence from then on the approach I took to teaching and research.) I also started teaching the first year Keynesian course at Adelaide in the early 1960s when Peter Karmel (who had designed the course) left his chair at Adelaide to become the first Vice Chancellor of the Flinders University of South Australia. The lectures were the basis of my first book, *Economic Activity* (1967), co-authored with Peter Karmel and Bob Wallace. Bob took the course over from me when I returned to Cambridge in 1963, first, for a year's study leave and then, completely unexpectedly, to a University Lectureship in the Cambridge Faculty of Economics and Politics and a Fellowship at Trinity Hall, posts to which I was appointed while on leave. As a result I held the appointments for three years, having obtained three years leave without pay from Adelaide to do so, as I felt I had a moral obligation to return to Adelaide.

When Robin Matthews was elected to the Drummond Chair of Political Economy at Oxford in 1965, I took over his first year macroeconomics course at Cambridge. I lectured from the notes that became *Economic Activity*. I told the undergraduates present at the lectures that 30 years or so previously Keynes had lectured to a specially chosen set of undergraduates from the proof sheets of *The General Theory*. I added that they were not *that* special and I was not Keynes, but that the lectures were on the economics of Keynes. The most distinguished of the undergraduates present was Mervyn King, who became Governor of the Bank of England. Three times in public (sort of) he has singled out the lectures for special praise; I wish he would put this in writing!

18.5 Political Activities

During my first six years at Adelaide I was politically active in a number of areas but always through the ›usual channels‹. I was Secretary (in later years Vice-President and President) of the Howard League for Penal Reform, S.A. Branch, and President of the Mitcham Branch of the Australian Labor Party (ALP) (we met in our home so you can imagine what a large membership the branch had). I also was associated with the bi-partisan movement then formed to try to rid Australia of the White Australia Policy in our immigration laws. As the ALP had, for historical reasons, White Australia in its platform, I could not be officially associated as I (and many other members of the ALP with the same views) would have been expelled from the Party, so we worked behind the scenes to get White Australia removed from the platform and Australia's immigration policy.

I published quite regularly in my first years as a university lecturer once my Ph.D was out of the way (I had also published three articles before I was awarded it in late 1959, one of which probably secured my appointment at Adelaide). I wrote my papers in the third person with numbered paragraphs as though they were natural scientific reports. There was no intrusion of personality or values in them. Moreover, I was very chuffed when after one of my introduction to Keynesian macroeconomics lectures at Adelaide, I overheard a student saying: »I can't work out whether Harcourt is Labor or Liberal [Tory in Australia] from his lectures!«

18.6 Teaching at Cambridge in the 1960s

All this was to change during my years as a teacher at Cambridge. First, I allowed a little of my personality to intrude into my papers (have a look at the opening paragraph of ›The accountant in a Golden Age‹, *Oxford Economic Papers*, 1965). I had a great burst of publication over that period, mostly in what we now call ›Brownie Point‹ journals, and there was even something approaching wit in my narratives. This last was subsequently to grow, so much so that Joe Stiglitz, in the first draft of his unfavourable review article in the *Journal of Political Economy* (1974) of my 1972 book on capital theory, commented that some of my jokes (in the book) were »nearly as funny as Harcourt seems to think they are«, a remark he removed from the published version, rather to my disappointment. Joe sent me the first draft of his review article and I, perhaps foolishly, sent him eight pages of comments on it. I have kept a file on this episode as I received comments on Joe's draft from Joan Robinson, Eric Russell, Mario Nuti, Neil Laing, and Piero Sraffa. Joan's comment began: »I am sorry you have let this ass get under your skin«. I should add that Joe had a room next to me in Cambridge in the mid 1960s when Samuelson and Solow sent him to the ›other Cambridge‹ to hear its views first hand. Sadly, Joan and Joe did not get on at all – principally Joan's fault, not Joe's – but Joe and Nicky Kaldor did. Joe and I also became friends then and have remained so. (Indeed he recently told our son, Tim, when he met him in Australia, that I had been a great influence on him. He did not say whether it was good or bad.) In my view, he has been doing God's work in recent years with his courageous, outspoken and forthright views on economics and politics (he was always a progressive in his politics).

Secondly, and more to the point, I began to be very disturbed about the Vietnam war and Australia's role in it, using conscripts, and as one of the few respectable allies of the USA in that most immoral of wars. The Faculty at Cambridge was divided into doves and hawks, as were Bob Solow (a hawk) and Ken Arrow (a dove). Both visited Cambridge in 1963 – 64. To his credit, Solow subsequently changed his mind. Knowing I was to return to Australia in 1967, I had myself briefed by Martin Bernall and Ajit Singh who were really extremely well informed on Vietnam, for I was determined to do something about Australia's involvement when I returned in early 1967.

18.7 Direct Action in the 1960s and 1970s

I became a foundation member of the committee of the Campaign for Peace in Vietnam in South Australia (CPV), which was formed in mid 1967 and subsequently its chair for two periods later on. As well as writing pamphlets, organising meetings, writing letters to newspapers and going on the radio and TV, we also organised protest marches and moratorium marches.

At first, anyway, we took a non-violent stance (until one of our marches was attacked by drunken soldiers; the police were none too gentle either). On the whole we cooperated with the police but in 1970 there was a major confrontation associated with a sit down in the middle of the city as the culmination of a moratorium march. Many arrests were made. I have to say that although I was prominent all day as a marshal of the march and after, I was not arrested, partly because the cops needed some of the leaders out of jail to negotiate the release of those in jail, partly because as a moderate in the anti-war movement, I had good personal relationships with the police. I regard confrontation with them as counter-productive (our quarrel was not with them). Also my wife Joan and our children had received many death threats as well as one actual attempt to kill us by trying to blow up our car, so that the police were not unsympathetic to us as people. (Adelaide was in many ways a very small town; the ASIO man [the Australian equivalent of the UK's M15] who spied on me was the son-in-law of one of my colleagues in the Economics Department!) For eight and a half years I averaged two and a half days a week in the anti-war movement and also took part in action at the university to reform aspects of its governance. (I should add that I gave my fair share of lectures, looked after graduate students, wrote papers, including the survey of capital theory in the June 1969 *Journal of Economic Literature*, Harcourt (1969), and books and took a full part in the department's activities, as well as playing cricket in the summer and Australian Rules Football in the winter, running three miles every day, and being the father of four young children.)

My conversion to the need for direct action if other more orthodox means proved ineffective, and if the issues concerned were fundamental enough, was greatly helped by reading Noam Chomsky's essay, 'The responsibility of intellectuals' (1967) and Hugh Stretton's remarkable book, *The Political Sciences* (1969). Chomsky argued that it was not good enough, say, for natural scientists to invent napalm, but not take a stance on the use made of it – they had a social responsibility to speak up. Stretton argued that in the social sciences (and other disciplines) there was no such thing as an objective, value-free discipline, that ideology and analysis were indissolubly mixed. To claim otherwise was to corrupt both yourself and your students. Personal values always should be made explicit in teaching, speaking and writing. (Maurice Dobb made similar arguments.)

So in my classes from then on, I started every course of lectures by setting out my philosophical, religious and political values, and how they were entwined with my approach to political economy. I said I did not expect my students necessarily to agree with me but I wanted them to know exactly where I was coming from. I followed the same course in public addresses, speaking on radio and TV and writing political pamphlets, articles, letters to the editor; and so on. All my papers and books from then on were permeated with these views. I was especially outspoken in the 1960s and 1970s as I was inspired and humbled by the example and courage of the student radicals involved in the anti-war movement and university reforms. After all, I was by then a tenured professor whereas they were using their first time at university to fight for just causes, often at the expense of the time they could give to their studies which in turn often affected the marks they received – a much higher permanent sacrifice than someone in my position could ever have been asked to make.

From then on, I have always tried to call a spade a spade in what I say and write, taking Kalecki's 1943 classic, *Political aspects of full employment*, as the role model. I try to use dispassionate arguments in my political writings and speeches, also ›to hate the sin but love the sinner‹, and I never expected ›favoured nation‹ treatment, if I broke the law on protests – only that I should be neither framed nor beaten up in the process! (For the record, I was not.)

18.8 Return to Cambridge in 1982

When I returned to Cambridge in 1982 I still held to these values but I have never been as politically active again. Partly this was because though I had been an important ›back room boy‹ for the ALP in policy formation in the 1970s, the ideologues in the British Labour Party did not (and still do not) want to know. (For example, I was the economist on the ALP's National Committee of Inquiry, which was set up in the late 1970s to see why the party had done so badly in the 1975 and 1978 federal elections. I wrote the first draft of discussion paper number six on economic policy and the future of Australia. In it I set out a package deal of policies, which was post-Keynesian in approach. It was especially influenced by Ralph Willis's lone voice advocacy in the ALP and the writings of Eric Russell and Wilfred Salter on incomes policy from the 1950s on. I like to think that Bob Hawke set this policy in motion for a good half hour after he was elected Prime Minister in 1983.)

Partly also, my academic workloads – teaching, research, supervising graduate students, college, faculty and university administration – were much higher and I had set myself the task of documenting the intellectual history of what may be called Joan Robinson and her circle – to see what was lasting in the contributions of the first generation and after of Keynes's pupils. As I returned to Australia permanently at the end of July 2010 (Joan [Harcourt] and I flew home on our 55th Wedding Anniversary), I have all but fulfilled the task with the publication in 2006 of *The Structure of Post-Keynesian Economics: The Core Contributions of the Pioneers* and the publication in 2009 with Prue Kerr of the intellectual biography, *Joan Robinson*. I still have to see through my last major project, a two-volume handbook on post-Keynesian Economics for Oxford University Press, USA, which I am co-editing with Peter Kriesler; and I am preparing two more volumes of selected essays to be published by Palgrave Macmillan on *Skidelsky's Keynes and Other*

Essays and *The Making of a Post-Keynesian Economist: Cambridge Harvest* [all have now been published]. In Australia I am to mentor indigenous students doing undergraduate and graduate courses at the University of New South Wales (UNSW), so I shall still be politically active in my 80th year and on.

18.9 Egotistical Evaluation

As Prue Kerr had already suggested, Philip Arestis also asked that I add a section summarising my own work, emphasising my main contributions to economics and indicating the extent to which democratic socialist principles and Christianity have influenced them. I respond with reluctance because ›blowing your own trumpet‹ is not an Australian characteristic (even if it is a Cambridge one). The greatest compliment I was ever paid was by Anand Chandavarkar, an Indian friend of mine in the World Bank. He said (I paraphrase): »I always think of you as the Keith Miller of economics, the last of the great all-rounders.« As Miller, the great Australian all-round test cricketer of the 1940s – 1960s, was my boyhood hero, it is easy to understand why I was so chuffed by his comment. And it is true that I have written articles and books on theory, policy, applied work [including one econometric paper(!)], intellectual biography, history of the economic theory and even methodology. Partly this is because my generation thought this was what economists did; partly because I was never a narrow specialist but followed up whatever caught my eye and/or what I thought were important and pressing issues.

In a most generous preface to a selection of my essays published in 1995, the late Mark Perlman classified my writings into four groups:

a. Works analysing contemporary economic theoretical problems
b. Works synthesizing states of debates in economic theory
c. Works having a distinctly biographical favour and pertaining to various contemporary economists, and
d. Works pertaining to economic and allied social policies.

He singled out as my »*greatest* research contributions [...] the essays written under the second rubric«, judging me to be a »something of a master« because I get »each side's position ›straight‹ and sympathetically stated [and my] judgements are original, pithy and sound« (Perlman 1995: ix, emphasis in original). He wrote that I had »become of that rare breed, a teacher's teacher [, one] of only a few who really can teach others what and how to teach« (Perlman 1995: ix). He quoted with approval what I had come to believe ›what economics is about‹, that it is

> »to make the world a better place for ordinary men and women, to produce a more just and equitable society. In order to do that, you have

> to understand how particular societies work and where the pockets of power are, and how you can either alter those or work within them and produce desirable results for ordinary people, not just for the people who have power. I see economics as very much a moral as well as a social science and very much a handmaiden to progressive thought. It is really the study of the processes whereby surpluses are created in economies, how they are extracted, who gets them and what they do with them. All economies have created surpluses in one way or another. Capitalism does it in a particular way and that is the process in which I am most interested because I live in capitalist economies. At the same time I would like to help to create a society where the surplus is extracted and used in a way quite different from a capitalist society.« (Perlman 1995: vii)

I believe my commitment to democratic socialism and Christianity run through, and are integral to, this statement. Over the years I have had to lower my sights as to what we may hope to achieve in an increasingly imperfect world. The most explicit statements of this are to be found in the paper, 'The mixed economy,' written with Prue Kerr and published in 1980; in my 1982 John Curtin Memorial Lecture, *Making Socialism in your own country*; and in the 1992 Second Donald Horne Address, *Markets, madness and a middle way*.

