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EMPLOYMENT AND COMPETITIVENESS

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INTRODUCTION.[1]

The last ten years have been a period of instability and disruption in the world economy. Energy costs rose dramatically in two abrupt episodes that created serious adjustment problems for countries dependent on imported oil. The world of fixed exchange rates that was established through the Bretton Woods Agreement was replaced by one in which rates fluctuate much more widely than was anticipated by those who advocated flexibility. Inflation, already accelerating during the late 1960s, reached levels during the 1970s that have never previously been sustained in peacetime. Adjustment has been made more difficult by the arrival on the labour market, at the time when the abnormally small cohort born during the First World War was reaching retirement age, of the very large number of children born in the expansive years after the Second World War. In most countries unemployment rates have soared to levels that we thought our students would only read about in histories of the 1930s.

In this paper I wish to examine the experience of the last ten years in regard to employment, summarising alternative interpretations of the contrasts between these recent years and the more buoyant decades of the 1950s and 1960s, and between the recent experiences of the United States and Europe. Against this background an assessment of the prospects for the years ahead is attempted.

THE WORLD WE HAVE LOST.

A distinguished group of American experts writing in 1961 concluded that

> all three goals---an adequate rate of economic growth, low levels of unemployment and reasonable price stability---can be achieved simultaneously, and they are fundamentally compatible if we do not expect the impossible from each. While conflicts may arise under certain conditions between reasonable price stability and low levels of unemployment, there are no conflicts between low levels of unemployment and economic growth, and between reasonable price stability and an adequate rate of economic growth.[2]

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[1] I am grateful to J.P. Neary for helpful comments on an earlier draft.

[2] Report of the Commission on Money and Credit, cited in Arthur M. Okun, ed., The Battle Against Unemployment, New York, 1965, p. 51.

The record of the 1950s seemed to vindicate this claim. Sustained growth in output wa accompanied by moderate levels of inflation and, in the United States in particular, th very rapidly growing population of working age was absorbed into employment remarkabl smoothly, despite pessimistic forecasts of the structural unemployment that would b caused by "automation".[3] Although the inflation rate began to accelerate during the sec ond half of the 1960s, this was readily ascribed to a predictable and acceptable trade-of between inflation and unemployment, the policy implication of the Phillips curve, which ha been popularised by two distinguished economists in the following terms:

> In order to achieve the non-perfectionist's goal of high enough output to give us no more than 3 per cent unemployment, the price index might have to rise by as much as 4 to 5 per cent per year. That much price rise would seem to be the necessary cost of high employment and production in the years ahead.[4]

Over the years 1963-73 the American economy grew at an annual average rate of jus over 4 per cent, price inflation averaged under 5 per cent and unemployment remaine below 5 per cent. Although this outcome was somewhat less favourable than that envi saged by Samuelson and Solow in 1959, the discrepancy was not very great. The econom functioned more or less as they had predicted. Nor was the United States exceptiona over this period. Real output grew more rapidly in France, Canada, Japan, Italy and Wes Germany than in the United States. Only the United Kingdom, among the OECD countrie recorded a significantly inferior performance, but even in this country output grew at 2. per cent a year, inflation remained under 5 per cent and unemployment rarely reached per cent of the labour force.

Stable exchange rates prevailed during this period, interrupted only by occasion crises in France and Britain. This combination of low inflation and stable exchange rate gave no grounds for worry about international competitiveness. True, American commen

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3 See, for example, Charles C. Killingsworth, "Automation, Jobs, and Manpower", i Stanley Lebergott, ed., Men Without Work, Prentice-Hall, In., Englewood Cliffs, N.J 1964.

4 Paul A. Samuelson and Robert M. Solow, "Analytical Aspects of Anti- Inflationar Policy," in M.G. Mueller, ed., Readings in Macroeconomics, New York, 1966, p. 384.

tators were becomming concerned about the sustained high rate of productivity growth in the newly reconstructed European countries. In the 1968 edition of his influential textbook, Professor Samuelson included an illustration of the problems that would arise if productivity in a country such as Germany increased more rapidly than in the United States over a long period. At fixed exchange rates, he warned, the dollar would become overvalued and "a country with an overvalued currency will be under great internal pressure to interfere with free trade." In view of the difficulty of forcing internal costs and prices to adjust to a pegged exchange rate, he advocated flexible exchange rates as the solution to this problem: "Blood has often run in the streets of nations trying to adjust to an overvalued currency by internal cost deflation."[5] But this concern with international competitiveness was not widespread in America, where trade was a small proportion of GNP, whilst in Europe the stimulus derived from currencies that were gradually becoming undervalued was welcome.

