Labour-Market Policy:

A Symposium

Patrick T. Geary*
Kieran A. Kennedy
Brendan M. Walsh.

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* Maynooth College
+ E.S.R.I.

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THE BASIS FOR LABOUR MARKET POLICY:

A CRITIQUE OF RECENT PROPOSALS

By

Patrick T. Geary,

Economics Department,
Maynooth College.
1. Introduction

"Building on Reality", the Governments plan for the years 1985 to 1987, projects an unemployment rate of 15½% for 1987. This represents a fall of only ½% from the rate which obtained in April 1984. The expected persistence of such a high rate of unemployment raises difficult questions about the workings of the labour market. The past nine months have witnessed the publication of a number of documents which relate to these questions. In addition to the Plan itself they include the Irish Congress of Trade Unions' "Framework for a National Plan", the National Planning Board's "Proposals for a Plan" and the E.S.R.I.'s "Employment and Unemployment Policy for Ireland".

It is well known that these documents reflect different views about the labour market; reactions to them indicated the existence of further variety. The nature of the differences is one of the concerns of this paper. Another is the extent to which they are a reflection of a dearth of analysis of and evidence on the functioning of the labour market in Ireland and elsewhere. A lack of hard evidence, after all, is an invitation to the flaunting of eccentric opinions, as well as a serious impediment to policy formulation and evaluation.
2. Analysing the Labour Market

A systematic analysis of the Irish labour market would include the following ingredients. The first is a model of the demand for labour. Specifications of varying degrees of complexity are available but they would typically allow for the influence of wage costs, employment taxes, other factor costs and output market conditions. The second is a model of labour supply. Again, the influence of wages and taxes would be incorporated, as would the effect of migration. The supply side could be modelled as competitive or unionised. The third is a model of wage and employment determination. The simplest one is market-clearing; among the alternatives are a disequilibrium model and collective bargaining. The fourth is an evaluation of the relationship between wages, employment and unemployment. This depends not only on the nature of the labour market but also on exactly what published unemployment figures are measuring.

Within such a framework many issues could, in principle, be examined. For example, what are the effects of wages and PRSI on employment? Does unemployment compensation materially raise measured unemployment? Have capital subsidies had a detectable effect on employment? How do income tax and indirect tax rates affect labour supply and employment? Has employment protection legislation had any effect on unemployment? Have trade unions had any effect on employment or wages? The list could obviously be extended. Rather
than looking at aggregates, disaggregation by age, sex, industry, occupation or even region might be contemplated. Even then, longer term issues like the effects of demographic change or structural change within the economy remain to be considered.

The general framework just outlined would probably be convivial to many economists, though of course not all. It is used extensively in the study of the U.S. labour market and forms the basis of much of the recent work on the British labour market.¹ It would be wrong to suggest that answers to all questions of interest have resulted; data deficiencies, estimation problems and inadequate theories have all contributed to prevent it. But enough has been achieved to suggest that the market framework provides a way forward.

A number of the issues just mentioned has been the subject of research in Ireland despite data limitations, among them the influence of migration, demographic factors, unemployment insurance and wages. But the research has not always been within this framework. For example, following the wage-price models of the 1970's, the employment and wage sectors of the large macroeconometric models separated employment (or unemployment) and wage determination. The wage-price models treated unemployment as exogenous; typically, the large models make employment a function of wage costs (among other variables) but wages are determined
separately as a function of prices, productivity and perhaps lagged employment. These practices are common elsewhere; some recent comments on them by Nickell\(^2\) are worth quoting:

"empirical work on wages has... been dominated by the Phillips Curve paradigm with the labour market firmly in the background. By this I mean that wage equations are not typically treated in conjunction with their natural market partner, namely, employment. (p.2)

The important fact to bear in mind is that wage models are part of labour market models. If wages and employment are treated independently, information is lost and ad hoc specifications reign supreme. This is bad theory and bad practice...." (p.25)

3. The E.S.R.I. and I.C.T.U. Documents

It is interesting to look at the E.S.R.I. and the I.C.T.U. documents from this perspective. The I.C.T.U. document doesn't contain a detailed analysis of the labour market; the type of issues raised earlier are not seriously considered. What it consists of is a set of proposals for increased Government intervention in the economy in the belief that this will lead to sustained growth of high wage employment. The I.C.T.U. apparently sees government as a means of achieving a protected position which might be unattainable without its regulating hand and which might insulate trade union members from the hazards and disciplines of the market economy. Especially in a very open economy, this seems to be asking a lot; it would be interesting to
know which economies have achieved such enviable goals by means of the kinds of policies advocated in this document. For the record, they include a national statutory minimum wage, work-sharing and the extension of employment protection legislation; while urging that resources be devoted to training, the document clearly rejects arguments for labour market flexibility and what it calls the "Americanisation" of the Irish Economy.