18.10 Concluding Remarks

Finally, may I quote what Ken Arrow (who has been a friend since we met in Cambridge in 1963, who I regard as the greatest living economist and who I admire tremendously as a compassionate human being) wrote in the Foreword to volume three of my *Festschrift*, edited by Claudio Sardoni and Peter Kriesler (1999):

> »I only came to realise later the extent to which [his] concerns were motivated by strong humanitarian and egalitarian values which derive from [his] religion. Regardless of their source, these are the values which both sides in the 1960s controversies [on capital theory] hold high and which have come under steady attack in the last twenty years. Geoff's firm convictions have been a pillar of fire in the night.« (Arrow 1999: xviii)

I close by saying how grateful Joan and I are to the organisers of the conference at Bilbao and the speakers at two of the sessions for honouring me and my work. When I am depressed about the state of the world – climate change, the Middle East, the rise of budget-size fetishism, for example – I take heart that there are progressive humane people out there doing God's work (even if they are agnostics or atheists) and I feel privileged to be able to join them, not least the concentration of such people at the conference in Bilbao.

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19

Piero Sraffa: A Tribute

G. C. Harcourt

G. C. Harcourt opened the workshop 'New Perspectives on the Work of Piero Sraffa', held at Queens' College in Cambridge on 9 and 10 July 2010, with a tribute to Piero Sraffa. We are grateful to him for providing the following version for this Special Issue which has arisen from contributions to the workshop.

It is a great privilege to be included in this Special Issue of the *Cambridge Journal of Economics*, which celebrates 50 years on from the publication of Piero Sraffa's classic, *Production of Commodities by Means of Commodities* (1960, Cambridge University Press). I am delighted that, building on such a solid base, the contributors look forward to the new developments arising from his criticisms, insights and positive contributions. But perhaps I may be indulged if I look backwards, first, to my association with Piero Sraffa and his writings; and, secondly, to those of his and my dear friend, Krishna Bharadwaj, who died far too young at 56 in March 1992, but who left such a rich legacy in her writings, and with her wonderful life as teacher and scholar and extraordinary gift for supportive, deeply honest, friendship.

When I came to Cambridge in the Michaelmas Term of 1955 to do a PhD, Piero was the mentor, together with Robin Marris, of the research students. (Five of the research student body from that time were at the conference: Pierangelo Garegnani, Joan O'Connell, Luigi Pasinetti, Amartya Sen and myself.) Sraffa and Marris presided over the main research students' seminar, which was held each Thursday afternoon of Full Term in the old Marshall Library in Downing Street, and which was noted for the provision of tea and chocolate biscuits. We all admired Piero, but were very much in awe of him. At that time he was rather reserved, partly because, though the Ricardo volumes (Sraffa with Dobb, 1951–55, *The Works and Correspondence*

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of David Ricardo, 10 vols, Cambridge University Press) had been published (except for the Index), he had not yet delivered his *magnum opus*, *Production of Commodities by Means of Commodities*. Moreover, he was still recovering from the serious injuries he incurred when he had a bad fall while climbing. He fractured his skull and temporarily lost his memory.[1]

Sraffa could be a disconcerting chair of the seminar, for his comments and questions were often as unexpected as they were unnerving. For example, towards the end of my first period in Cambridge, I read a paper on the quantitative effect of using replacement rather than historical costs to measure the taxable profits of the UK quoted public companies (Harcourt, 1958, "The quantitative effect of basing company taxation on replacement costs", *Accounting Research*, vol. 9, 1–16). Right at the start of the paper, I compared the capital consumption at replacement cost of all the companies with the historical cost counterpart. Piero asked: '"Why should anyone ever want to compare them?"

When I returned to Cambridge in 1963 (on leave from Adelaide until 1966), he was a changed person, at ease with himself and fulfilled. Early on in my leave I met Vincent Massaro, who had come from Notre Dame to work with Joan Robinson and Sraffa. We agreed we would read *Production of Commodities by Means of Commodities* together and not go onto the next sentence until we felt we had understood the one before. This task was the hardest intellectual task of my life; so it was a humbling experience to realise that when we did get to the end and felt we were on top of what we had done, the author had had to start with blank pages and write what we had read! Vince had a great advantage. As the son of Sicilian migrants, he was fluent in Italian and so could spend many hours talking in Italian with Piero.

We wrote a note on subsystems (which was published in the *Economic Journal* in 1964). We discussed a draft of it with Sraffa on the night of Bob Solow's first Marshall Lecture. At the traditional party following the lecture, Len Warren, the custodian of what is now the Austin Robinson Building, made us drunk by putting far too much gin in the fruit cup, of which we all drank deeply as it was an extremely unseasonably warm night for October. It gave me the Dutch courage (further fortified by Piero's whiskey) to argue with Piero about our draft at a meeting in Trinity later that night. As is well known, you had to be a very strong (or drunk) person indeed to argue with him, especially as at one instance in our draft we had attributed to him a view he vehemently denied ever having.

Vince and I decided next to write a review article of Sraffa's book. We may fairly claim it to be a definitive review because Piero, in the end, approved of every sentence. (It was published in the *Economic Record* in 1964 and in 1972 in a slightly amended version as Appendix to chapter 4 of Harcourt, 1972, *Some Cambridge Controversies in the Theory of Capital*, Cambridge, UK, Cambridge University Press.) When writing it I amended an example in the sections on joint production and fixed capital goods (see Sraffa, 1960, *Production of Commodities by Means of Commodities*, Cambridge University Press, pp. 68–9; and Harcourt, 1972, pp. 190–2). I thought I had persuaded Piero that the amended example made his points without the puzzles associated with his initial example. However, two months or so later, he said he did not accept what I had done. I rashly said: "But, Piero, the last time we discussed this you agreed," where upon he shouted at me, his fine eyebrows raised heavenward, "I am not the Pope, I am not infallible!"

What do I think are the core foundations he has provided for us? First, I think he made the most profound critique of the conceptual foundations of supply-and-demand theories, culminating in the capital-reversing and reswitching results, but taking in on the way the incoherence of basing value and distribution theory on scarcity. Secondly, as Ronald Meek pointed out at the time (Meek, 1961; 1967), Sraffa provided a magnificent rehabilitation of the approach to political economy by the original political economists, which was brought to fruition by Marx. Of the many people influenced by Sraffa, may I comment on the outstanding positive contributions of Luigi Pasinetti and Krishna Bharadwaj? I have written in several places about the content and nature of Luigi's contributions (see, e.g., Baranzini and Harcourt, 1993, *The Dynamics of the Wealth of Nations. Growth, Distribution and Structural Change*, Macmillan; Harcourt, 2006, *The Structure of Post-Keynesian Economics: The Core Contributions of the Pioneers*, Cambridge University Press, ch. 7; Harcourt, 2009, "A revolution yet to be accomplished: reviewing Luigi Pasinetti", *Keynes and the Cambridge Keynesians: A 'Revolution in Economics' to be Accomplished*, Cambridge University Press; Harcourt, 2009, *History of Economic Ideas*, vol. XVII, pp. 203–8). Here I want to emphasise Krishna's application of the surplus approach to her work on both advanced capitalist economies and, especially, developing economies and their agricultural sectors. Her early work at the Department of Applied Economics, eventually published as Bharadwaj (1974), is an example of this and the papers she wrote in her last years are the mature development of this (see Harcourt, 1993–94, Krishna Bharadwaj, 21 August 1935–8 March 1992: A Memoir, *Journal of Post Keynesian Economics,* vol. 16, pp. 299–311).

Those last years resulted in great psychological strains on Krishna. Her devotion to Piero and her great admiration of him and his contributions meant she spent many months of hard detailed work on his papers in the Archives of the Wren Library, at the same time fretting because she wanted to be working in India, teaching and supervising students and researching on her country's pressing problems.

As we know, Krishna had come to Sraffa's writings when the editor, Sachin Chowdhury, asked her to review the 1960 book for the *Economic Weekly* (later the *Economic and Political Weekly*). To write the review, she followed the same intellectual pilgrim's progress as Sraffa himself had done—reading Petty, Smith, Ricardo, Malthus, Mill, Marx, Marshall and Walras. This allowed her to write a most profound review article, its title, "Value through Exogenous Distribution", reflecting how deeply she had absorbed his basic insights. The review led to the invitation from Joan Robinson to come to Cambridge to meet Sraffa and was the start of her deep friendship and collaboration with him. After he died she wrote a wonderful tribute to him (Bharadwaj, 1984, "Piero Sraffa: the man and the scholar—a tribute", *Economic and Political Weekly*, vol. 19, pp. 1236–50; Bharadwaj, 1989, *Themes in the Value and Distribution—Classical Theory Reappraised*, Unwin Hyman). Its conclusion reads:

> "Uncompromising in his convictions but truly modest, solitary but full of friendly generosity and warmth, Sraffa endeared himself to his close friends and was a pillar of strength to younger students who were as much impressed by him as a person as a scholar ... [The deaths of Joan Robinson and Piero Sraffa in 1983, and of Maurice Dobb in 1976 mark] the close of a memorable era in Cambridge history [but] also the resurgence of Classical Theory and a prelude to new possibilities of exploration in our science." (Bharadwaj, 1989, p. 332)

The same evaluation could, with justice, be made of Krishna.

Note

1. Clarissa Kaldor once described to me how his close friends sat round his hospital bed for hours deeply distressed. Piero regained consciousness and asked them to stop making such a fearful racket—which rather nonplussed them for they felt that their concern, loud though it was, had not been appreciated. Piero himself said that when his memory was finally restored, the last thing he remembered on his tumble before he was knocked unconscious was the reflection of the sun off Nicky's head.

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Peter Kenyon 1952–2012: A Memoir and a Tribute

G. C. Harcourt

Peter died in Perth of cancer on 15 February 2012 at the age of 60. It was my privilege and pleasure to have had Peter as my Master's student and colleague in Adelaide in the 1970s. This memoir therefore is mainly about Peter's Adelaide years. We kept in touch when he went to Western Australia, especially during his years at Curtin, but we only met a few times in person, as I was in Cambridge from 1982 on. The last time I saw Peter (November 2011), there was a wonderful dinner party at Peter and Jan's home, memorable for the gathering together of old dear friends, much gossip and laughter, and for vintage Kenyon cooking.

He was an ideal student, colleague and a wonderful friend. Peter had enormous enthusiasm for his subject, he bubbled with ideas. He always kept up with the literature, spending part of each week in the Barr Smith Library reading the latest issues of leading journals. He was unfailingly cheerful, extraordinarily friendly and warm-hearted, kind, supportive and unselfish.

Peter had a wide range of interests; prominent amongst them were cooking and music of all varieties. With a number of other members of the Adelaide department, he went to gourmet cooking classes. Turns were taken to try out dishes at each other's homes. It was therefore not surprising that, like the founder of the No. 1 Ladies Detective Agency in Botswana, Precious Ramotswe, Peter was a person of traditional build. Nevertheless, he cheerfully, though not painlessly, put up with the necessary but not sufficient condition to be one of my research students: a three-mile run at noon each weekday.

As a teacher he was a role model. While he expected high standards, he was approachable, kind and always well prepared. He could explain difficult ideas in a clear, informative and exciting way, teaching his students to be both knowledgeable and sympathetically critical. Above all, he was a

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humane and progressive idealist. As Peter Kriesler put it to me, the parallels between Precious and Peter extended into many dimensions. Foremost among them was the mutual loving and supportive partnership of Peter with Jan Wright.

His Master's thesis (it could easily have been a PhD thesis) was entitled 'Some Aspects of Pricing and the Investment Decision in Post-Keynesian Economics' (MEc, Adelaide, 1983). An article, 'Pricing and the Investment Decision', based on the principal chapter of the thesis (Chapter III) and written jointly with me, was published in *Kyklos* in 1976 (Harcourt and Kenyon 1976).[1]

Peter was a discussant at the only session on post-Keynesian economics that the AEA ever held – it was held in Georgia in 1979 (see Kenyon 1980). He had previously contributed the chapter on post-Keynesian pricing, Kenyon (1978), to the volume edited by the late Al Eichner and published by M.E. Sharpe, *A Guide to Post-Keynesian Economics* (1978). The chapters of this volume arose from a series of articles on post-Keynesian economics in Sharpe's widely read journal, *Challenge*.

Never one for meeting deadlines because his great intellectual curiosity had him chasing many ideas at once, his Master's thesis was only submitted in 1982. By then he had been to the University of Virginia to do a PhD which was never completed (like many others, Peter was 'ABD'). At Virginia he got rather carried away with the rational expectations revolution then in full swing, though Peter never wandered far from a basically Keynesian view of the world and a consequent application of it to policy.

I want now to argue that Peter was an important figure in the development of post-Keynesian pricing theory in the 1970s. Modern mainstream economists all too often view the world as if perfect competition market structures prevail everywhere. In the 1950s to 1970s, the dominant market structure, certainly in manufacturing, was that of a price-leading oligopolist. One of the on-the-frontier developments was concerned with what determined the size of the mark-up on normal costs in this situation. Starting with James Ball (1964), several authors developed theories of the size of the mark-up by linking discretionary price-setting (price-making) to investment decisions, in which financing of investment by retained profits as much as possible was emphasised. Prices and the amount and type of investment were therefore determined simultaneously. The seminal articles and books in this literature were written by Ball, Eichner (1973, 1974, 1975, 1976), Adrian Wood (1975) and by Peter and myself (1976). (Wood and Peter and I acknowledged the influence of Michał Kalecki and Nicky Kaldor on our ideas.) Our article was the first to conduct the analysis of a process occurring in historical time, that is to say, as descriptive analysis. Wood's elegant contribution was explicitly Golden Age analysis in logical time.[2] Eichner's model, which is the most referred to in the literature, is also in historical time but in our view is marred by its dependence on the unsatisfactory analysis of investment demand in Chapter 11 of Keynes's *General Theory* (see Harcourt 2006: Chapter 4).