EAST OF EDEN.

As we mark the tenth anniversary of OPEC's first exercise of its oligopolistic power, which has been far more successful (on its own terms) than economists anticipated in 1973, there is an understandable willingness to attribute much of the difficulty that we have experienced in the interim to this event. We should, however, recall that several adverse trends had already become apparent before the disruption of world energy markets. Inflation in most OECD countries accelerated sharply as the 1960s drew to a close, exceeding 6 per cent in the United States in 1969. This upward drift in inflation was not accompanied by the decline in unemployment that the Samuelson-Solow analysis predicted. In fact a gradual rise in unemployment rates was becoming evident in most western economies at the same time as inflation rates began to accelerate.

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[5] Paul A. Samuelson, Economics: An Introductory Analysis, Seventh Edition, New York, 1967, p. 643.

That economic policy might not be as straightforward as mainstream economists h suggested was argued by Milton Friedman in his American Economic Associati Presidential Address in 1967. He outlined the now famous concept of the "natural"[6] ra of unemployment, namely the rate which

> is consistent with equilibrium in the structure of <u>real</u> wages. . .The "natural rate of unemployment", in other words, is the level that would be ground out by the Walrasian system of general equilibrium equations, assuming there is imbedded in them the actual structural characteristics of the labour and commodity markets, imcluding market imperfections, stochastic variability in demands and supply, the costs of gathering information about job vacancies and labor availabilities, and so on.[7]

This passage set a rich research agenda for economists during the 1970s. On a mo concrete level it reminded us that what matters in labour markets are real, rather th nominal, wages. This implies that negotiators take into account expected rates of infl tion, based on recent experience or even on the policy stance of monetary authorities, evaluating wage offers. It follows that, in the long run, equilibrium in the labour mark is largely independent of monetary factors, whereas the rate of inflation most certainly not. The stable trade-off between inflation and unemployment along the lines depicted Samuelson and Solow becomes much less credible. The gains in terms of reduced une ployment are likely to be be short lived, but the damage caused by higher inflation ma prove enduring.

It is important, however, to bear in mind what Friedman's counter-revolution did n achieve. The concept of the natural rate of unemployment cannot be readily identifie with any clearly defined labour market situation.[8] It does not for example correspond to simple balance between the number of job seekers and vacancies. Nor is it stable. It now commonplace to argue that the natural rate has risen sharply in many countri

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6 The adjective is unfortunate. It was used by Wicksell in an analysis of the equilibriu interest rate that Friedman extended to the labour market.

7 Milton Friedman, "The Role of Monetary Policy", in <u>The Optimum Quantity of Mone</u> London, 1969, p. 102.

8 Friedman stated "unfortunately, we have as yet devised no method to estimate accu rately and readily the natural rate of either interest or unemployment", <u>op. cit.</u> 104.

because of a deterioration in the structural characteristics of labour markets that macroeconomic policy can do little to correct.

As the inflation rate accelerated, and the trade-off between inflation and unemployment deteriorated, problems emerged in relation to the trade balances of the United States, Japan and the countries of Western Europe. The improved competitiveness of countries such as Japan and Germany in areas of traditional American superiority, combined with massive overseas military spending by the United States, led to a surplus of US$ on world money markets by the end of the 1960s. As inflation rose, the divergence between inflation rates in individual countries became much larger. Whereas in 1966 the difference between the highest and lowest inflation rates in the main OECD countries was only 2.2 per cent,[9] by 1971 the difference between the highest and lowest inflation rates had widened to 4.4 per cent (between France (6.2) and West Germany (1.8)). The differential was now larger than the average level had been three years earlier. The strain that these developments placed on the system of fixed exchange rates was enormous. The move to generalised floating in 1973 was in line the approach that had been advocated by the majority of academic economists during the 1960s. The new regime was, however, to bring with it problems that has not been foreseen by its fervent advocates.