The E.S.R.I. study was not singled out for criticism by the authors of the I.C.T.U. document, unlike the "Proposals for A Plan". This suggests that there is some common ground between them. One characteristic which they clearly share is their attitude to private enterprise, which mixes contempt for its perceived failures with hostility towards its ambitions. For example, the former refers to "piratical raids" by private firms on successful state ventures while the latter refers to "the selfishness and profit-hunting of private enterprise" (in contrast, no doubt, to the selflessness and loss-hunting of public sector monopolies).

The evident distaste for private enterprise contrasts with the benign attitude to the public sector, which is viewed as a prodigal but reformable rogue and the only hope for employment growth. What is of concern here, however, is not the preference for state enterprise which shines through the E.S.R.I. study but whether it influences the
analysis of the underlying problems and the range of policy recommendations which follow from it.

A serious attempt to grapple with the problem of why the unemployment rate in Ireland is so high would seem to be a useful preliminary to designing policies to lower it. The E.S.R.I. study points to such structural factors as the proportion of the workforce still in the agricultural sector and regional imbalances and to increases in labour supply arising both from population growth and higher female participation rates. In discussing the demand for labour, the emphasis is on the importance of increasing output and particularly exports, with wage costs accorded a lesser role. In summary, the demand for labour depends critically on exports and also on wage costs; the supply of labour is increasing and is much larger than demand. Wage determination is seen as "a struggle between labour and employers....... [in the absence of incomes policy] the outcome would largely depend on the relative bargaining strengths and would serve the objectives of fostering economic growth only fortuitously (p.218). An incomes policy is therefore recommended, supplemented by increased public sector employment to offset in part the limited employment growth potential of the private sector.

The E.S.R.I. view of the labour market is thus that there is a demand for labour and a supply of labour, but perish the thought that the interaction between them should
be allowed to determine wages and employment. It would be reassuring if this conclusion were seen to be the outcome of a studied appraisal of a comprehensive body of Irish and foreign research, but it's not. For one thing, much relevant research remains to be done in Ireland, as the study acknowledges. For another, some of what has been done hasn't been referred to. An example is the literature on job creation and migration flows. As far as research on the labour markets of other countries is concerned, much of it is ignored or overlooked. It is not intended to suggest that its conclusions could automatically be translated to Ireland - there is an Irish problem - but many other countries are experiencing historically high unemployment rates and even in the U.S., unemployment at the peak of the current boom is well above the 5½% achieved in mid 1979.

The constraints on Government macroeconomic policy imposed by its debt position are accepted in the E.S.R.I. study. It might have been expected that this would have focused the study much more on the microeconomics of the labour market than it did. The result is that among the opportunities missed was that of confronting the growing literature on such policy options as marginal employment subsidies and targeted employment subsidies. The former are subsidies which depend on the firm's employment level and thus increase when the firm increases employment. The latter are subsidies which are directed at a particular
category of workers. Two examples which appear in the literature are subsidies paid to firms which are proportional to incremental employment above some specified level and subsidies paid to low-paid workers which are financed by taxes on high paid workers. To date much of the work on these policies is of a theoretical nature so that little can be said about the size of their effects on unemployment. It might be noted that the analyses have a strong labour market orientation but are clearly "interventionist", which may surprise some and appal others.

To conclude this section, both the I.C.T.U. and E.S.R.I. documents are forceful expressions of views which have some key elements in common. But the latter should have been more.

4. "Proposals for a Plan" and "Building on Reality"

The National Planning Board's "Proposals for a Plan" is an even bigger document than the E.S.R.I. study. It diagnoses the unemployment problem in the following way. The supply of labour has been growing rapidly for demographic reasons and because of increased female participation. The demand for Irish output is depressed by the recession and by high costs, both labour and non-labour. Structural factors are also at work. The result is that demand greatly exceeds supply. So far, the analysis
closely matches that of the E.S.R.I. study. The similarities go deeper. Demand and supply must not be allowed to determine wages and employment on the grounds that the market will not produce a proper balance between economic efficiency and equity. Various reasons why this might be so are suggested e.g. the existence of a sizeable Government funded non-market sector. Attention is devoted to special measures to reduce unemployment. Of greatest interest in this context is the Employment Incentive Scheme which is an example of a targetted wage subsidy. That it had some success in 1983 is encouraging. The proposal to modify and reduce employers' PRSI further exemplifies a difference between the general attitude of the authors of this document and that of the E.S.R.I., namely the belief that incentives matter. The kind of models and evidence on which its recommendations are based have to be inferred, given the nature of the document, and that's hard to do. That the assessment of the employment effects to 1987 of its recommendations are obtained from a large macroeconometric model might raise an eye-brow.