Eichner's and Wood's versions were published before Peter and mine (shamefully, Ball's 1964 version was overlooked by us all), but I had written the first draft of what became our 1976 article in 1966. I made a logical error in the argument and I only saw a way to overcome it in 1974 (see Harcourt 1995: 75–6).

As an example of Peter's approach to economic issues, and of his clarity of thought and presentation, published below is Chapter IV of his thesis – the last chapter except for a summary concluding chapter.[3] It is a natural follow-up to, and policy application of, the arguments of the core Chapter III. Though it was first written in the 1970s, the underlying arguments and approach are still relevant today. They form the basis of, for example, a recent letter to the Editor of *The Age* and *The Australian Financial Review* (mid-February 2012) written by Raja Junankar, Peter Kriesler, John Nevile and myself. We argued for the imposition of an excess profits tax on the proportions of banking profits in excess of the average rate of profits in the economy as a whole. This illustrates yet again how a training in the history of our subject often has direct applications to modern theory and policy.

The chapter has never been published though we did try a paper based on it with the *Economic Record*. It was perceived, quite wrongly, to be an attack on, rather than a complement to, Brian Parmenter's and Roy Webb's work on related issues (Parmenter and Webb 1974; 1976), and was rejected. Such is life.

I have gone into these historical details because Greg Moore pointed out to me (through one of the Editors) that I should provide an historical context for the memoir. He added that 'though [I] might not realise it [I am] a passing historical figure and what [I regard] as modern theory is, to the young, theory that was produced prior to their birth'.[4] The context of Peter's chapter is a world in which government policy was directed towards controlling levels, and changes in the levels, of money wages and prices. One of the institutions introduced to do this was the Prices Justification Tribunal (PJT). (It is described in more detail in note 2 of Peter's chapter.)

Greg Moore has kindly allowed me to quote him about Peter in Western Australia:

> I knew him by reputation in WA, where he worked most of his adult life at Curtin Uni. He was known for providing guidance to and inspiration for colleagues and young students. This important role in academia is now sadly held at a discount with our so-called masters pursuing production targets with regard to publications. Mention should also be made of the fact that he was a kitchen hand at the Loose Box, which is a famous French restaurant in the West, while on long service leave ... He also ran a chef school around the corner from me and was known as the 'Cooking

> Professor' (and he catered I think). He was also endlessly on the local TV here as an economics commentator (and I mean endlessly), usually saying nothing of consequence (but what can you say when you have 30 seconds [?]). I went to his funeral celebration in the local park and there were hundreds in attendance. He was loved by all.

For me, that last sentence is the core reason for writing this memoir of, and tribute to, Peter.

Notes

I am much indebted to Prue Kerr and Peter Kriesler for their comments on a draft of this article. I also thank Greg Moore for his helpful advice.

1. I tell the background drama of its creation and fulfilment in Harcourt (1995: 75–6).
2. For the distinction between historical and logical time analysis, see Joan Robinson (1962: 23–6).
3. Not included here but may be found in *History of Economics Review*, 57, Winter 2013.
4. This is a bit hard as I try to keep up with what is going on in both modem mainstream and post-Keynesian theory. One of my latest papers is 'The Crisis in Mainstream Economics' (Harcourt 2010), and I do not see how I could have written it if I had not tried to keep up to date.

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21
Phyllis Deane 1918–2012: A Memoir and a Tribute

G. C. Harcourt

I was very sad to learn today (7th August 2012) that my dear friend and long-time colleague, Phyllis Deane, had died. She and I were colleagues in the Cambridge Faculty in the 1960s. She supervised my Part I Trinity Hall pupils in economic history and I supervised her Part II Newnham pupils for the principles and applications papers in Part II. When I returned permanently to Cambridge in 1982 (I had been there on leave in 1972–73 and in 1980), Phyllis had just retired from her Personal Chair. We shared a room together in the Faculty. Shamefully, I cumulatively overflowed, as is my wont, onto her desk and she tactfully withdrew after a few years. I read a number of her later books in draft – I especially remember *The State and the Economic System: An Introduction to the History of Political Economy* (1989). Peter Kriesler commented to me that the book "was excellent in showing how economists' views on the role of the state and economic policy are strongly tied to their overall economic outlook, to their underlying economic theory. [It emphasised] the fundamental nature of the relationship between theory and policy". I went in the 1970s to the lectures that became *The Evolution of Economic Ideas* (1975). For many years, Maurice Dobb had lectured on the history of economic thought and Phyllis's lectures continued this tradition. I loved Phyllis's last major book, her biography of J.N. Keynes, *The Life and Times of J. Neville Keynes: A Beacon in the Tempest* (2001), one of the finest jewels in the crown of our profession. Phyllis much admired Neville Keynes for his integrity, hard work and good sense, like calling to like, I think.

Phyllis was both respected and liked by everyone in Cambridge's deeply divided Faculty. Her own views were explicit and clear and her fair mindedness and balanced approach were a much needed Godsend. As a result she did far more than her fair share of committee work in the Faculty.

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As a scholar her contributions were highly original, pioneering, and extremely wide ranging – regional development in Africa, using social accounting structures, United Kingdom economic history, the history of economic ideas and institutions. Phyllis was unassuming, never one to blow her own trumpet or fight for a place in the sun. When I told her that Bob Fogel and Doug North had won the Nobel Prize for their contributions to economic history, she was over the moon because, she said, it was at last proper recognition of their and her subject; to which, I add, she had made such major pioneering contributions. For example, part of the citation on Phyllis's election as the 2010 Distinguished Fellow of the History of Economics Society (USA) states: "It is difficult to over-estimate the significance of [her best known work, *British Economic Growth, 1688–1959: Trends and Structure* (1962, written with Max Cole)] in twentieth-century economic history. It represented the foundation of British quantitative economic history and guided and inspired a generation of economic historians." So, in my and the view of many others, she should have received the prize herself.

When Nick Crafts' celebrated volume with Oxford, *British Economic Growth during the Industrial Revolution*, Crafts (1985), came out, she told me that she was delighted that her much earlier estimates had now been superseded. In what was to prove to be my last conversation with her, I phoned to tell her she had been elected the 2010 Distinguished Fellow. Her comment: "How ridiculous!"

Phyllis came to Cambridge in the late 1940s, invited by Dick Stone in the early years of his Directorship of the Department of Applied Economics (1945–55). She worked on regional social accounts. She became a University Lecturer in 1961. She did sterling work as an editor of the *Economic Journal* (1967–75), working with her great friend and mentor, Austin Robinson, and also with David Champernowne and Brian Reddaway. In my view these were some of the greatest years of the *Journal*. That the *Journal* no longer contains either reviews (other than the excellent review articles of outstanding books in the Features issues) or book notes, or even obituaries, is a sad reflection on it not being what it used to be.

Phyllis was beloved by her pupils and her colleagues in Newnham. She followed her pupils' subsequent careers with pride and enjoyment. She was an outgoing and caring person, combining an admirable moral outlook with quiet anger at injustice and/or stupidity, and informed, down-to-earth criticism of economic and social happenings.

Phyllis and Joan Porter, her inseparable companion of over 50 years who was noted for her down-to-earth wisdom, set up a combined home for their aging widowed fathers in Cambridge and they continued to live there after their fathers died. Jane Humphries reminded me of the beloved Norwich terriers who guarded the home and who grew "even more plump on the doggie chocolate drops they earned for shutting the door". Whenever our mutual friend Mark Perlman visited Cambridge, Joan (Harcourt) and I would be asked to this comfortable home in Stukeley Close for wonderful lunches – old-fashioned British fare served with excellent wines. The conversation would be lively and wide-ranging, with much good natured gossip and anecdotes thrown in, usually from Mark's encyclopaedic knowledge of what was happening or had happened to whom in our trade, but with plenty of room for others to chip in.

Joan Porter's death following years of ill health was a great blow to Phyllis – she told me that until it happened she reckoned she had led a charmed life. I don't think she ever fully recovered from it and she gradually withdrew as increasing lameness and age made it more difficult for her to get out. A few years ago Philomena Guillebaud drove me out to visit Phyllis in her last home, Cottenham Court in Cottenham village. We had a pleasant time but it was clear that she was withdrawing. That she died peacefully in her sleep was an appropriate last blessing.

It was one of the greatest privileges of my life to have known Phyllis. I have often been thinking about her in recent days and I wonder now whether this was a premonition of her coming death. Her legacy of fine scholarship and the fond memories of her many friends remain.

Note

I am much indebted for comments on a draft of the memoir to Robert Cord, Jane Humphries, Prue Kerr, Peter Kriesler, John Nevile, David Newbery, and Vela Velupillai.

22
Allan Barton 1933–2012: A Tribute

Selwyn Cornish, G. C. Harcourt and Richard Holden

Allan Barton and one of the authors of this tribute (GCH) had been friends since 1950 when they both started Commerce Degrees at the University of Melbourne. They were together in the Honours Years (Final Division) of 1952 and 1953, they overlapped at Cambridge where both did Ph.Ds (GCH, at King's, 1955–58, Allan, at Christ's, 1956–60) and they were Lecturers together at Adelaide in 1959 and the 1960s, until GCH went to Cambridge in 1963 and Allan, to the Foundation Chair in Accounting and Business Studies at Macquarie in 1967. Subsequently he was at the ANU for more than 30 years, starting with his appointment to the Chair of Accounting and Public Finance in 1975 and becoming ANU Treasurer for 10 years, starting in 1984. Allan regularly went to Cambridge for study leave where he rejoined forces with GCH (who spent part of every decade there from the 1950s on and who was there for 28 years from 1982 to 2010).

As has been well documented in obituaries (Jacobs 2012a, 2012b), Allan was a most distinguished academic accountant (in reality, an outstanding applied economist) and an extraordinarily selfless university, community and church citizen. One of the authors (SC) was sub-dean in the Faculty of Economics and Commerce at the ANU when Allan arrived in 1975. He met Allan then for the first time, though he had heard his name on many occasions from Neville Cain, who was greatly impressed with the breadth of Allan's intellectual interests. SC recalls the many times that Allan showed great kindness to him, assisting him at times of great trauma in his life and advancing his career in the University. Allan always supported SC's interest in Keynes, for which he was especially grateful. Those were times when neo-conservative thought was dominant in the Faculty and to be a strong supporter of JMK was difficult.

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What may not be as well known is that Allan wrote a remarkable Ph.D Dissertation, "A contribution to the theory of the multi-product firm" (1961), supervised by Austin Robinson. Allan and Austin got on famously, not least because of their mutual passion for flying, Allan in gliders, Austin in seaplanes during World War I.

Allan never published his dissertation, or even any articles from it. Yet when it is read now, not least by RH who knows the relevant literature intimately, it is revealed as highly original. It contains years before their time, insights and ideas which subsequently earned other economists fame, including receiving the Nobel Prize. For example, Allan told GCH that the seminal ideas of Oliver Williamson are anticipated in the dissertation. GCH repeatedly pestered him to publish it but because of his selfless behaviour in and contributions to the university and elsewhere, especially to public policy, so that he always had far more to do, usually for others, than there was time to do them all, he never did. When he was dying, his brother Graeme and GCH conspired to pinch Allan's copy of the dissertation in order that after his death, this tribute could be written.[1]

Allan's dissertation is remarkable for its creativity and breadth. It deals with both the boundaries and internal organization of multi-product firms – a topic as relevant today as in 1931 when a 21 year-old undergraduate and future Nobel Laureate at the London School of Economics – Ronald Coase – first asked the question "if markets are so good at allocating resources then why do firms exist?" And although Allan wrote his dissertation at a time when the neoclassical theory of the firm was the dominant – indeed only – mode of analysis, in many ways it anticipates the transaction cost economics of Oliver Williamson (1971, 1975, 1979 – see Aghion and Holden, 2011, for a discussion), which helped to further elaborate many of Coase's ideas. It is striking to read the work of a then young scholar who is both shackled by the confines of price theory yet so clearly aware of its limitations.

Almost as interestingly there is a fascinating section on the role of advertising as a means of product differentiation (chapter 10) that is essentially a verbal description of classic models developed by Sanford Grossman and others (see, for example, Tirole, 1988).

When one reads Allan's dissertation now it is hard not to wonder what would have happened had he published it and it had become widely read. All three authors of this tribute wish that it had.

This note is a tribute to a greatly respected Australian and university citizen and, for so many people, a loving friend. His death is still hard to come to grips with; his behaviour when he knew he was dieing was, as always, exemplary, noted for his detailed caring for others. For those economists, such as RH, who did not have the privilege of knowing Allan in his lifetime, his work – and in particular the brilliance of his dissertation – remain a lasting reminder of a great scholar.