TEN HARD YEARS

The years since 1973 have not been uniformly stagnant or depressed in the economies of the OECD. The period 1976-79 was an interlude of quite rapid growth in most countries. The fortunes of individual countries have varied. Japan, the United States and West Germany have outperformed the rest of the developed world. But virtually all countries have experienced severe adjustment problems, especially in the wake of the second oil price increase in 1979, which have manifested themselves primarily in persistently high unemployment rates. These high unemployment rates have tended to distract attention from the fact that in most countries even during these ten years of slow growth there

[9] The highest rate of inflation was in Japan and the lowest in Italy!

has been a substantial improvement in living standards for the majority of househol This is because most households have not been affected by prolonged unemployme Even the severe problem of youth unemployment has been relatively restricted in its in dence. A recent study of youth unemployment in the United States concluded that "wh might be regarded as the most serious social ill, being out of school and unemploye touches just 4 per cent of youth at the moment."[10]

The priority given to fighting inflation in the major economies combined with the ri in the natural rate of unemployment has resulted in unemployment rates that have n been experienced since the 1930s. In the United States and the United Kingdom, over per cent of the labour force was out of work by 1982. In France and West Germa where a decade earlier unemployment was almost non-existant, the rate had passed 6 p cent. These figures are exclusive of people who drop out of the labour force and imm rants who return to their homeland in the face of poor employment prospects. Wh undoubtedly registered unemployment in some countries is inflated now compared with e lier periods by the higher real value of benefits, and the higher proportion of after-t earnings they replace, there is little evidence that this has had a large effect on t unemployment statistics of any major country.[11] The proximate explanation for most the sharp rise in unemployment is, of course, the **reduction in growth in GNP at a ti when the growth of the labour force remains very high**. For a deeper understanding what has happened, however, we need to ask **why labour markets have not adjusted mo smoothly to fluctuations in supply and demand** that by historical standards are not th extreme.[12]

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10 David T. Ellwood and David A. Wise, "Youth Employment in the Seventies:The Changi Circumstances of Young Adults," NBER Working Paper No. 1055, Cambridge, Mas National Bureau of Economic Research, 1983.

11 For a discussion of this issue see "Free to Lose", Chapter 8 of The Conditions f Economic Recovery, by John Cornwall, London, 1983.

12 The increase in the growth rate of the working-age population due to demograph factors has been relative mild and occurred gradually over a generation. It is pu ling that labour markets could not accomodate this when, for example, they ha adjusted fairly smoothly to massive increases in the civilian labour force after t

In attempting to understand the adjustment of labour markets in western economies, it is important to look at the behaviour of employment as well as of unemployment.[13] There is an extraordinary contrast between the record of the United States and Japan, on the one hand, and most European economies on the other. In the United States there was no slowing down in the rate of employment growth in the period 1973-81 compared with 1960-73. Civilian employment grew from 66 million in 1960 to 85 million in 1973 and climbed to more than 100 million in 1981--a cumulative increase of 34 million or over 50 per cent over a 21 year period. While unemployment remains a serious problem, especially in certain regions of the country and among certain demographic groups, it is encouraging to see that the resumption of rapid economic growth after the recession of 1979-81 has been accompanied by a further substantial rise in employment. The unemployment rate is now falling faster than envisaged in the most optimistic forecasts. In Japan employment continued to grow after 1973, although at a slower rate than in previous years. These achievements have not received as much attention as they deserve, especially in view of the popular anxiety about the "death of work" due to automation, micorelectronics, and changing lifestyles. They owe nothing to the "work-sharing" philosophy that is growing in popularity in many European countries. In fact, in the United States the trend has been towards later, rather than earlier, retirement, and labour force participation among married women is at an all-time high.