The Plan itself calls for limited comment in the
present context. It has relatively little to add about the labour market, although it manages to talk both about making the economy more efficient and about work-sharing. Its position on incomes policy, which is applied only in the public sector, contrasts with the Planning Board and E.S.R.I. positions; whether more will be heard on this question remains to be seen.

5. Conclusion

The general impression obtained from reading all the documents is that, to a greater degree than one would like, policies are being formulated and advocated on the basis of inadequate information. This refers not just to shortages of data or to the quality of data but to the amount of usable research which can be drawn upon in making decisions. That there will be disagreements about the desirabilities of different policies is inevitable, given people's proclivities, but as far as possible assertions should be subjectable to empirical scrutiny.

The existence of persistent high unemployment indicates that the labour market is not working properly. The first important question to be answered is why; when answers are found, the question is whether policies can be devised to make it work more effectively or whether, as some people clearly believe, more drastic surgery is required.

LABOUR MARKET POLICIES AND EMPLOYMENT GROWTH


by

Kieran A Kennedy
Director, Economic and Social Research Institute

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LABOUR MARKET POLICIES AND EMPLOYMENT GROWTH

Introduction

By the end of this year close to 17 per cent of the labour force will be registered as unemployed. This is an exceptionally high level, whether viewed in relation to our own past experience, or the current experience of other OECD countries. What is even more sobering, however, is that none of the three major documents published this year, which addressed themselves to this problem, promised any significant alleviation in the position even three years hence. The ESRI study stated that "the prospect has to be faced that high unemployment will continue for several years, and perhaps even indefinitely if policies cannot be implemented successfully" (Conniffe and Kennedy 1984:323). The Government National Plan (1984:26) envisages that the level of unemployment in April 1987 will be about identical with the April 1984 level, having in the meantime reached a peak in December 1984. While the National Planning Board (1984:xv) took the view that the overall impact of their proposals could "result in unemployment reaching a peak and thereafter falling within the period to which Proposals for Plan 1985-87 relate", no claim is made that the fall would be sufficient to restore even the 1984 level.

While this position is obviously unsatisfactory, I am not aware of any set of convincing proposals that would secure a much better unemployment outcome over the next three years or so. But can we even in the longer-term hold out the prospect of reduced unemployment? I believe that this is the major challenge facing not only the Government but also the economics profession in Ireland.
Why is the unemployment problem considered to be so intractable? There are many reasons, five of which seem to me to be of special importance. First is the prolonged depression in the world economy, followed by the uneven and uncertain recovery. It might be argued that, since the Irish share of markets abroad is so small, even a depressed world economy need not constrain expansion of Irish sales if the latter were sufficiently competitive. The reality is, however, that when world markets are depressed, other countries do not stand still either, but strive to defend and increase their share also.

Thus, for any given competitive effort by Ireland, the performance of exports will in practice be greater the more buoyant are world demand conditions. Moreover, depressed demand conditions abroad inhibit the flow of foreign enterprise investment on which Ireland has depended so heavily for increased exports. Another important consideration is that the depressed labour markets abroad have been a deterrent to emigration at a time of high indigenous increase in the labour force.

Second, there is the overhang of past misuse of resources, unsustainable public borrowing and high interest payments, which limit the Government's current freedom of action in many directions. Third, Ireland has other economic and social policy objectives - such as raising the relatively low average living standards, equalising the distribution of income etc. - which in some cases may conflict with employment creation, and there are limits on the degree to which society is prepared to give primacy to employment. Fourth, like most countries, there is downward rigidity in wages, and any solution is rendered more difficult by the relatively low levels
compared to other European countries. And, fifth, even if wages were flexible downwards, this is by no means the only imperfection that affects the labour market. There are also serious imperfections in relation to technology, marketing, access to capital etc. which can adversely affect the demand for labour.

There are other factors, of course, some of which will be referred to later, but I consider those listed to be the most fundamental.

Development Policies

In principle, at least, the initial thrust of all three of the documents mentioned above is similar. All three see the need to raise the long-term growth rate. All three view expansion of the traded goods sectors as the foundation of that approach, to be achieved by an improvement in competitiveness widely defined. To bring about the improvement in competitiveness, all three advance development, incomes, manpower and other policies. It is worth noting this broad degree of agreement to underline the fact that it essentially involves, implicitly or explicitly, a rejection of a range of views - "work-is-dead", the "leisure society", work-sharing etc. - that have achieved a certain currency in the past few years.

So far so good. But while there is a certain degree of overlap in the specific developmental measures advocated, there is a wide difference - in emphasis at least. Take manufacturing industry, for instance. All three documents purport to give effect to the essentials of the strategy advocated by the Telesis Consultancy Group (1982). But the Telesis strategy has been
understood very imperfectly even by many who profess to support it. It may be useful, therefore, to sketch very briefly the essential elements of that strategy as we at the ESRI saw it.