Note

1. Allan's experience brings immediately to mind the not dissimilar experience of Richard Kahn, a mutual Cambridge hero, whose remarkable Fellowship Dissertation for King's. "The economics of the short period", Kahn, 1929, was not published in English until just after Richard died in 1989. Kahn wrote in the Preface to the published version, Kahn 1989, xii (after rereading the dissertation for the first time fifty years on): "I made a mistake in failing to secure publication [immediately] ... I now strongly advise a young author of a striking but incomplete piece of work to publish it ... without delay".

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23
Frank Hahn 1926–2013: A Tribute

G. C. Harcourt

I was sad to hear that Frank Hahn had died. He and I were colleagues on and off at Cambridge from the early 1960s. We had many clashes (and three semi-public debates about approaches to economic analysis), he thought me a bit of a dill (Oz for thick), but I was fond of him and had great respect for him as an important intellectual influence in the Cambridge Faculty and beyond. He has never been adequately replaced since his retirement in 1993.

In this tribute I concentrate on his understanding of and contributions to the economics of Keynes. These start with his LSE doctoral dissertation, "The share of wages in the national income. An enquiry into the theory of distribution". It was only published in 1972 (by Weidenfeld and Nicolson), over 20 years after its submission, partly because of Frank's unsureness about its worth, partly because of the influence of his mentor, Terence Gorman, who had stringent views on what should be published.

His dissertation is a highly original contribution to Keynesian macro theories of distribution. Frank amalgamated IS and LM analysis, more generally, Keynes's aggregate demand and supply analysis, with the then state-of-the-art theories of the firm and entrepreneurial behaviour. He related the short-period level of overall activity to the share of wages in the national income, exploiting the implications of the differences in the marginal propensities to save of wage-earners and profit-receivers. The intersection of the two relations determined simultaneously, mutually, the equilibrium levels of the distribution of income and the level of activity. While there are details of the analysis to which exception could be taken, I wrote at the time that his version was in some ways the most satisfying we have. (I used to tease Frank that it was the best thing he ever did, that it had been downhill all the way since).

As well as his many articles (which he divided into serious economic analysis and what he dubbed blah blah, in which he reflected on broad

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conceptual and philosophical as well as theoretical issues), Frank was associated with (at least) three major treatises: the 1964 survey of the theory of economic growth in *The Economic Journal*, written with Robin Matthews, the role model for survey articles ever after; the 1971 definitive volume on modern general equilibrium theory written with Ken Arrow; and the 1995 courageous critique from within of modern macroeconomics, written with Bob Solow. (It is no accident that his co-authors were also amongst his closest friends.) All three treatises were relevant to his evolving understanding and evaluation of Keynes's contributions. Increasingly he came to accept that general equilibrium theory was not the appropriate approach with which to tackle Keynes's insights. Early on (1965) he wrote the definitive account of why it could not include money in any meaningful way, that Keynes's insight that the monetary and real aspects of the processes at work in capitalism had to be integrated from the start of analysis could not be captured within a general equilibrium framework where money is at best a ticket. Indeed Frank was eventually to say that general equilibrium's major contribution was a negative one: to make precise the conditions that had to hold for what he perceived to be Adam Smith's conjecture that greedy people in a competitive environment could bring about a sort of social optimum were so special that they robbed general equilibrium of any significant role in descriptive analysis.

Frank's great love of mathematics led him always to strive for preciseness in analysis, hence his attraction to general equilibrium. But increasingly he recognized, as did his friends and contemporaries, Bob Clower and Axel Leijonhufvud, that for the economics of Keynes to be properly developed, the Marshallian approach in which Keynes was steeped was the correct way forward. That is to say, on this path it may be better sometimes to be "vaguely right rather than precisely wrong", the Wildon Carr maxim that Gerald Shove in 1942 applied to Marshall's *Principles* 50 years on. A most succinct statement by Frank of this view is in his courageous 1982 Birmingham lectures, *Money and Inflation*, published by Blackwell, in which he criticizes the new classical macroeconomics of the Lucasians. He wrote in the Preface (xi) that he had been forced to make at times "plausible" rather than "clinching" arguments.

Frank had a deep understanding of the nature of money and its link to an inescapable environment of fundamental uncertainty in which all major economic decisions had to be made (He said he would forgive Joan Robinson all her other sins, as he saw them, because she too had such a deep understanding of this). With his colleagues he built on this base analysis of the implications of missing markets for the processes at work in the economy. Earlier on he had made an astute analysis of the implications for accumulation and growth theory of the same insight in a series of articles that have bequeathed "the Hahn process" to posterity. With Bob Solow he investigated the implications of imperfectly competitive market structures within the Keynesian system, developments that have increased our positive understanding as well as contributing an incisive critique of the results of modern, non – anti – Keynesian macro analysis.

Frank had very clear views on the links between theory and policy and was extremely modest about what could be claimed – hence his considerable ire for those who claim that their policies are based on coherent theoretical structures which show that their predicted results will follow from implementing their advocated policies. Nevertheless, with Robert Neild and then with the 364 British economists, he went after the ill-informed and damaging policies implemented by Geoffrey Howe as Chancellor of the Exchequor in the early 1980s, policies enthusiastically approved of by Margaret Thatcher.

Frank Hahn was a serious intellectual who thought deeply and was willing to change his mind. He had extremely high standards that he applied even more harshly to himself than to others. He has left an indelible mark on the thinking of serious members of the profession and I doubt if we will see his like again.

24

On Topical Themes in Veblen and Commons's Contributions

Remarks upon Receipt of the Veblen-Commons Award

G. C. Harcourt

Veblen's and Commons's contributions are outlined and related to the approaches to economics and political actions over the years of the author. Commons's philosophy and pragmatic contribution to economic and political institutions in order to help create decent living conditions for wage-earners within capitalism are reflected in the author's rethink in the late 1970s of what was possible for a social democratic government in Australia to achieve. The implication of John Kenneth Galbraith's example and writings on the war in Vietnam are linked to the author's actions in Australia during Australia's involvement in the war. The relevance of Veblen's damning critique of J.B. Clark's views on capital theory for the arguments of the Cambridge – Cambridge controversies in capital theory of the 1950s–1970s, first noted by Joan Robinson, are set out. Veblen's biting analyses of the nature of capitalism in his major writings are argued to be even more relevant now for the modern world of haves, have nots and have lots.

May I say how amazed but delighted I am to receive the 2010 Veblen-Commons Award; even more so because I receive it with Jan Kregel. I regard Jan as the best all-round general economist alive. Our friendship is approaching the legendary "40 years on" of the school days song.[1] I hope I may be excused if I try to relate the fundamental approaches of Commons and Veblen (and later institutionalists who were inspired by them, especially Ken Galbraith, one of my greatest heroes) to the approaches, stances and structures I have developed over my working life.

First, I want to point out some overlapping connections between Veblen and Commons, on the one hand, and events and instances that have affected me personally, on the other. Our American daughter-in-law,

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Jo Bosben,[2] comes from Wisconsin, which not only formed Commons and Veblen but also Selig Perlman, another heavy of the Wisconsin School, who was the father of Mark Perlman. In turn, Mark became a firm and extraordinarily supportive friend, following commissioning me, through a day's hard sell in Adelaide, to write the survey of capital theory (Harcourt 1969) for the second issue of the *Journal of Economic Literature*, of which he was such an outstanding, innovative and liberal editor. Mark was, of course, a pioneer of your Association; his work had much in common with the characteristics that Commons in particular but also Veblen bequeathed to how we should "do economics." His endless store of stories about the members of our tribe, often delivered at agreeable dinner parties, would surely have been warmly welcomed by Veblen.

Next I want to say something about Ken Galbraith. I was delighted but not amazed to find that he received the 1976 Veblen-Commons Award, as did another of my friends/heroes, Robert Heilbroner, whose *Worldly Philosophers* ([1953] 2000) I regard as the best introduction to political economy and economics ever written. Though Galbraith's seminal books have profoundly affected my thinking, I admired even more his courageous stand and eloquently passionate writings on the Vietnam War and America's role in it. I was a leader of the anti-Vietnam war campaign in South Australia (the Campaign for Peace in Vietnam, CPV) from 1967 on, soon after I returned from my first spell of teaching in Cambridge. The CPV made great use of Galbraith's example and writings in our own multi-dimensional direct actions in Adelaide and South Australia generally.

Finally, I have always been an admirer of Hirofumi Uzawa.[3] In preparation for this talk and paper, I read an interview that Hiro gave to Masahiro Okuno-Fujiwara and Karl Shell ([1998] 2008); in it he discussed his admiration of Veblen, his struggles as a penetrating, clear-minded mathematician to come to terms with what Veblen's admirable and sometimes sophisticated, even dense (in the sense of subtle but complicated) prose and arguments were about. Think of R.H. Tawney's and George Shackle's writings – beautiful, inspiring but requiring a different sort of concentration from that needed for mathematical analysis. Uzawa,[4] who also had problems with Keynes's writings, advanced the judgment that Veblen's 1904 ("almost a classic") volume, *The Theory of Business Enterprise*, not only anticipated the core of Keynes's *General Theory* ([1936] 1973) – "I was shocked to find out that the book contained the essence of Keynes's *General Theory*" (Okuno-Fujiwara and Shell [1998] 2008, 9) – but also, I conjecture Veblen would have agreed, set it out more fundamentally and in a more appropriate setting than did Keynes himself. This led me, of course, to read Veblen's book for this talk (paper).

I naturally also consulted the *New Palgrave* entries (Eatwell, Milgate and Newman 1987) on our two pioneers. Warren Samuels (1987) wrote positively and sympathetically on Commons. Thomas Sowell was more grudging about Veblen. He concluded: "It is difficult to see how economics as it exists today is any different from what it would have been had there been no Thorstein Veblen. Still, he had his time in the sun" (1987, 800). So much the worse for modern economics if this is so, but I doubt it. A favorite quote of mine from Maurice Dobb is to the effect that if this means returning to the boundaries more generously drawn by our classical pioneers, so much the better for that. The more the scenarios of modern capitalism reveal themselves, the more to the point do the analyses of *The Theory of the Leisure Class* (1899), *The Theory of Business Enterprise* (1904), Veblen's other writings, and those of Commons and Galbraith reveal themselves as highly relevant and illuminating.

We all know that Alfred Marshall said that the Mecca of economists was biology even though he was never able to solve his own dilemma of theorizing in terms of concepts derived from classical physics while having a "vision" of capitalism as an evolving organic system. I recently examined a most remarkable PhD dissertation written by Neil Hart of the University of Western Sydney (Hart 2009). Hart provides the deepest account of the source of Marshall's dilemma I have read, pointing out that the biological theories of evolutionary processes in Marshall's time were in too great a state of flux and controversy to allow Marshall to apply any prevailing conventional wisdom in his economic theorizing. Hart argues that the much greater progress made since Marshall's death in 1924 by the modern pioneers of evolutionary economics owe their advances in part to the more settled nature now of biological theories of evolution (I note with pleasure that your Association recognized Richard Nelson's leading role in this with the 2007 Veblen-Commons Award). Fortunately, Hart's remarkable work has now been published by Palgrave Macmillan in two volumes, one on Marshall in his lifetime (Hart 2012), the other on what has occurred since Marshall died (Hart 2013).

Let me now say something about Commons's philosophy. Basically, like Keynes, Commons wanted to work toward establishing capitalism with a human face. He was neither a revolutionary nor an idealistic socialist (I do not mean that he did not have ideals). But he wished to create institutions, compromises, realistic policies and other set ups that would allow wage-earners to have reasonable working conditions and lifestyles within the embrace of a capitalist system in which decisions concerning accumulation, pricing, production, and employment drove the system along. This vision of a desirable society, one asymptotically at least approaching a just and equitable one, lay behind his extensive theorizing and practical contributions to the administration of both the civil service and political institutions generally.

Veblen seems to me to be much more of a curmudgeon, even an anarchist, much more hostile to how capitalism works and what it does to people's lifestyles and values, more concerned to analyze deeply its institutions, its rules of the game, the dominant roles of business and business people. (Engineers also get a guernsey, as we say in Oz.) This led him to be more and more critical of the "vision" and detailed analysis of his teacher, J.B. Clark, and others of the earlier neoclassical theorists on how value (increasingly regarded to be the same as price) and distribution are determined in modern society. I would love to have known what Veblen would have made of Gerard Debreu.

Well into the Cambridge controversies in capital theory (Cohen and Harcourt 2003), Joan Robinson pointed out that had people remembered Veblen's devastating review article, (Veblen 1908) of J.B. Clark's theory of value and distribution (Clark 1907) there would have been no need to have the controversies in the first place. Joan had either forgotten or just read it for the first time (Robinson 1979, 37). As in Marshall, so it was all in Veblen.