In the countries of the EEC the record of employment creation has been much less impressive not merely since 1973 but over the entire period since 1960. Total employment in the EEC-9 was only 4.5 million, or about 5 per cent, higher in 1973 than in 1960. Between 1973 and 1981 it grew by only half a million. Over the entire period from 1960

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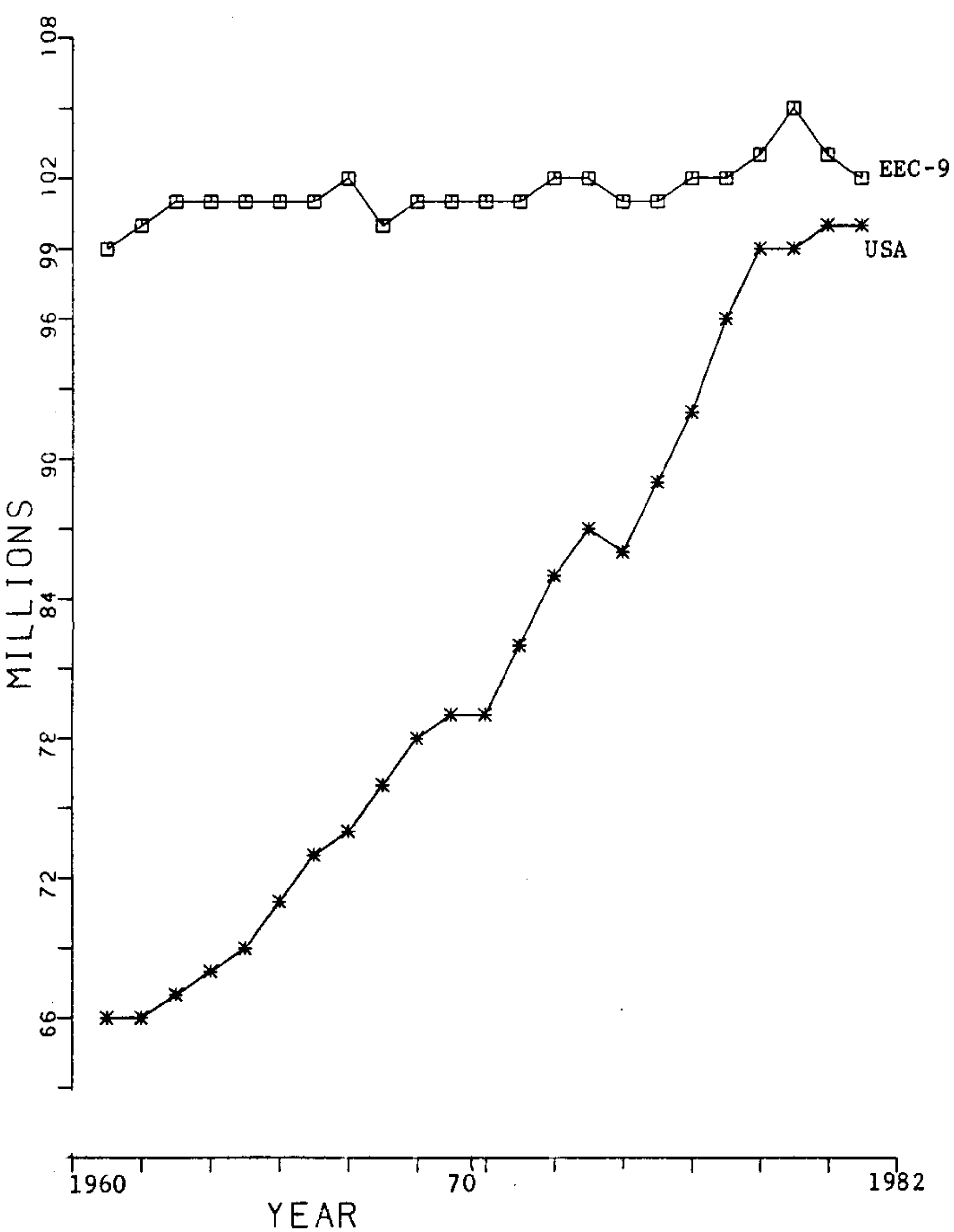
two World Wars. For that matter, in most countries the labour market appears to be able to absorb the enormous seasonal variation in supply assocated with school and college vacations without too much difficulty.

13 The statistical material summarised in the text is drawn mainly from OECD sources. See M. Wegner, "The Employment Miracle in the United States and Stagnating Employment in the European Community," Commission of the European Community, Directorate General for Economic and Financial Affairs, Economic Paper No. 17, July 1983.

EMPLOYMENT IN THE USA AND EEC-9, 1960-82



to 1981, employment in the EEC increased at an annual average rate of only 0.2 per cent, compared with the United States average rate of increase of 2.0 per cent. The effect of this sustained divergence in growth rates has been dramatic. Whereas in 1960 there were 50 per cent more people at work in the EEC-9 than in the United States, by now the numbers at work are almost equal in the two areas.