First, the Telesis report takes the view that there are major imperfections in other areas of the market besides the labour market, and that these imperfections constitute serious barriers to entry and expansion for Irish industry in free trade conditions. Second, the recommended remedy is not to attempt to break down these barriers by creating more perfectly competitive markets: clearly that would be beyond the power of the Irish Government, or indeed perhaps any government. Rather, what the Telesis report is advocating, essentially, is that Irish industry should seek to create a particular set of barriers of its own! In other words, strong companies should be formed which would develop their own specific technological and marketing functions so as to give them a competitive edge over foreign competitors not having similar access to such facilities. Third, the Telesis report believes that this transformation will not take place by the unaided operation of market forces. A major reason for this is that the structure of indigenous industry is such that it does not possess enough companies on the scale required for international success, while foreign firms have not by and large located the key functions here. While the eventual aim would be to develop capabilities in firms rather than in the development agencies - to be achieved by a switch from State services to State grants - there is no doubt that in the initial phases a more active role by at least some of the development agencies would be called for. Fourth, the development of large, stand-alone, companies requires a high degree of selectivity, a
restructuring of incentives and a more active dialogue between government policy-makers and large companies about development plans, with sticks as well as carrots being used. And, fifth, it was explicitly recognised that the policy would be more costly in terms of State subventions, at least in the initial years.

If one examines carefully the Government White Paper (1984) on industrial policy, it is difficult to disagree with the conclusion of Ruane (1984) that "overall it seems reasonable to conclude that the changes in industrial policy announced in the White Paper do not constitute a change in direction" (p.357). Whether this be a good or a bad thing, is of course open to argument: after all the Telesis report is not gospel, and I have voiced some qualifications and reservations of my own (Kennedy 1982). But if a reasoned debate is to take place on industrial policy, then it is important that those who disagree with the essence of the Telesis strategy should spell out their reasons, ideally in terms of an alternative model of development.

The last point applies a fortiori to those commentators who seem to take the view that the unfettered operation of the market constitutes the best recipe for successful economic development in Ireland. I say "see to" because these views have not been articulated in any systematic and comprehensive way. We know that the proponents are against commercial State-sponsored bodies, but what is not very clear is just how great is their faith in the untrammelled free market. Do we need an IDA at all, an IIRS, a NBST etc? What about the CAP? If these deviations from the free operation of market forces are justified, surely there
is a case for toning down a bit the rhetoric of the free market. And could I also here make a plea that, in drawing on ideas from the experience of other countries, we import not just the ideologies but also the key facts. In this connection, I would like to quote a paragraph relating to the United States by Westcott (1983) from the recent Adams and Klein study on industrial policies:

Government PROCUREMENT spending has also had a strong high-technology bias and has helped create winn er industries as well. Over 80 percent of the aircraft industry's output, over 50 percent of the telecommunications-industry's output, and over 40 percent of the electronic-component and machine-shop-products industries' output have either directly or indirectly been dependent on government purchases. Although such procurement has had mainly military rather than industrial objectives, it has fostered high levels of sectoral investment. It has also promoted exports because of the economies of scale or lower average fixed costs that result from effectively guaranteed government markets. Such policies have sometimes even had apparent firm-specific impacts. IBM's prominence in the computer industry can be traced to its nurturing by huge SAGE air-defense contracts, for example. (p.145)

My purpose in quoting this evidence is not to argue that such intervention by the US government is optimal and still less to suggest that our government should intervene simply because the US government does. Instead I simply want to point out
that those who ascribe the supposed superiority of the US in new technology to the free operation of the market are not speaking in accord with the facts.

To conclude on this point, let me say that I would very much welcome a systematic articulation of a free market development strategy for Ireland, since none such exists as yet. Whatever the differences in emphasis and substance between the three documents I have been discussing, all three are massively interventionist as regards development policy. Probably the National Planning Board document is least so on balance, even if some of its specific proposals, such as Recommendation No. 132,\(^1\) go much beyond the other two.

**Taxation**

I think it is not unfair to say that while the ESRI study treated taxation as an instrument of policy, the reduction of tax as a percentage of GNP has been elevated almost to the status of an objective of policy in the Planning Board document and in the National Plan - indeed in the latter document stabilisation of the overall level of taxation is explicitly treated as one of the "essential needs", listed next after reducing unemployment (p.10). This is of course an extremely contentious subject,

1. Recommendation No. 132 is as follows: "Action is needed to ensure that increased profits are invested in Ireland. This could take the form of requiring firms to place increases in retained profits, which had not been invested in Ireland after two years, in Irish Government securities."
and I will confine myself here to stating briefly the considerations underlying the ESRI approach to the issue. First, while not denying the existence of disincentive effects, the research evidence available on the subject, mainly for other countries, does not support the extremity of the statements that are made on the subject, not only by pressure groups but also by economic commentators. At a more general level, some of the countries that are cited for our emulation as regards lower tax rates, like the UK, do not provide much evidence of the massive economic gains that would supposedly follow from lower taxes. On the other hand, some countries which are not cited in this context, like Austria and the Scandinavian countries, seem to have performed well in terms of living standards and employment, despite a higher tax burden.