> [M]uch is made of the doctrine that the two facts of "capital" and "capital goods" are conceptually distinct though substantially identical . . . "Capital is the permanent fund of productive goods, the identity of whose component elements is forever changing. Capital goods are the shifting component parts of this permanent aggregate" (p. 29). Mr Clark admits that capital is colloquially spoken and thought of in terms of value, but he insists that . . . the working concept of capital is . . . that of "a fund of productive goods," considered as an "abiding entity."
>
> This conception of capital . . . breaks down in Mr Clark's own use of it when he comes . . . to speak of the mobility of capital, that is to say, so soon as he makes use of it . . . The continuum in which the "abiding entity" of capital resides is a continuity of ownership, not a physical fact. (Veblen 1908; Kerr with Harcourt vol. III, 2002, 287–288)

I have Joan Robinson's copy of her textbook with John Eatwell (1973). She has annotated this passage as follows: "In modern times they [mainstream economists] have resorted to the desperate expedient of assuming machines are 'malleable'" (46).

Another astute Veblen insight is his insistence that we concentrate, in our analysis of how capitalism works, on the nature and roles of the business firm and the people who run it, especially those businesses and people who control the commanding heights of the economy. Lorie Tarshis also made the capitalist firm the unit from which to start analysis at both the micro and macro level. This is yet another reason why it was a tragedy that the American Right stopped Tarshis's marvelous textbook ([1947] 1966) with its 250 or so pages on Keynes's theory, based on Lorie attending Keynes's lectures at Cambridge as the embryonic *General Theory* developed, being the principal means of educating the post-World War II generations of American (and other countries') economists. Samuelson's textbook was published a year later. It received the remnants of the Right-Wing backlash yet survived to ensure that these generations were brought up on it and Hicks/Hansen

IS/LM instead of on Keynes's aggregate demand and supply analysis of *The General Theory*. Like Keynes, Tarshis (and even more so, Kalecki) was able to build up a satisfactory systemic analysis of the economy as well as a realistic account of the price formation and other behavior of the capitalist firm. The foundation of all this is to be found in Veblen's work, fused with anthropological, historical, sociological and psychological speculations which Veblen thought as an economist perhaps he should not make, but what the heck!

As Keynes sometimes did – "The reader will perceive that I have been drifting into a review of Dr. Hayek's *Prices and Production* [1931]" (1973, 252) – I seem to have strayed from where I started. When I commenced studying economics at Melbourne University in 1950, I quickly discarded the right-wing, free enterprise views of my leather merchant father. My father was a wonderfully decent and moral man, see Harcourt (1999, 33), for an idealistic democratic, ultimately Christian, socialist view of life. As I have written elsewhere (Sardoni 1992, 1–2), it was the lectures on economic geography (really comparative economic systems) that initiated my changed stance. I realized for the first time that not all societies corresponded to the middle class suburb of Melbourne in which I was brought up. Rather, most – all – societies often functioned irrationally and unjustly, especially with regard to the use of resources which would be needed for future as well as present generations. I had in mind the development of the Californian oil fields by private enterprise but, of course, this general problem is now even more urgent with the onset of global warming and climate change, replete with the possibility of catastrophic irreversibilities in a drastically short time frame unless firm and responsible actions are taken now, Republicans please note.

Naturally in the 1950s and in an Australian/British context, I thought about nationalization, a concept alien in principle in America but not evidently now in practice. But after the disastrous economic and political events of the 1970s which destroyed the first Federal Australian Labor Party (ALP) government Australia had had for 23 years (I joined the ALP in 1954), I had to rethink and lower my sights in a thoroughly Commons-like manner. In the second half of the 1970s and early 1980s when a conservative Federal government was in power and inflation and unemployment were pressing problems, I wrote papers, often with colleagues at Adelaide, on ways of tackling them within the political constraints imposed by the government, Federal problems and being a small open economy (see chapters 4, 5, 13 and 14 in Harcourt 2001).

When I was asked to be the economist on the National Committee of Inquiry set up by the ALP in 1978 to ask why the ALP had done so badly in the Federal elections in the second half of the 1970s, I wrote the first draft of the Committee's Discussion Paper No. 6 (1979). In it I set out a package deal of policies consistent with these external constraints and my "new" view. I included in it an appendix on the insights of Hy Minsky (the 1996 Veblen-Commons awardee) on how financial, industrial and commercial capital interrelated and what policies were needed to tackle the malfunctionings the interrelationships threw up. A hostile editorial in the *Sydney Morning Herald* referred to me drawing on the work of an obscure American economist, Hyman Minsky. I drew on the arguments of a paper I wrote with my long time collaborator, Prue Kerr (Harcourt and Kerr 1980; Harcourt 2001, ch. 5). We like to think that when the ALP Prime Minster, Bob Hawke, came into office in 1983, he implemented what we had proposed for a good half hour before floating the exchange rate, cutting tariffs and deregulating financial markets.

I mentioned the primary emphasis placed on the firm by Veblen and Lorie Tarshis. This emphasis was continued and developed by Galbraith in *The New Industrial State* (1967) which Galbraith thought his most profound book (unlike many of its reviewers, I agree with him). Furthermore, I would argue that his analysis in it about the dominant role of increasingly multinational large oligopolistic firms in both activity and in government policy really came into their own in the ghastly years of George W. Bush, Dick Cheney and their neo-con backers. I used to say that Bush was only a heart beat away from becoming President of the United States. Veblen would have cheered Galbraith on from the sidelines and the arguments of his *Theory of the Leisure Class* (1899) illuminate perfectly the behavior of the top income receivers and property holders in the current era of haves, have nots and have lots.

Joan Robinson, as well as crediting Veblen with the essence of the capital theory critique, also followed him (and Marx) by asking her pupils to seek out the "rules of the game" of any society they were analyzing, a principal emphasis also of her great intellectual friend, Michał Kalecki, who I regard as the greatest all round economist of the twentieth century (see Harcourt 2006, 163 for my reasons why). Veblen also reinforces Marx's view that instability and often crises are likely to occur when the actions of finance capital get out of kilter with industrial and commercial capital. In recent years I have written papers on what would Marx, Keynes and Kalecki have made of the last 30 years or more, papers that contain both an explicit critique of the mainstream macroeconomic theory of that period and an exploration of what I think my gang of three would have argued. I followed these by suggested package deals to restore full employment, tackle inflation and bring about more satisfactory relationships with regard to international trade and capital movements as well as tackling the systemic harm done by speculators in foreign exchange markets, property markets and on the stock exchange (Harcourt 2006, ch. 8; 2007).

I fervently hope that the insights and findings of Veblen, Commons and those inspired by them are also reflected in what I have written.

Thank you very much indeed.

Notes

I thank, but in no way implicate, Raja Junankar, Prue Kerr, Peter Kriesler and Nigel Stapledon for their comments on a draft of this talk/article.

1. When I looked up or rather, had looked up for me – I don't do e-mail—the glittering cast of previous award receivers I was even more amazed but also chuffed to see how many of the economists I most admire were also recipients. May I single out Ken Galbraith, Adolph Lowe, Dudley Dillard, Robert Heilbroner, Hy Minsky, Warren Samuels and Anne Mayhew? But what a sad comment on our trade that only one recipient, Gunnar Myrdal, also received the Nobel Prize – and his pleasure was minimized by the Electors coupling him with Hayek, which no doubt minimized Hayek's joy too.
2. Jo is married to Tim, our third of four children. Tim met her at the University of Minnesota where he did a Master's Degree in industrial relations, a two years degree that he did in one because he could not face another mid-West winter. He accepted a once-in-a-lifetime opportunity to work for the Australian Council of Trade Unions (ACTU) in Melbourne. Tim worked for the ACTU for eight years.
3. I have known Hiro from 1965 on. I was delighted that he wrote the Foreword to the Japanese translation of *A "Second Edition" of The General Theory,* which Peter Riach and I edited and which was published in English in two volumes in 1997. Sadly, he died in 2014.
4. The Uzawas were tenants of Veblen's step-daughter at Stanford in the 1960s. Hiro went to Bernard Haley's "beautiful lectures" on Veblen, Haley's "model professional economist" (Okuna-Fujiwara and Shell [1998] 2008, 9).

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25

Paolo Sylos-Labini's Contribution to Modern Economic Theory

Joseph Halevi

Paolo Sylos-Labini is a major economic thinker and one of the foremost Italian intellectuals of the post-war period.[1] The significance of Sylos-Labini's work lies both in the range of issues addressed by the author – spanning from growth and development theories to oligopolistic formations, to the study of social classes – and in the very conception of the nature of economic analysis contained in his contributions (Rothschild, 1995). In a nutshell, Sylos-Labini's methodology can be described as unifying the *historical* with the *theoretical* approach. The historical dimension differentiates the author's works from most contemporary formalistic theorizing: the validity and the limitations of a particular theoretical construction are sought both in relation to its logical robustness and in connection to the reality that the theory is supposed to study. The contextualization of economic theories emerges particularly well in Sylos's treatment of classical economics, of Smith, of Marx, of Schumpeter and of Keynes. The role of history in forming the essential reference point for the development of economic ideas, stems from his idea that 'in the social world, the fundamental premises, i.e. the phenomena forming the social reality, are of a historical nature: they vary qualitatively and irreversibly'.[2] It therefore follows that the process of abstraction requires two types of theories: 'theories concerned with phenomena which are observable at a given point of time, and theories dealing with the transition from one reality to another' (1960, 6).

The emphasis on history brings Sylos's endeavour close to the path followed by economists such as Kuznets, Lewis and Abramovitz. The contributions of these economists do not explicitly intersect with the main body of economic doctrines, as if the empirical and the abstract proceeded on two separate planes.

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In order to highlight the connection between theory and history in Sylos-Labini's thought, I will survey his writings on a thematic basis rather than chronologically. This procedure is made easier by the fact that Sylos's works have displayed over time a basic common core centred on the interaction between technical progress and market structures. This essay will deal therefore with the following aspects of Sylos's contributions: the conceptualization of the main phases of economic growth, including the extremely original approach taken towards Smith, Marx and Schumpeter, the three major theorists of growth and/or cycles; the seminal study on the connection between oligopoly and technical progress; and, finally, on the socio-economic dynamics of post-oligopolistic capitalism.

25.1 The Phases of Economic Growth

The phases of economic growth from the 19th century to the present are studied by Sylos-Labini in relation to the factors engendering the growth of productivity. In his view, the causes and implications of technical change differ as to whether the economy operates under competitive or oligopolistic market forms. The dynamics of competition is viewed essentially in Smithian terms, whereas Keynesian ideas are considered to be relevant in the subsequent oligopolistic stage, particularly when drastic declines in effective demand overshadow all other structural phenomena. The historical evolution from competition to oligopoly is addressed in a number of essays which I shall now attempt to synthesize (1954, 1970, 1974a, 1991, 1993a).

25.1.1 From the Smithian Process to the Spread of Oligopoly

The competitive mechanism, call it a Smithian process, is identified with a situation in which prices are determined by classical costs of production in the long run while in the short run they fluctuate according to demand and supply conditions. The chief factor in the determination of long-run competitive prices is the distribution of the fruits of technical progress conjointly with the dynamics of money wages.

In the Smithian process, the increase in productivity is accompanied by 'a slower increase in money wages, with the consequent fall of prices, precisely as happened in the last century. The Smithian process presupposes flexibility of both prices and wages, and in both directions, upward and downward; thus it presupposes a situation not far from competition in the product and labour markets' (1993a, 313).

It is, then, suggested that competitive capitalism evolved into an oligopolistic system towards the end of the 19th century, with the turning point being located around 1897. Using data for the UK and the United States, Sylos argues that – except for a brief interruption due to the American civil war – industrial prices fell steadily until 1897. During the same period, money wages rose moderately, so that the gains in real wages were due chiefly to the fall in prices. A major feature of this period is the similarity in the behaviour of industrial and raw material prices. While in the short run both fluctuated according to the conditions of supply and demand, in the long run their variations were determined by the relative rate of change in productivity.

The process just described can be likened to a classical growth mechanism fuelled by the interaction between productivity growth, prices and the rate of profits. The first element leads to a decline in the production costs of commodities, which in turn leads to lower natural prices since capitalists – in virtue of competition – cannot retain the fruits of technical progress within their firms by means of higher profit margins. The absence of barriers to entry means that, in the Smithian process, production prices gravitate towards creating a uniform rate of profits.