The contrast between the employment records of Europe and the United States has been carefully investigated by economists. Reflecting the influence of the natural rate of unemployment concept, considerable attention has been paid to the role of wages, and specifically of the rigidity of real and money wages, in the adjustment of the labour market.[14] Even a casual examination of the evidence shows that there has been a striking difference between the two regions in this regard. In the United States over the period 1973-81 real product wages (that is, money wages deflated by output prices or the price of value added) rose by only 0.3 per cent a year, while output per worker rose by 0.2 per cent a year. In Europe, on the other hand, real labour costs rose by 2.4 per cent and output per worker rose by 2.0 per cent a year. In several countries there has been a considerable increase in the share of labour income in value added. The United Kingdom has experienced the most dramatic increase in this share, from 71 per cent in 1973 to 84 per cent in 1981.[15] Included in labour costs are, of course, all direct taxes, such as income taxes, social security and other payroll levies, which account for a higher share of the total in Europe than in the United States, and which have risen in importance in all countries over time.

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[14] This represents a return to pre-Keynesian ways of thinking about unemployment. "...classical arguments about the causes of unemployment, which fell into disrepute in the late forties, are somewhat fashionable again." Edmond Malinvaud, The Theory of Unemployment Reconsidered, Oxford, 1977, p. 108.

[15] This is the normalised share of labour income in value added in manufacturing. See Jeffrey D. Sachs, "Real Wages and Unemployment in the OECD Countries", Brookings Papers on Economic Activity, 1:1983, Table 3; see also G. Basevi, O. Blanchard, W. Buiter, R. Dornbusch and R. Layard, "Macroeconomic Prospects and Policies for the European Community," Commission of the European Community, Directorate General for Economic and Financial Affairs, Economic Papers No. 12, April 1983, and D. Grubb, R. Jackman and R. Layard, "Wage Rigidity and Unemployment in OECD Countries," European Economic Review, Vol. 21 (1983), pp. 11-39.

When real labour costs rise more rapidly than the trend rate of growth in productivi ty, employers have an incentive to invest in labour saving technologies and productio processes. Various attempts have been made to measure the extent to which this type "real wage gap" has contributed to the rise in unemployment in Europe and America sinc 1973.[16] There is general agreement that large wage gaps have emerged in several OEC countries and these together with the extremely tight monetary policies that have bee pursued in recent years, and specific labour market factors that have caused a rise in th natural rate of unemployment, account for the extremely high rates of unemploymen throughout the western world. The relative importance of these factors in accounting fo the unemployment problem differs from country to country, as indeed does the magnitud of the unemployment problem, but in general there has been a much more severe rise i unemployment, and more of this rise seems to be attributable to the real wage gap, i Europe than in the United States. Adjustment to supply side shocks, on the other hand appears to account for little of the international variation in the rise in unemployment.

The Japanese experience might be cited as a counterexample to this explanation o slow growth in employment. In Japan wages adjusted for productivity growth have rise even more rapidly than in Europe but the rate of employment growth has also been high This might be taken as strong evidence against invoking a "real wage gap" as the caus of the rise of unemployment in Europe or the United States, but the Japanese experienc can be explained by reference to the very low level of wages relative to productivity i Japan at the beginning of the 1970s, which left room for a major catching up in livin standards without adverse repercussions on the country's international competitiveness.

Thus, even commentators who ascribe a significant proportion of Europe's presen unemployment problem to the conservative monetary and fiscal policies pursued by th governments of the major countries since 1979 accept that over the period since 1973 rea wages have grown too fast for the maintenance of full employment. Much higher rates o total factor productivity growth than were recorded would have been required to hav

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[16] See the articles cited in the preceding footnote.

averted the adverse effects of high rates of real wage growth on employment. For example, Basevi et al. estimate that to support the growth in real wages actually recorded in the United Kingdom over the period 1972-80 and achieve the 4.1 per increase in employment required to absorb the growth in the labour force (in contrast with the decline of 17 per cent in manufacturing employment actually recorded)[17] total factor productivity should have grown in excess of 1.5 per cent a year, compared with the actual growth of less than one per cent a year. Stated alternatively, their calculations suggest that the achieved rate of total factor productivity growth was sufficient to justify a cumulative increase of real wages of just over 3 per cent, compared with the 16 per increase that was actually recorded. These estimates are tentative, some might even say tendentious, but they are the best available at present.