Second, several major issues seem to be entirely ignored. In regard to the question of incidence, for example, if the estimates of Hughes (1984) are at all near the mark, then the impact of reductions in PRSI on labour costs would be much less than is generally anticipated. It also seems to be taken for granted by some that the public services, cuts in which are advocated to make room for tax reductions, have zero value to the general body of workers — surely a very extreme assumption.

Third, it is implausible to expect that the Government current deficit can be closed in the foreseeable future while at the same time reducing taxes as a percentage of GNP. On the contrary, we believe that it will involve some rise in the overall tax ratio. In the longer term, once the public finance imbalances have been corrected, the scope for reducing the overall tax burden...
is related to the rate of progress in output and employment in the market sector, which will be considered further below.

Fourth, while the overall burden will remain high, there is scope for moderating possible disincentive effects by widening the tax base and restructuring tax rates. As regards the latter, the disincentive/wage push effects of any given tax will tend to be greater the higher is the ratio of the marginal to the average tax rate. However, we would expect the scope here to be less dramatic than is often claimed, if only because equity considerations restrict the degree to which tax rates can be restructured. Much dissatisfaction about the tax burden among PAYE workers arises because of a perception that other groups are not paying a share commensurate with their income and wealth. Implementation of the necessary measures to widen the tax base would help to moderate this dissatisfaction, and would be important to the success of any incomes policy designed to improve competitiveness.

Incomes Policy

While none of the three documents regard wage restraint as a sufficient condition for sustained employment expansion, all three regard it as a necessary condition, though with varying degrees of emphasis. The underlying model being akin to Lindbeck (1979). The takes the view that pay restraint could best be achieved through a broadly-based negotiated incomes policy, and also favour incomes policy by consent, though not ruling out temporary compulsion. simply sets guidelines (the same as recommended by the National Planning Board), but is not forthcoming about how they are to be achieved.
Both the ESRI and the Government National Plan also favour a break in the uniformity of the labour market - to use Lindbeck's term - through a relative reduction in public sector pay. The *quid pro quo* in the ESRI case would be a relaxation of the present public sector employment cuts. In the Government National Plan, the pay cuts form a major part of the reduction in the current budget deficit, with the implied penalty that, since the cash limits are to be treated as fixed, pay increases above those specified would result in still greater public sector employment cuts.

While few economists would dispute that general and relative pay moderation of the kind contemplated in these documents is desirable in the interests of employment, there is no assurance that it can be brought about. Because of the state of the public finances, none of the three documents is able to offer much by way of trade-off for pay restraint in the form of real tax cuts - at least not in the years immediately ahead. This would require a more drastic pruning of public expenditure. Apart from other objections, it would almost certainly be unacceptable to the unions (whose consent is needed for a voluntary incomes policy) if, as is likely, the cuts embraced socially sensitive expenditures or public sector jobs. It may well be, as some would argue, that in the present depressed state of activity, pay restraint can be better secured in the private sector by decentralised bargaining. But the difficulty of coping with the public sector remains. Moreover, activity will hopefully, not remain depressed indefinitely, and there could then be an explosion of pay increases emanating first from the buoyant sectors. A satisfactory incomes policy cannot then be conjured out of the air to deal with such a situation, since it depends on a
sustained development of trust and co-operation.

If as I believe, a negotiated incomes policy holds out the best prospect for long-run pay moderation, then there is a major implication for the way a government should go about planning. It should not announce its full intentions in the form of a plan, leaving the incomes portion to be determined later. The reason is not just that those whose consent is being sought feel they have not been consulted, but, more important, that the government is then left with few bargaining counters. As is well known, eaten bread is soon forgotten.

*Employment Implications*

Probably the single issue which, in the public mind, most distinguishes the ESRI study from the other two is its insistence that, even in the longer term, the regular market sectors would not generate enough jobs to match the growth in labour force, and that public sector job creation of one form or another would be needed. Before giving the reasons for this viewpoint, I would like to make a few clarifying comments. First, public sector job creation did not have an initiating role in the ESRI strategy. Rather, it was seen as contingent on success of other measures. In the short run, it was recommended only if financed by agreed relative cuts in public sector pay. In the long-run, it was seen as possible only with expansion in the traded goods sectors.
Second, the essence of the contention related not to public sector employment per se, but rather to the need for tax-funded employment in non-traded goods and services. It is true that such goods and services are largely supplied by public sector employees in all countries, and we believe that this will be the most common arrangement for the future. But a variety of other supply arrangements are possible—third sector activities, more sub-contracting to private firms, or even the issue of vouchers for education, health, housing etc., leaving the choice of supplier with the user. The choice of method of supply should depend on which gives best value for money.