The connection between the aforementioned elements is bound to break down in the oligopolistic stage of capitalism. Both market forms, however, are subjected to the process of 'dynamic substitution', a term coined by Sylos-Labini himself (1988, 1995). Dynamic substitution occurs whenever the technological improvements in the capital goods sector reduce the cost of machines relative to wages. A similar view has been offered by Pasinetti for whom in the new situation 'it takes a lower total (direct and indirect) amount of labour inputs per unit of output to make the new machines and then to operate them with fewer workers than to employ the replaced workers with the old machines' (Pasinetti, 1981, 216). The concept of dynamic substitution is very important in Sylos's works and, in fact, it existed in his writings well before the invention of the term. Under competition, where no barriers to entry or exit exist, dynamic substitution spreads to the whole range of industries inducing a cumulative process of investment and technical change. Under oligopoly, the possibility of retaining the benefits of technical progress within the large firms tends to generate a labour-saving form of investment without a correspondingly strong cumulative process.[3]

25.1.2 Oligopoly and the Rise of Unused Capacity

The changes in wage and price behaviour which set in after 1897, are revealed by the role played by collective bargaining in a context dominated by the emergence of concentrated industries. The latter meant that:

> Each firm tends to regulate price on the basis of cost variations, provided that cost variations are common to all firms, in order not to lose its market share. As a rule, demand does not affect price simply because firms tend to regulate supply in such a way as to adapt it to demand variations – which is possible not only when output is to be reduced, but also when it is to be increased, since as a rule capacity is not fully utilized; thus demand and supply vary together and price is not affected by their

> variations. Price, then, is modified only if cost, particularly direct cost, varies. (Sylos-Labini, 1993a, 315)

The novel analytical element in the presentation of the price mechanism in a concentrated economy is the role played by the degree of capacity utilization which, in turn, has significant repercussions on the business cycle. Unused capacity may exist also during the cycles underlying classical–Marxian competition as a result of the idling of the equipment of the firms which cannot survive the fall in prices below production costs (Sylos-Labini, 1984a, b). Under oligopoly, spare capacity becomes, so to speak, a control variable in the firm's strategy to regulate supply in relation to demand. The possibility of using excess capacity in a strategic manner is due to the existence of barriers to entry, which are tied to the technological structure of oligopolistic firms. However, not all productions are undertaken under oligopolistic conditions. This is especially true of agriculture and raw materials outputs, where product differentiation is limited and substitution is high. In this case, prices are determined by the conditions of supply and demand in the short run and by the cost of production in the long run. As a consequence, the new regime of price formation entails a systemic divergence between the variations of prices in industry as compared with those in agriculture and raw materials. In industry, prices vary asymmetrically in relation to costs. When money wages increase more than productivity and/or raw material prices rise because of a rising demand for them, industrial prices rise as well. The transfer of the additional costs on to prices does not take place in full because of the limits imposed by the existing degree of competition. These limits are felt especially when international trade grows significantly. By contrast, if the dynamics of money wages fall short of productivity growth and raw material prices remain stable or decline, the rise in profit margins replaces the fall in prices of the era of competitive capitalism.

The asymmetric price behaviour alters also the dynamics of the terms of trade. During the 19th century, the long-term tendency in the terms of trade was determined, as foreseen by Adam Smith, by relative movements in the cost of production. In the present century, productivity gains in industry, as well as technological innovations leading to a reduction in the use of raw materials per unit of output, do not translate themselves into a relative cheapening of industrial products. On the contrary, *ceteris paribus*, they tend to reduce the demand for raw materials, with a negative impact on their prices. Innovations in the raw materials sector tend, on the other hand, to reduce the supply price of primary commodities. Thus in the oligopolistic stage of capitalism, productivity gains tend to be retained within firms rather than being distributed to the whole system via a reduction in prices. As a consequence, the dynamics of the oligopolistic regime are governed by the interplay between the forces which push towards an expansion in demand and the forces which constrain such an expansion. On this basis, the new regime is split into two phases: one spanning from the turn of the century until the 1930s, and one covering the whole of the post-war period (Sylos-Labini, 1991, 1993b). In the second phase, money wages increased more than prices while real wages often increased more than productivity. This phenomenon, coupled with the expansion of public expenditure and of exports, reduced the constraints on demand creation, thereby explaining the much milder character of economic fluctuations since 1945.

25.1.3 The Optimum Rate of Profits

Sylos's analysis of the first phase brings into sharp relief the different role played by the rate of profits in the new regime as compared with the old one. The analysis is centred on the formulation of a new concept defined as the *optimum rate of profit* (1984c, 1992). This represents the point where the effective demand effect of a wage increase is maximized while its cost effect is minimized. Classical theory privileged the inverse relationship between the rate of profits and the wage rate. Yet any radical departure from the stringency of the competitive mechanism leading to a uniform rate of profits would bring up the issue of too high or too low profits rates.

According to Sylos-Labini, the First World War and the adjustment period immediately following it gave a new impulse to the process of concentration started at the turn of the century (Steindl, 1976). The use of new technological systems in the United States expanded labour productivity very rapidly. But money wages increased less than productivity with a slight fall in industrial prices. Consequently, the lag between the growth of real wages and that of productivity limited the expansion of consumption demand. The latter was growing only on the account of the expansion of the wage bill and in the wake of a sharp rise in luxury consumption. Yet these factors were not sufficient to offset the negative impact on effective demand stemming from a slow growing wage bill. Profits were then used for the provision of international loans, which did not, however, make up for the slack in effective demand. Speculation on the stock exchange became, at this point, the natural outlet for the mass of profits which could not find an adequate level of effective demand for their absorption. The Great Depression was thus caused by excessive profits (Sylos-Labini, 1984d, 1993b).

A crisis engendered by a too high rate of profits is the polar opposite case of the classical concern with falling rates of profits. The identification of such a possibility stems from a typical Marxian–Kaleckian conception of wages as being both a cost of production and a source of effective demand for consumption goods. The notion of the optimum rate of profits is an attempt to combine these two aspects of the role of wages.

A change in the wage rate, when measured in relation to the rate of labour productivity, has upon investment both a demand effect and a profit effect. Aggregate investment can, then, be portrayed as the product of two independent functions (Sylos-Labini, 1984c, 215):

$$I = I_g I_d \tag{25.1}$$

where I is total investment, I_g is the level of investment generated by the profit effect and I_d that caused by considering wages as income. In terms of the rate of change of investment we have (asterisks denote rates of change):

$$I^* = I^*_g + I^*_d. \tag{25.2}$$

Once the above two functions are analysed separately, it is found that the increase in aggregate investment is maximized when:

$$(d\, I^*_d / dw^*) = -(d\, I^*_g / dw^*). \tag{25.3}$$

In other words, the rate of aggregate investment reaches its maximum when the increase induced by a rise in the wage rate, w, offsets the fall caused by the negative impact on profits of a rise in w. The optimum rate of profits is derived from an optimum wage rate. This is not, however, an equilibrium solution as it only shows that, for accumulation to proceed without major breakdowns, the wage rate cannot diverge too much from its optimum rate. In a multisectoral framework, Sylos argues, there will be some activities in which the optimum rate of profits is zero. These are thought to be located mostly within the speculative financial sphere, especially when their function is not the creation of wealth but, rather, its social redistribution.

Sylos-Labini's conception of the optimum rate of profits has certain affinities with Pasinetti's dynamics of vertically integrated sectors (see Pasinetti, 1981 and Teixeira (1998)). According to Pasinetti, the growth rate of wages, engendered by technical progress, constantly changes the coefficients of per capita demand. There will then be sectors where demand will be growing very slowly or even stagnating. Eventually, these sectors will either disappear or will represent just a minimal proportion of the economy's output. In this case, the optimum rate of profits will be tendentially falling.

25.1.4 Rethinking the Cobb–Douglas

The concept of the optimum rate of profits plays, along with the concept of dynamic substitution, a crucial role in Sylos's works. Indeed, the latter concept existed in Sylos's writings well before the invention of the term. Under competition, where no barriers to entry or exit exist, dynamic substitution spreads to the whole range of industries inducing a cumulative process of investment and technical change. Under oligopoly, the possibility of retaining the benefits of technical progress within the large firms tends to generate a labour-saving form of investment without a correspondingly strong cumulative process.

The concept of dynamic substitution, however, serves a more general theoretical function. For it allows us to go beyond the question of the choice of technique raised during the capital theory debates in the 1960s. In this context, the traditional Cobb–Douglas production function acquires a novel dimension (Sylos-Labini, 1995). As a tool for expalining the distribution of income this function was made irrelevant by those very debates. Yet it can be reformulated in the context of the theory of economic growth. Sylos argues that the two exponents of the function, α and β, can be collapsed into one, γ, which can in fact be greater than unity. This gives the new relation

$$Y/L = (K/L)^{\gamma}$$

where variations in the capital/labour ratio express both changes in the technical features of production and in the skills of the labour force. The possible values of the exponent γ have nothing to do with marginal productivity principles. Indeed, these values relate to the rate of change in labour productivity resulting from the rise in the degree of mechanization due to the expansion of production and to the increasing ratio of the price of labour to the price of machinery.

This is the most that can be asked from the Cobb–Douglas aggregate production function. According to Sylos-Labini, however, dynamic analysis should be based on multi-sector models which account for changes both in demand and in technical progress. Here Sylos seems to share again Luigi Pasinetti's approach with the difference that Sylos attaches greater importance to endogeneous technical progress.

25.2 Economic Theory and Historical Perceptions

25.2.1 Smith and Ricardo

Following Sraffa's critique of the Marshallian approach to the laws of returns under competitive conditions, Sylos considers classical economics as the appropriate analytical framework for the study of the regime of competition. In this context, Sylos-Labini has brought about a major reappraisal of Smith's position, which led him also to highlight the different economic concerns and historical perceptions of Smith and Ricardo (1984a, 1990a).

Smith's theory of labour commanded is justified if it is interpreted as an instrument aimed at studying intertemporal comparisons under the assumption of a given distribution of income between profits and wages. This original interpretation of the concept of labour commanded has become an integral component of a recent reappraisal of Smith's theory of value (O' Donnell, 1990). Consider a situation in which *w* is the unit wage rate per hour, expressed in terms of a given commodity; H is the quantity of labour embodied in production, measured in terms of the number of hours and P is the unit price. Then:

$$wH = P. \tag{25.4}$$

Thus the ratio P/w is the amount of labour commanded. Assume now that the quantity of labour embodied to produce a given commodity declines, because of technical progress, from H_1 to H_2, where $H_2 < H_1$. We have:

$$(H_2/H_1) = (P_2/w_2)/(P_1/w_1). \tag{25.5}$$

The left-hand side of equation (25.5) is the ratio between two different quantities of labour embodied. This ratio will coincide with the ratio between two different quantities of labour commanded only if the distributional factor remains unchanged. Now, according to Sylos-Labini, Ricardo's dissatisfaction with Smith's measure derives from Ricardo's own concern with changes in the distribution of income, arising from the conviction that the tendency towards decreasing returns in agriculture will outweigh, in the long run, improvements generated by technical progress. As a consequence accumulation was seen by Ricardo to meet with increasing difficulties owing to variations in the distribution of income in favour of rents. This was historically determined, in Sylos's view, by the upheavals caused by the inflationary effects of the French Revolution and Napoleonic wars on the price of corn (1984e, 32–3).

For Sylos-Labini, the modernity of the Smithian approach can be gauged in relation to the additional issues (i) of comparisons between different economic systems, and (ii) of the similarity between the labour commanded standard and the modern price deflator. In the first case, the exchange rate is not an appropriate measure of the different degrees of development. Statistical comparisons must be made by taking a given basket of commodities and then establishing how many hours of work are needed for their purchase by, say, a worker in China as against a worker in the United States. The notion of labour commanded allows us to do just that.

The second issue, the price deflator aspect of Smith's notion, may be evinced by looking at the inverse of the ratio (P/w). If P is taken as the price of consumption goods, w/P is nothing but the real wage rate. Hence a rise in w/P, with an invariant distribution of income, means that productivity has increased by the same proportion. Such a ratio would have no meaning outside an intertemporal framework or outside comparisons between altogether different economic situations. Today the price deflator takes up the role played by the labour commanded standard, yet it is conceptually linked to it. Both measures are by necessity imperfect because of modifications in the quality and in the range of products (Sylos-Labini, 1984a, 1992).

In Adam Smith, the competitive mechanism led to growth because it did not allow the retention within the innovating firms of above-normal rates of profit. The existence of legally based limits to entry is, in Smith, linked to institutional backwardness stifling technological progress. In Sylos-Labini's study of contemporary oligopoly, the existence of entry barriers and of differential profit rates is tied to the process of technical change. In this context, if in the post-war phase of oligopolistic capitalism, growth rates were much higher than in the competitive era, this was due not to endogenous but to institutional factors, such as the role of trade unions, as well as to the exogenous factor represented by public expenditure, the expansion of which, however, is thought to give rise to increasing troubles (1993c, 59–62).

25.2.2 Marx and Schumpeter

If Smith is portrayed as the theorist of competitive growth, Marx is identified as the theorist of competitive accumulation and cycles leading to concentration, while Schumpeter is the economist straddling between the two epochs. The historical importance of the two authors is brought out by Sylos in an essay on Marx and Schumpeter published in Italy in 1954. The dominant theme in the Marx part of the Marx–Schumpeter essay is not value theory but the process of accumulation and concentration of capital (1984b).

The seeds of the optimum rate of profits concept, discussed above, can be found already in this essay. Sylos observes that the contradictory nature of capital accumulation revolves in Marx around the role of wages as a source of effective demand and as an element of costs of production. When accumulation expands, employment rises and wages act as a source of effective demand for consumption goods. However, when unit wages begin to rise, they start acting upon accumulation as costs of production. Capitalists then try to reduce costs by means of new machinery which increases the organic composition of capital. A great merit of Sylos's essay consists in proving how important the notion of classical competition is in Marx's theory. The study shows very clearly that Marx's theory is centred on the regular extension of capitalist relations. In other words, the more the economy's technical basis expands, the more systemic becomes the mechanism of cyclical accumulation founded on the periodic formation of the 'industrial reserve army'. In this respect there is a significant conceptual difference between Sylos's conception of the reserve army and the characterization given to it by authors such as Kaldor (1956) and Morishima (1968), for whom Marxian unemployment arises only when the stock of capital is not large enough as to employ the whole of the labour force.