It may be argued that the performance of neither the United States nor the European countries has been satisfactory. While the former achieved a substantial expansion of employment, much of this has been in low wage, low productivity jobs, with little job security. The diminished role of trade unions in the United States economy has facilitated the growth of this type of employment. The static level of real wages has meant that for the typical family living standards have improved only through increased labour force participation, such as the entry of the wife into paid employment. In Europe, on the other hand, while those who have retained their employment over the recession have enjoyed rising living standards, considerable hardship has been loaded onto school leavers, migrants and other members of the "secondary labour force" whose employment prospects have been very poor. In a better world, both real wages and the level of employment would have expanded, but as in the case of the United Kingdom this could only have been achieved if productivity growth had been much more rapid than was the case. In fact, the period since 1973 has been notable for a sharp reduction in productivity growth in most western countries. The reasons for this slowdown have been extensively reviewed.[18]

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[17] This assumes that the share of manufacturing in total employment remains constant. For details, see Appendix 3 and Table 4 of the reference.

It is possible that it may prove to be a temporary phenomenon, due to a combination several unfavourable factors during the period under review, such as energy price incre es and the need to adjust to higher environmental standards, but it would be Utopian hope that our problems will be resolved through higher rates of productivity growth in t immediate future.

The contrast between Europe and the United States in the trend of real wages, a hence in the growth of employment, has been widely ascribed to the tendency for wa contracts in the United States to be binding for two or three years regardless of t affect of rising prices on real wages, whereas wage contracts in Europe have tended be for shorter intervals and to contain provisions for indexation to protect workers fr the effects of rising prices.[19] This has led to a rigidity in real wages in Europe during period when a sharp deterioration in the terms of trade required a reduction in livi standards. If indexation provisions prevent preclude the required adjustment in the real wages the employed labour force, the consequence will be an increase in unemployment unle there is an offsetting rise in trend productivity growth.

In recent years, however, there has been a marked modification of the system indexation in Europe, and real wages have begun to decline, in some cases quite sharpl The real wage gap therefore cannot be invoked to account for the rise in unemployme in Europe since 1981, much of which has to be attributed to the tight monetary policies.

BEGGAR THY NEIGHBOUR?

The previous section ignored the international repercussions of developments in domest prices and costs. In a world of fixed exchange rates and uniform rates of inflation, th omission would not be important. However, the resumption of generalised floating in 197

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[18] The most recent survey is A. Lindbeck, "The Recent Slowdown of Productivit Growth," The Economic Journal, Vol. 93, No. 369, March 1983, pp. 13- 35.

[19] See William H. Branson and Julio Rotemberg, "International Adjustment with Wag Rigidity," European Economic Review vol. 13, March 1982, pp. 13-44, and th references to the real wage gap, above.

injected a new ingredient into discussions of costs and competitiveness. Accepted as a means of overcoming the strain imposed by large inflation differentials on the system of fixed rates, floating has resulted in a decade of exchange rate variability (both nominal and real) on a scale that was not foreseen by its advocates. The behaviour of real rates (that is, ~~nominal rates~~ adjusted for inflation differentials) is of greater interest. Some of the swings in recent years have been spectacular. Between October 1976 and January 1981 sterling's real trade-weighted exchange rate rose by 68 per cent. Between October 1978 and June 1983 the real trade-weighted value of the US$ rose by 42 per cent.[20] In addition to these medium term swings in real exchange rates there has been considerable short-term volatility. In 1978, for example, the average monthly variation in nominal effective exchange rates ranged from 1.7 per cent in Canada to 4.1 per cent in Switzerland. In 1982 the range was from 1.0 per cent in Austria to 6.7 per cent in Sweden.[21]

The burden imposed by large swings in exchange rates on small open economies trying to compete on world and domestic markets with the output of other countries is considerable. Whereas wages are negotiated through a protracted bargaining process and fixed for at least a year, exchange rates change hourly and can abruptly alter a country's ranking in the international competitiveness league table. The element of uncertainty that this injects into the business environment gives employers a further incentive to reduce as much as possible the level of quasi-fixed employment costs they have to bear. The impact of this factor on the economies of Europe, which are so much smaller and more open to trade than the United States, may have contributed to the poorer employment record of these countries since 1973.