Third, it is not at all clear that the other two documents dissent from the ESRI viewpoint. Neither tries to look beyond 1987, but in the period up to then both accept the need for state employment creation schemes. Indeed, in the Government National Plan, almost half of the envisaged net increase in total employment of 45,000 is seen as coming from such schemes. Nonetheless, it is fair to say that the impression left by both documents is that such arrangements are temporary—until the market can absorb the surplus.

Why then did the ESRI take a different view—assuming that it is a different view? The following were the major considerations:

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1. Formally, the idea has an affinity to the view of the "role of government as an employer of last resort or a residual purchaser of non-traded goods" developed in the modified Scandinavian model by Söderström and Viotti (1979).
(a) Even given an optimistic view of the success of the development, income etc. policies, the growth of output in traded goods will be constrained by a number of factors – notably the sluggish demand in export markets and CAP restrictions. If, for example, instead of the Government White Paper (1984) target growth rate of 7 per cent in manufacturing output accompanied by an employment growth rate of 2-3 per cent, we could realistically contemplate a Korean-type expansion (15½ per cent output growth rate and 8 per cent employment growth rate during the 1970s), then of course the problem would not arise. The ESRI is not alone, however, in doubting that a Korean-type expansion of manufacturing will be achieved. Another way of coping with the problem would be to develop policies to turn more of our non-traded services (education, training, health etc.) into important export earners, and the ESRI study considered that there were some possibilities in that regard. Curiously, neither of the other two documents has much to say on the subject of marketed services, despite their belief that most of the jobs will arise there!

(b) Productivity growth in traded goods is expected to remain high. No one doubts that agricultural productivity growth will continue to exceed output growth. In manufacturing, some believe that changes in the relative price of labour and capital could substantially reduce productivity growth relative to output growth, involving a better employment performance for any given output performance. Against this, however, the following points should be noted. The estimate of the elasticity of substitution between labour and capital in the ESRI medium-
term model (MTM) is low – about 0.3. Also, the evidence of Denison (1967) and Kendrick (1981) suggests that other influences apart from capital intensity – such as improved allocation of resources, economies of scale and the reduction of the lag in the application of knowledge – were most important in explaining the much higher growth in output and productivity in Europe than in the US in the quarter century after World War II. Because of its lower state of development, these influences are likely to continue to generate high productivity growth in Irish industry for quite some time into the future.

If (a) and (b) hold, then the direct employment impact in the traded goods sector will amount only to a fraction of the growth needed to match labour force growth. I do not think this conclusion has been seriously contested. The objective of the Government White Paper (1984) on industrial policy is to achieve an increase in manufacturing employment over the next decade of between 3,000 and 6,000 jobs a year. Taken in conjunction with the expected drop of 3,000 a year in agriculture, this would mean a combined net increase in the two main traded goods sectors of between 0 and 3,000 a year.

(c) Where disagreement really arises is on the scale of the indirect effects in the rest of the market sector, particularly in services. Expansion of output and incomes in the traded goods sector will of course automatically generate jobs in other market sectors – either through purchases of producer goods as inputs, or through consumer purchases out of higher incomes. But there are a number of factors also which will limit the extent of such induced employment effects: the high import leakages, the fact
that there is overmanning already in some important market services (e.g. transport and communications), while in other services (e.g. banking) labour-saving technological changes are in process of application. Simulations with the MTW are not unduly encouraging in regard to induced employment effects: a 10 per cent sustained rise in real world demand leads to a sustained rise of 2,000 in industrial employment, but only a further 1,000 in market services. Likewise the input-output results are not encouraging either - see O'Riordan (1984). The possibility now being aired that, in the face of sustained unemployment, people will drift in large numbers into low-paid service occupations, seems implausible without drastic changes in social benefits. And the outcome of such drastic changes might well be a considerable acceleration in the growth of what is already in the last decade one of the fastest growing areas of public sector employment, namely defence and security!

In regard to international experience, the remarkable growth of public sector employment in OECD countries in the last 20 years, shown in Table 1, deserves more analytical attention in the context of employment policy than it has received so far. In particular, the contention in the Söderström and Viotti (1979) model that the expansion of the public sector arises not just as a consequence of preferences between private and public consumption but is also associated with political commitment to full employment in an open economy, is an important issue for further theoretical and empirical research.