Although Marx is praised for having anticipated the tendency towards concentration, he is criticized for not delving in its economic aspects, and for not considering that real wages might rise secularly thanks to the combined action of technical change and trade unionism. This last theme has been given added emphasis in a recent critical evaluation of Marx's ideas.

The whole thesis about immiserization is considered by Sylos as politically motivated. In fact, he argues, Marx was aware of Smith's view about the long-run increase in real wages. Furthermore, while *Das Kapital* was being written, real wages in England had been rising for quite some time, although very slowly (Sylos-Labini, 1994).

According to Sylos-Labini, Schumpeter shares with Marx the notion of circularity of production and the idea that cycles are the very essence of capitalist development. The difference lies in the role played by the entrepreneur in generating innovations. The introduction of an innovation stimulates imitating firms to demand loans in order to purchase new capital goods. Prices and output of these new goods will rise more than the rest, but when the innovation is finally installed and becomes fully operational, the repayment of banks' loans will give way to a price deflation. A further impact of innovations consists in the secondary wave generated by the diffusion of purchasing power. Under these conditions, a speculative boom is virtually inevitable so that the cycle itself is described as comprising four phases: prosperity, downswing, depression – the latter being the phase of debt liquidation – and recovery.

Great importance is assigned to Schumpeter's distinction between the innovating industries leading the cycle and the industries towed by them. Schumpeter's distinction is seen also as a methodological criterion for empirical studies. Sylos's own research has shown that the fast growing industries are those in which variations are less regular and where the overall cycle is less apparent. Both Marx's and Schumpeter's contributions are appreciated for attempting to explain cycles in endogenous terms.

Sylos points out that Schumpeter did recognize the formation of what he called 'trustified capitalism', but thought that such a system would be quite stable. As a consequence, the outbreak of the Great Depression is explained by Schumpeter as due to the action of competitive forces. Because of the neglect of the role of large concentrated firms, Schumpeter's theory of the cycle is valid up to the First World War. Afterwards, Sylos argues, the process of concentration changed the nature of the cycle in a rather radical manner.

The social implications stemming from Sylos's analysis of the tendency towards concentration, or rather oligopolization, are quite distinct from the pre-Sweezy Marxist view (Preobrazhenski, 1985), as well as from marginalist approaches (Robinson, 1941). Marxists, such as Rosa Luxemburg and Evgenii Preobrazhenski, did recognize the negative impact of concentration on effective demand, but gave to it an immiserization content because they excluded any possibility of an increase in real wages. Likewise, economists such as Austin Robinson considered that monopolies would sharpen social conflict. The analytical basis for such a conclusion was derived from Cournot's theory according to which under monopoly profits are above, and output below, the ideal competitive norm. But in the context of Sylos-Labini's dynamic approach, the Cournot static solution is 'irrelevant for the critical evaluation of the social implications of different market forms'. For surplus profits, if 'invested in plant and equipment or if used in R&D, may allow for a growth of production and of productivity higher than that of the small firms operating under conditions close to perfect competition' (Sylos-Labini, 1993b, 164).

Thus the social implications of the rise of oligopolies should be gauged in terms of the impact on the forces generating investment and accumulation. It is at this point that Sylos-Labini's seminal contribution to the relationship between oligopoly and technical progress must be brought in in its full dimension.

25.3 Oligopoly, Technical Progress, Effective Demand

The first edition of *Oligopolio e progresso tecnico* was published in Italy in 1956. The first English edition appeared in 1962 and the final revised version in English dates from 1969. Its status as a fundamental work is evidenced by the fact that the book has been reprinted in 1994 by the American publisher Kelley in its series on economic classics. Translated into many languages, including Japanese, *Oligopoly and Technical Progress* has had a profound effect on both the Marxian strand of thought, represented by Paul Baran and Paul Sweezy, and on economists who tackled the twin issue of development and the terms of trade (Baran and Sweezy, 1966; Merhav, 1969; Glynn and Sutcliffe, 1972; Sau, 1982). Among microeconomists the influence of the book shows up via its treatment of the barriers to entry. In this case, Sylos's approach has been associated with the parallel work of Bain (Scherer, 1980). However, *Oligopoly and Technical Progress* differs from Bain's study (1956) in that much greater emphasis is given to technological discontinuities while the whole question of oligopolies is tied to their macroeconomic impact.

25.3.1 Oligopolies as an Expression of Dynamic Transformations

To put Sylos-Labini's conception of oligopolistic structure and pricing into proper perspective, it is necessary to add to the irrelevance of Cournot's proof the shortcomings of the solution – independently formulated by Sweezy and Hall and Hitch (1939) – based on the kinked demand curve. The main limitation of the kinked demand curve consists in that it fails to account for the determination of a particular oligopolistic price.[4] By contrast, the analysis of price formation must be grounded in the structural features of modern production processes which are characterized by scale economies involving indivisibilities and technological discontinuities of plant and equipment. In Sylos's model, firms differ in relation to their productive capacity. Thus changes are irreversible since their occurrence entails variations in the number and in the composition of plants.

The novel conceptual dimension contained in *Oligopoly and Technical Progress* has been highlighted by Modigliani in a famous review article discussing Bain's and Sylos's books (Modigliani, 1958). Modigliani pointed out that, in Sylos's theory, differences in firms' productive capacity exclude the possibility that large firms will increase their output in order to conquer the space of smaller ones. The example given by Modigliani is based on the assumption that the size of the market occupied by small firms is smaller than the output of the plant of the large firm. The large unit will then have to build plants of the size of those of small firms, or it will adopt an intermediate technology. In the first case, the costs of running the small plants might produce a too low rate of profit relative to the large plant. In the second case, the invasion of the market might require the reduction of prices below the average cost of small firms for a considerable amount of time. For Sylos-Labini this kind of price war is not worth the candle, so that the oligopolistic units will refrain from upsetting the balance between large and small firms. Large firms do not pursue the elimination of the smaller units because of technological discontinuities. Their existence brings about a tendency for prices to settle just above the point at which the least efficient among the existing firms would not obtain the minimum rate of profit. It is important to observe that the level of the minimum rate of profit is exogenously given.

Entry barriers are effective whenever they allow a particular firm to perfect them through its technological ability to produce new goods or to differentiate them. Analytically, barriers allow the determination of the limit price which will deter entry. Sylos starts from the postulate that firms attempting to enter a particular market will expect existing firms to respond by adopting a policy based on an unchanged level of production and on lower prices. The upshot of his discussion is that technological discontinuities, leading to scale economies, make it impossible to have a perfectly competitive solution. In particular, a different price will emerge depending on the type of firm which has started the entry process.

Sylos's theory of entry barriers, known in the literature as the *Sylos Postulate*, has been absorbed by mainstream microtheorists. Models have been built with the purpose of identifying strategies for dynamic entry (Friedman, 1983). Furthermore, the notion of limit pricing has been relaxed in order to show that unused capacity provides a strong enough deterrence to entry (Spence, 1977). Little can be said against the rigour with which these models have been constructed. Just the same, they lack the dynamic insights of Sylos's reasoning. In particular, neither of the above mentioned authors attempts to develop a theory of structural and technical change, even at the level of the firm. Moreover, the issue of excess capacity is not tied to the implications that such a phenomenon would have for the economy as a whole. This question remains untackled also in the game theoretic approaches to oligopoly which nowhere discuss matters related to capital accumulation and effective demand.

By contrast, the dynamic essence of Sylos's approach consists in that a higher degree of monopoly may increase output and accumulation if the appropriate level of investment is forthcoming. The crucial question here becomes whether or not investment is endogenously generated. This would require study of the variation of prices and costs under oligopolistic conditions. To grasp the link between variations in prices vis-à-vis costs and the determination of investment, one may refer to classical–Marxian competition where any reduction in the cost of production leads to a fall in the natural price of commodities. In this context, as clearly shown in Marx's own formulation of the trade cycle (Marx, 1967, 1968) and in Sylos's treatment of Marx's and Schumpeter's theories, the level of investment is always positively related to the share of profits over national income. Thus a different price–cost regime ought to have different implications for the determinants of investment (Del Monte, 1975; Halevi, 1985).

25.3.2 The Dynamics of Costs and Prices

Two crucial observations flow from the analysis of the role of entry barriers: (i) perfectly competitive situations are structurally impossible, as acknowledged by Modigliani; (ii) profit rates are unequal. The first observation means that if a large firm wanted to penetrate the market of a rival to obtain part of that profit rate, it would not achieve the desired outcome. Instead it would cause chaos in the market concerned. The second observation distinguishes between the existence of differential profit rates under competitive as compared with oligopolistic conditions. In the former case, differential profit rates result from temporary maladjustments and imperfections. In the oligopolistic case, by contrast, the differences are structurally determined by the nature of technology and the related scale economies. This is the economic context of the relation expressing the full cost principle, as presented in *Oligopoly and Technical Progress*. Hence the price given by the full cost formula is:

$$p = v(1 + q). \tag{25.6}$$

In equation (25.6), v is the variable or direct cost and q is the margin charged on it. In fact, qv contains two elements. The first, $q'v$, is the ratio of fixed costs to output per unit and the second, $q''v = g$, defines the margin on v necessary to obtain a gross profit, g, per unit.

Price setting under conditions of barriers to entry explains only why large firms are uninterested in price wars. It does not explain their market power. By the same token, formula (25.6) does not explain the determination of the price, but only its variations. Thus the notion of the mark-up q is meaningful only in a dynamic context when changes in cost factors are brought in. In equation (25.6), prices fall or rise following a decrease/increase in prime costs v on the assumption that overhead costs vary in the same direction as the cost of labour and of raw materials. The inclusion in the formula of $q''v$ implies that oligopolistic firms incorporate into their pricing decisions a target rate of profit. This factor eliminates the dichotomy between sales maximization and profit maximization because, as long as investment projects are financed by profits, the maximization of profits leads to a maximization of sales. In fact, the maximization of sales at the expenses of profits operates only in the very short run. In the longer run, profits are needed to finance investment in order to expand sales. This last aspect – systematically stressed in the book – is seldom emphasized in neoclassical writings on oligopoly which focus instead on the type of equilibria attainable by the firm.

Technological innovations play a particularly important role in determining variations in costs. By and large, productivity increases depend both on regular improvements in organization and, especially, on the introduction of new technologies embodied in new equipment. If the new methods are available to all firms, the ensuing overall decline in v will lead to a fall in prices. But if the new methods can be installed only by large firms, the reduction in v will be limited to this set of firms, so that the prices of their outputs need not fall. Part of the productivity increase can be absorbed by higher wages paid out by those firms, and part can be transformed into a higher rate of profit through the rise in q. If the oligopolistic units feel safe enough in their new position, the new value of q becomes the new parameter for the determination of price variations in the wake of further changes in the costs of labour, of raw materials and of overheads.

Consequently, thanks to technological discontinuities, oligopolistic firms tend to become privileged because they are able to retain the gains ensuing from improvements in productivity. Oligopolistic structures are common in industry, while in agriculture and mining competition prevails. It follows that industry is a privileged sector relative to primary activities. As pointed out earlier in this essay, the prices of primary products vary in the short run according to supply and demand conditions, whereas in the long run they depend upon the costs of production. The terms of trade tend to move in the long run against the primary sector because, when industries are oligopolistic, increases in industrial productivity lead either to increases in profit margins or, more frequently, to parallel increases in real wages. Thus industrial prices do not fall relative to those of primary commodities. Such an asymmetry in price behaviour is strengthened if one adopts Kaldor's view according to which raw materials are produced under diminishing returns (Kaldor, 1976). In this case, given the mark-up on industrial costs of production, the rise in the price of raw materials leads to an increase in the price of industrial products, rather than to a change in the terms of trade in favour of primary producers.

Sylos's dichotomy between privileged and non-privileged industries has had a great influence on the study of the relations between developed and developing countries. His work has provided a theoretical foundation to the theses of Prebish (1951) and Singer (1950) on the deterioration of the terms of trade between countries producing primary commodities and the industrialized world (Merhav, 1969).

As far as industry proper is concerned, the picture that emerges from the analysis is as follows. The mark-up q tends to remain stable in the long run. In the short and medium term, the mark-up declines whenever prime costs increase, while it rises when they decline. The limit to the transfer, in an open economy, is stronger the more the source of cost increases is of a domestic nature – for instance, wage increases caused by the institutional forms of collective bargaining existing in any one country – and the higher is the share of external trade.

The fact that under oligopoly firms do not take prices as given by the market, means that they can regulate supply instead. Such an option implies the existence of unused capacity as a structural characteristic of the modern economic system. Other authors (Morishima, 1976) have expressed similar views, taking the regulation of supply as a datum without explaining how it came about.