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20 These examples are based on data contained in the International Monetary Fund's International Financial Statistics. The adverse repercussions of these unprecedented swings in real exchange rates have not been as obvious as might have been expected: see, Peter Hooper and S.W. Kohlhagen, "The Effects of Exchange Rate Uncertainty on the Prices and Volume of International Trade", Journal of International Economics, November 1978, pp. 483-511.

21 H.Ungerer et. al., The European Monetary System: The Experience, 1978-82, International Monetary Fund, Washington, D.C.,1983, Table 7.

Despite the disruptive effects of these developments under generalised floating, th has not been a large-scale resort to competitive devaluations, nor is there widespr agreement about the desirability of a return to a new regime of fixed exchange rat The limited regional grouping of the European Monetary System has operated less as rigid band of fixed parities than as a set of orderly adjustable pegs. The experience this System illustrates the impossibility of returning to a Bretton Woods-type arrangem until there is much greater convergence between the economic policies of the main tradi nations than exists at present.

In the absence of a new Bretton Woods real exchange rates will probably continue fluctuate widely. This poses a latent threat to free trade in as much as a coun experiencing a sudden deterioration in its international competitivenes due to a sudd rise in its real exchange rate will naturally be under considerable pressure to prote domestic employment from "cheap" foreign imports. It is arguable that the existing syst of generalised floating has endured as long as it has without causing a retreat into lar scale protectionism because economic agents have not expected the wider swings in r exchange rates to be lasting. It is possible, for example, to reassure those who are h by the current strength of the US$ that the currency has "overshot" and will fall to more "normal" level in the near future. If this belief were undermined, the internatio economic order would become a lot more unstable.

Small countries that experience a substantial appreciation of their currencies a faced with a profit squeeze to which the response has been to increase productivity order to survive. High cost, labour intensive firms tend to cease production, while s viving firms accelerate the adoption of variable cost (labour) saving technology. T induced rise in productivity has as its corollary a reduction in the level of employme This effect has been noted in several of the smaller European countries.[22] This highligh the importance for small countries of longer-term exchange rate stability, to be achiev

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[22] See N.Thygesen, <u>Exchange Rate Experiences and Policies of Small Countries: So European Examples of the 1970s</u>, Essays in International Finance, No. 136, Princeto 1979.

through some form of viable currency union or pegging to a suitable basket of currencies.

THE SHAPE OF THINGS TO COME?

An unfailing object of publicity are estimates of the number of jobs that must be "created" over the years ahead if certain labour market targets, such as a reduction in unemployment or the attainment of full employment, are to be met. The press coverage of a recent OECD report[23] concentrated heavily on a single paragraph, where it is stated that

> 20,000 extra jobs will be required every day during the last five years of this decade if OECD unemployment is to be cut to its 1979 level of 19 million [p. 7].

While this statistic is of considerable general interest, it has little real significance for policy. All that is conveyed is the impression of an urgent need to get employment growing again at the fastest pace consistent with the other goals of economic policy, namely price stability and output growth.

The United States economy generated an average of 4,500 additional jobs every day over the period 1973-81 despite the impact of oil shocks and a substantial run-down of the numbers in the armed forces. If there had been no increase in the labour force participation of the working age population, this employment growth would have led to full employment by any reasonable definition. Such a record would hardly have been predicted in 1973, especially if the forecaster had been aware of the difficult environment that was to obtain. Even less predictable would have been the structure of the additional employment that was to materialise. In particular, the extent to which the spending public in the United States revealed a preference for the output of the service sector has taken most commentators by surprise. Seven million additional jobs have been generated in a very heterogeneous "other services" category, in occupations ranging from legal auditing to medical orderlies, from computer programmers to restaurant personnel. There is no economic reason not to expect the growth of the service sector to continue, although

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23 <u>Employment Outlook</u>, OECD, Paris, September 1983.

fears that it will prove difficult to sustain the trend have often been expressed.[24] With higher income levels, expenditure on services tends to increase rapidly, and as productivity rises in the other sectors, the number of jobs in services that can be "supported" by a job in agriculture or manufacturing increases.