But will more public employment of whatever form not simply add to inefficiency and the retention of outmoded public services? This is a possible outcome, but not an inevitable one. Restructuring is something that should go on all the time, regardless of whether the overall level is expanding or contracting. In practice, it is not at all clear that restructuring is done any more effectively when the overall level is being reduced. No one would deny the need to improve the effectiveness of public services, but such improvements offer the possibility, if the society so desires, to have more and better public services.

A further doubt in some minds is whether there are in fact additional public services on which more people could usefully be employed. Obviously what constitutes useful work in this context is
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<td>2.6</td>
<td>n.a.</td>
<td>3.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Austria</td>
<td>2.0</td>
<td>-0.4</td>
<td>2.5</td>
<td>-1.2</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.5</td>
<td>0.7</td>
<td>1.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Canada</td>
<td>n.a.</td>
<td>n.a.</td>
<td>4.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Denmark</td>
<td>n.a.</td>
<td>n.a.</td>
<td>6.7</td>
<td>-0.5</td>
</tr>
<tr>
<td>Finland</td>
<td>4.1</td>
<td>0.3</td>
<td>5.0</td>
<td>-0.4</td>
</tr>
<tr>
<td>France</td>
<td>-0.5</td>
<td>0.7</td>
<td>2.2</td>
<td>0.7</td>
</tr>
<tr>
<td>Germany</td>
<td>4.6</td>
<td>0.1</td>
<td>2.5</td>
<td>-0.5</td>
</tr>
<tr>
<td>Italy</td>
<td>2.8</td>
<td>-1.3</td>
<td>2.4</td>
<td>-0.3</td>
</tr>
<tr>
<td>Japan</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.0</td>
<td>1.5</td>
<td>1.9</td>
<td>0.7</td>
</tr>
<tr>
<td>Norway</td>
<td>3.5</td>
<td>0.7</td>
<td>4.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>3.5</td>
<td>2.1</td>
<td>3.9</td>
<td>0.5</td>
</tr>
<tr>
<td>Sweden</td>
<td>4.5</td>
<td>0.2</td>
<td>6.9</td>
<td>-0.5</td>
</tr>
<tr>
<td>U.K.</td>
<td>-0.1</td>
<td>1.0</td>
<td>2.5</td>
<td>-0.9</td>
</tr>
<tr>
<td>U.S.</td>
<td>2.9</td>
<td>1.5</td>
<td>3.9</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Sources: OECD Employment in the Public Sector, Paris, 1982. Updated figures, and some revisions in the earlier figures, have been kindly supplied to the author by the OECD Secretariat. The Irish figures are taken from Conniffe and Kennedy (1984) and relate to the periods 1961-66, 1966-71, 1971-75 and 1975-81. Public sector employment covers public administration and defence, health and education services, and non-commercial semi-state bodies. Private sector employment is measured as total employment less public sector employment.
a matter for social decision, rather than of market test. I believe that there is an almost unlimited amount of activities where there would be a broad consensus that the work was socially useful. The problem lies not in finding enough such activities, but in finding resources to finance even a fraction of them, in determining the order of priority among them, and in managing them effectively.

Conclusion

Both the market and the non-market sectors have a vital role to play in seeking a solution to the employment problem, and neither on its own is likely to be successful. Both have weaknesses that need to be corrected, but both also have strengths that can be built upon. A more general recognition of the profound interdependencies between all sectors of the Irish economy would in itself be an important step towards a satisfactory resolution of the unemployment problem.

Employment policy has a central role in the larger issue of income distribution and redistribution. To the extent that the market system can provide enough jobs for all who are willing and able to work, then this will go a long way towards widely distributing the fruits of economic progress. In that case, the State's redistribution activities could be confined to measures for moderating disparities in after-tax incomes, helping those with many dependants and taking care of those who are unable to work. When, however, the market system, even when given maximum feasible encouragement by the State, still leaves a large and
growing minority of unemployed, the State is now confronted with a more acute income redistribution problem. Realistically, the State can either go on paying unemployment compensation, or it can create or fund jobs. The latter requires more tax revenue than the former, but can add to the supply of useful goods and services.

I believe that the latter course is not only more humane, but in the long-run more efficient - even if it does require maintenance of tax rates at a high level. Given the prospective situation in the world economy, nobody has yet been able to establish convincingly that the market sector in Ireland, no matter how much primed by incentives, grants etc., will itself provide enough jobs to bring down unemployment. In such circumstances it would scarcely be sensible to go on paying people to be idle when there are so many social and environmental needs they could supply. Moreover, the social consensus needed to maintain satisfactory incomes, industrial and other policies, that are essential to the creation of wealth, is unlikely to survive in the face of prolonged unemployment.