25.3.3 The Macroeconomic Impact of Oligopoly

The treatment of unused capacity appears to be rather problematical in contemporary economic thought. Let us take, for instance, the works of Michał Kalecki, whose ideas were extremely close to those of Sylos-Labini. In Kalecki's approach spare capacity is viewed both as a central feature of oligopolistic economies and as a factor of stagnation stemming from an inherent deficiency of effective demand (Kalecki, 1971). Methodologically, Kalecki has conflated these two elements into one. In his analysis, no distinction is made between the spare capacity planned by oligopolistic firms and the economy-wide unused capacity resulting from insufficient aggregate demand. In my view, a logical, and historically determined, answer to this question can be obtained from Sylos's classic book as well as from other papers (1954, 1984e). His arguments, if I have understood them correctly, are centred on the significance of aggregate demand for the investment decisions of oligopolistic firms.

The regulation of supply by oligopolistic firms implies that their individual productive capacity is not insignificant relative to the size of the market of their products. This factor conditions the type of innovations which these firms plan to introduce. If innovations require a complete restructuring of the methods of production, a new set of capital equipment is needed. For a given value of variable costs, restructuring involves an amount of expenditure which will increase the total cost of production. Lower costs per unit can be obtained, therefore, only if the firm's output expands. If the oligopolistic enterprise finds itself operating in a particularly dynamic market, the expansion of the demand for its own products – special demand – is not strictly related to the overall level of effective demand. Of course, firms can stimulate demand for their products by means of commercial policies, but such an action has its limit in the amount of income per capita which can be spent in purchasing these products. On balance, the growth of special demand is a function of the firm's commercial policies and of the rate of expansion of aggregate demand (Sylos-Labini, 1984f).

As a consequence, the introduction of innovations involving an increase in total costs is heavily dependent upon the dynamics of aggregate effective demand. In this context, the type of innovations that oligopolistic firms are ready to undertake without much difficulty are those leading to a reduction in prime costs.

Under oligopoly, the fruits of these innovations do not manifest themselves through a decline in prices but are translated into higher profit margins and/or higher wages in the industries concerned. The principle of dynamic substitution – determined by an increase in the ratio of the money wage rate to the price of machines – operates also under oligopolistic conditions. Unlike Smith's competitive process, oligopoly's ability to retain the benefits of technological improvements causes a persistent bias in favour of labour-saving innovations without compensation. Indeed, the compensatory mechanism would depend, in the main, on the expansion of aggregate investment, not on the individual decisions of firms. In particular: 'the expansion of demand must come from stimuli that are external to the system of private enterprise. These can be of two types: public expenditure and foreign demand' (Sylos-Labini, 1984f, 139).

How will profits be used if the exogenous growth in aggregate demand is not large enough to induce oligopolistic firms to expand? The answer given in *Oligopoly and Technical Progress,* albeit insightful, is not fully developed. If demand determines the limit to investment, firms may use their monetary proceeds to invest in financial assets and in operations on the stock exchange. These activities are certainly rational from the standpoint of the single corporation. But from the perspective of the economy as a whole, financial operations as such do not constitute investments as they do not expand productive capacity. The existence of oligopolies is associated with a high degree of self-financing. This entails changes in the role of the rate of interest. Investment decisions in the large firms will be, relatively speaking, little influenced by variations in interest rates. These will affect mostly the investment policies of small firms. The financial impact of oligopolies is presented only in general terms. The major insights that can be derived from Sylos's presentation are the possibility of a systemic separation between investment and finance and the asymmetrical impact of variations in the rate of interest.

25.3.4 Circular Flows and Oligopolistic Structures: A Simple Critique

Sylos considers the Sraffian–Marxian schemes of intersectoral relations to be the necessary starting point of the analysis of production. Both in his *Oligopoly and Technical Progress* and in a more recent book entitled *Progresso tecnico e sviluppo ciclico* (1993b) a Sraffa-type model is used to show that an innovation under competition will lead to the reabsorption of displaced labour, while under oligopoly it will not. These results depend exclusively on the special behavioural assumptions made by Sylos. In the model presented in *Oligopoly and Technical Progress*, the competitive outcome is tied to capitalists' decisions to move from a zero rate of accumulation to a positive one in order to purchase the new capital goods. This kind of decision is an assumption. In general, there can be a number of outcomes – not involving full employment – all consistent with the competitive hypothesis. This raises a second observation about whether it is at all possible to establish a connection between circular intersectoral flows and the analysis of oligopolistic structures.

For my purposes it suffices to focus on the mark-up of the consumption goods sector (Loranger and Halevi, 1986; Halevi, 1991). In a two-sector circular model based on capital and consumption goods, the value of the consumption goods output must be equal to the combined wage bill of the two sectors and to capitalists' consumption. Assume now that the latter is negligible, that workers do not save and that unused capacity exists in both sectors. If the consumption goods sector's mark-up is given, then it must follow that, for a given initial distribution of the stock of capital, the oligopolistic forces operating in that sector are so strong as to determine the ratio between the two rates of utilization and the ratio between the sectoral techniques of production. This is very difficult to accept even for the short run. This conclusion stems from the structural characteristics of the two-sector classical model (Harcourt, 1963). More fundamentally, it is doubtful that Sraffa–Marx circular flows can integrate in a satisfactory manner the impact of oligopolies on the economy as a whole. Sylos's approach to the question of oligopoly should be looked at independently from the classical macrosectoral picture of production.

25.4 Beyond Oligopoly

In Sylos-Labini's more recent work there is an attempt to outline a post-oligopolistic transformation of the system under the twin impact of non-manual labour and of the flow of innovations. The rise of intellectual labour is due to the large firms' emphasis on R&D, both on an internal basis and in connection to research institutions. Moreover, the flow of innovations has gained strength from the renewed growth of small firms thanks to the spread of electronic and computer-based methods of production and of organization (Sylos-Labini, 1989). Unlike the traditional small units of the past, the workforce of today's small firms has a large and rising share of technicians, project designers, and so on. In the formulation of a post-oligopolistic view of capitalism, Sylos's own analysis of social classes has, undoubtedly, played an important role (1974b, 1986). The reference point of the study was Marx's thesis of the expansion of the proletariat and of the immiserization of the working class. The book argues – as Marx did – that the growth of non-blue collar jobs cannot be reduced to the expansion of mental services catering for the rich. Instead, the decline of the working class is seen as a physiological phenomenon stemming from both the long-run rise in real wages and the formation of new types of activities based on intellectual labour.

25.4.1 The New Labour Market

The new transformations affecting contemporary capitalism are having a direct impact on the concept of unemployment as well. Keynes, and also Marx, viewed employment in relatively homogeneous terms. Today, it is imperative to look at both the unemployed and the employed as being constituted, within each group, of different categories of people. An analysis should also include the distinction between employment in small and large firms, as well as between payroll employment and independent occupations.

The overall trend of employment is determined by the interaction between the growth of income which stimulates demand, and technological innovations which reduce the quantity of labour per unit of output in the industrial sector. Industry is, therefore, still viewed as the branch generating the strongest impulses to growth. However, its importance is qualitative rather than quantitative. In this framework, Sylos-Labini introduces the novel idea of an optimal growth rate of wages, which is that rate lying just above the growth rate of productivity. Its optimally consists in that the positive impact of wage increases on demand would not be offset by the negative impact on accumulation, since firms would have enough financial margins to bring about new technologies. The optimal growth rate of wages is not exactly the dual of the optimal rate of profits discussed earlier in the essay. In the case of the optimal growth rate of wages, the profit rate has to suffer a bit since unit wages are made to grow just a little above the rate of productivity.

Alongside the optimal increase in wage rates, an optimal degree of labour mobility is identified. The necessity of labour mobility stems from the fact that new activities arise and old ones disappear also when the growth rate is given. In this respect the Sylos thesis about the relationship between employment and labour mobility could be strengthened by using Pasinetti's theory of structural dynamics (Pasinetti, 1993). In Pasinetti's model, even with a given average growth rate, the economy's sectors will expand at different rates because of non-uniform technical progress. Furthermore, the per capita demand for each product will not grow uniformly because of Engel's law. It follows that workers must always move from the declining to the expanding sectors. Both Sylos and Pasinetti show that labour mobility and wage flexibility are not the same thing.

The dominant elements of the oligopolistic stage of capitalism are industrial concentration and technological discontinuities. In this stage mass production methods characterize the industrial sectors that impart the most dynamic impulses to the whole economic system. The following stage, which can be deemed to have started in the early 1970s, is characterized by an increasing number of small but technologically advanced firms, both in industry and in services, operating under conditions of differentiated oligopoly. Thus the concentration process, already envisaged by Marx at its inception and later emphasized by Schumpeter, has come to an end as a process. Such a change was examined by Piore and Sabel (1984) in a well-known book. Yet it had already been outlined by Sylos-Labini in a public lecture given at the University of Sydney in 1980 (1984g). In the new stage of economic growth we notice, together with the expansion of technologically advanced small firms, the rapid increase of activities heavily based on intellectual labour. In this context, the need to limit unemployment is no longer tied to the prescription of expanding output in the Keynesian sense.

The decoupling of employment creation from the traditional Keynesian mechanism, the latter deemed to be inapplicable today, is only a first step towards a more general separation of payments from measurable productivity (Sylos-Labini, 1989). The process by which the economy moves away from a Keynesian situation can be outlined in the following way.

In the Great Depression, unemployment was the result of a sharp fall in effective demand. This phenomenon was captured by Keynes, for whom employment and output move in the same direction. In the post-war period, the connection between employment and output has become gradually more and more complex. The rise in wages and public expenditure have kept for a long period the major Western countries near a full-employment situation. Concomitantly, universal schooling has given rise to a population which – rather than seeking any type of employment – is interested only in certain kinds of occupations.

This complexity is bound to increase for two reasons. On the one hand, the process of automation will certainly continue unabated, leading to further expulsions of people from productive activities. On the other hand, new non-commodified tasks will have to be undertaken for strict social reasons. These are jobs where the traditional measures relating wages to productivity cannot possibly be applied. The waning of an objective economic basis in the determination of payments for the amount of work performed, raises the issue of the institutional mechanism on the basis of which distribution will be carried out. If distribution is centralized, it will have to be carried out according to each and everyone's needs. Alternatively, shares may be distributed to every citizen, but the practical difference in the two methods will be minor. In both cases the criterion of distribution will not depend upon a wage productivity relationship. The hypothesis of a fully automated society is an extreme case. Yet the possibility of a robotized economy is not so unrealistic as it might have sounded only a few decades ago (Sylos-Labini, 1986).

25.5 Conclusions

I would, at this point, place the advances made by Sylos-Labini in economic theory on two levels. The first pertains to his theory of oligopoly and technical progress. Sylos's approach links together the study of market forms with the movements in productivity and their macroeconomic implications. In other words, each market form has its own macroeconomic side. A general microeconomic basis for an unspecified macroeconomy does not exist. In the case of oligopolistic systems, the Keynesian exogeneity of investment emerges neatly from the way in which firms utilize the fruits of technical progress.

The second level consists in Sylos's long-lasting endeavour to use and develop theoretical concepts in order to produce a *histoire raisonnée* of socio-economic evolution. This type of research is, for the post-war period, unique within the economics profession and outstanding in its own right. Sylos's approach allows us to link in an evolutionary manner different economic epochs within the history of industrial systems. It follows that every set of economic concepts, as well as their interaction – such as the notion of unemployment and its connection with technical progress – is historically specific (Sylos-Labini, 1987, 1990b).

Sylos's works raise questions concerning the historical validity of any economic doctrine containing elements of dynamic transformations. Only marginalist analysis is not given an historically determined position because of the purely imaginary dimension of the market form it describes – static perfect competition. Interestingly enough, for similar reasons Hicks too did not contextualize marginalism (Hicks, 1969). On the whole, Sylos's approach now goes beyond economic analysis, although it originates from it. As society evolves it becomes more and more institutionalized. Cultural as well as other phenomena impact upon its transformation as much as economic phenomena do. This position is very firmly expressed in a special addendum to the English translation of the essay on Marx and Schumpeter (Sylos-Labini, 1984b).

Hence no specific hierarchy of disciplines can be established in relation to the study of society. More explicitly, may it not be the case that Max Weber's refusal to separate the different elements of the social discourse is particularly valid today when 'economics' appears to be just a branch of applied mathematics?

Notes

1. Sylos-Labini was born in Rome on 30 October 1920. He studied economics and law at the University of Rome. After the Second World War, he spent a year at Harvard University studying with Joseph Schumpeter. Sylos-Labini became Professor of Political Economy in 1954, teaching at the Universities of Bologna and Catania before moving to the University of Rome 'La Sapienza', where he has been working

for more than three decades. Sylos-Labini has been invited as a distinguished professor by a number of universities, such as Harvard and Sydney. In Italy he is a member of the Accademia dei Lincei.
2. All the translations from Italian are mine.
3. The notion of dynamic substitution may also be used to criticize the conceptual and empirical validity of the Cobb–Douglas production function. In a recent study, for instance, Sylos shows that in a dynamic framework the two exponents of the Cobb–Douglas can be unified into one. Although irrelevant for the analysis of income distribution, this may be used for the study of economic growth (1995).
4. An excellent discussion of the differences between the approach based on the kinked demand curve and those of Kalecki and Sylos-Labini is found in Kriesler (1988).

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