A serious potential problem should, however, be noted. Much of the growth in employment in the service sector has not been financed through normal market channels. Direct public sector employment has expanded very rapidly in recent years. Service employment as a whole is concentrated in areas such as health and education that are to a greater or lesser extent provided by the public sector in all countries. The growth of public spending on these services has not been matched by a willingness to raise the tax revenue needed to finance them. The emergence of unsustainable deficits, notably in the United States, precludes further expansion of service sector employment in the relatively painless fashion that has been common over the recent past.

Recourse to higher taxation as a means of financing consumers' apparent preferences for these types of services does not recommend itself in view of the very high marginal tax rates now in place in most OECD countries. These have contributed to the growing popularity of "supply-side economics", which takes the view that high tax rates act as an impediment to the growth of the private sector of the economy. The only way out of the dilemma would appear to be a resumption of faster economic growth. At present or even lower tax rates this would generate the revenue that is required to finance additional public sector services and maintain a balance between the growth of the private and public sectors. However, if recovery is being retarded by an imbalance between these sectors, and will not materialise until the public sector has been drastically pruned, then

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[24] In 1963, Killingsworth wrote: "The United States is the only country in the world in which jobs in services outnumber the jobs in goods industries. Will the growth of jobs in the services offset the losses in goods industries? This kind of offset is possible, but by no means inevitable". Op. cit. p. 57. For a discussion of the trend in sectoral shares in employment see W.K. O'Riordan, "A Note on the Sectoral Employment Pattern," The Economic and Social Review, January 1981, pp. 133-139, and "Productivity and Employment Projections", Journal of Irish Business and Administrative Research, Vol. 3, No. 1, April 1981, pp. 75-85.

we face a very difficult transition to renewed sustainable growth.

CONCLUSION.

High rates of unemployment have squeezed most of the wage and price inflationary pressure out of the OECD economies. Those who are sceptical of the monetarist approach fear that the underlying inflationary forces will re-emerge as soon as the slack in the economic system begins to be taken up, in which case nothing of lasting value will have been gained through all the hardship that has been inflicted on the unemployed.[25] The reason for this pessimism is the belief that monetary tightness has done nothing to alter the fundamental factors behind the recent wage inflation, namely, resistence to real wage reductions, inter-occupational rivalry and similar intractible labour market problems. There are grounds for fearing this intuition may be correct. As one economist has put it: "it continues to appear that only extreme duress in the labor markets can bring about real wage deceleration in the European economies."[26] On the other hand, recent American experience suggests some important lessons regarding labour market policy that could with profit be imitated in Europe. The most obvious of these is that there is a stark trade-off between the characteristics (such as pay and security of tenure) and the total number of jobs that an economy can generate.

i.e. Dis-inflation to bring down Real wages.

All too frequently debates about the present unemployment problem degerate into an either/or contest between those who blame restrictive monetary policy and those who blame the real wage gap. In reality both factors appear to share some of the responsibility, and hence both have a role to play in the solution. The scope for successful Keynesian-type policies should be seen to depend on the preservation of real wage moderation during a demand-led recovery. If a consensus does not emerge on this point, we shall be be forced to relive the painful lessons of the recent past as recovery rekindles an unsustainable inflation.

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25 See, for example, John Cornwall, The Conditions for Economic Recovery, op. cit.

26 See Sachs, p. 257.

A more stable international monetary order also has a contribution to make, especially for the countries that are most open to international trade. The present system is increasingly recognised to be precarious, even in the United States, whose conduct in this regard is of considerably more consequence for the rest of the world than for itself. Similarly, the continued non-participation of the United Kingdom in the exchange rate mechanisms of the European Monetary System reduces the contribution that that System can make to economic recovery in Europe.

The interrelations between the growth of real wages, output and employment are complex. They determine the growth of living standards and how increased wealth is distributed between the employed and unemployed. The economic systems of the West have a proven ability to atttain high rates of growth in real output and to deliver an ever-increasing array of high quality goods and services to their consumers. Their record in sharing the fruits of this progress equitably among their citizens remains less impressive, however, despite the major expansion of the welfare state since the Second World War. The present high rates of unemployment are the most dramatic manifestation of this weakness since the 1930s. We must hope that the response to this problem will be quick and effective, and help to restore the faith of the present numerous generation of young adults in the value of the system.