Finally, while much attention has been devoted to rigidities that can develop in full employment conditions, not enough attention has been devoted to the resistances to adaptation and the application of technological progress that are likely to arise when there is a prolonged scarcity of jobs. In this connection it is well to recall that Europe up to the early 1970s managed to sustain an unprecedentedly high rate of productivity
growth in conditions of full employment. Europe's performance on both counts far outstripped that of the United States — notwithstanding the much vaunted flexibility of labour markets in the US. And if Europe's performance now is inferior in several respects to that of the US, the explanation in my opinion lies less in structural deficiencies than in the unwillingness and/or inability of European governments to devise co-ordinated reflationalary measures.
REFERENCES


LABOUR MARKET POLICIES

AND

EMPLOYMENT GROWTH

Brendan M. Walsh
University College Dublin
and the National Planning Board

Contribution to a Symposium at the
Dublin Economic Workshop
Seventh Annual Policy Conference
Kenmare, Oct. 20th, 1984
Recent Trends

The contrast between North America and Europe with regard to employment growth over the past two decades is a useful point of departure for a discussion of labour market policies. In Figure 1 the annual growth rates in the labour forces (employed and unemployed) of the two areas are shown. The persistently high growth rate of the American labour force was due both to demographic factors (the effect of the post-war baby boom on the working age population 20 years later and significant net immigration) and to increases in labour force participation rates (especially among women). In Europe, net emigration and a fall in labour force participation rates moderated the impact of the post-war baby boom on the labour force, presumably in part because of the inadequate expansion of employment opportunities in the region.

During the 1970's the growth of the total labour force in Ireland was similar to that recorded in the U.S.:

<table>
<thead>
<tr>
<th>Total Labour Force</th>
<th>Annual Average Percentage Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.America</td>
<td>2.8    1.7   2.0   1.7   1.3   1.3</td>
</tr>
<tr>
<td>OECD</td>
<td>0.7    0.8   1.0   0.8   0.7   0.2</td>
</tr>
<tr>
<td>Europe</td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>1.5    1.7   1.7   2.1   1.5   1.3</td>
</tr>
</tbody>
</table>

Source: OECD, Employment Outlook, Sept. 1984, Table 5.

Moreover, the Irish record with regard to net migration and labour force participation was similar to the American. Between 1971 and 1981 there was a net inflow of 38,000 people aged 15-64 (in 1981), which would account for 23,000 additional workers at 1981 labour force participation rates. The main source of increased labour force participation was among women. The rise in participation
among women between 1971 and 1981 added 44,000 to the labour force. The fall among men reduced the labour force by 42,000. The very rapid growth in the female labour force relative to the female population in recent years has more than offset the decline in participation among older men:

<table>
<thead>
<tr>
<th></th>
<th>Males</th>
<th>Females</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>15 &amp; over</td>
<td>15 &amp; over</td>
<td></td>
</tr>
<tr>
<td>1971-79</td>
<td>1.7</td>
<td>1.3</td>
<td>1.7</td>
</tr>
<tr>
<td>1979-81</td>
<td>1.3</td>
<td>1.1</td>
<td>1.3</td>
</tr>
<tr>
<td>1981-83</td>
<td>1.1</td>
<td>0.4</td>
<td>1.2</td>
</tr>
</tbody>
</table>

*including first job seekers


The fall in the growth rate of the population of working age after 1981 reflects the resumption of some net emigration. The total labour force is estimated to have increased by only 0.9 per cent in 1984 over 1983. (see Building on Reality, Table 1), indicating an acceleration in this trend.

In keeping with the rapid growth of our labour force, the rate of increase of employment in Ireland was higher than in the rest of Europe until 1980. But, since 1980 our record has been very poor even by European standards. The 2.3 per cent decline of employment in Ireland in 1983 was the largest recorded in the OECD in that year. By mid-1984 total employment in Ireland was about 44,000 or 3.8 per cent below the 1980 level. (see Figure 2)
Employment
(Annual Average Growth Rates)

\begin{tabular}{|c|c|c|c|c|c|c|c|}
\hline
\hline
N. America & 3.4 & 0.3 & 0.7 & 1.3 & -1.1 & 1.3 & 4.0 \\
OECD Europe & 0.3 & -0.4 & 0.5 & -1.0 & -0.7 & -0.8 & 0 \\
Ireland & 1.8 & -0.1 & 1.6 & -1.0 & -0.4 & -2.3 & -1.2 \\
\hline
\end{tabular}

Source: OECD, Employment Outlook, Sept. 1984, Table 4 and Table 13

This brief survey of recent trends reveals that during the 1970's Ireland was relatively successful in absorbing a rapidly growing labour force into employment. Since 1980, however, we have suffered an exceptionally severe fall in employment. This has resulted in a resumption of emigration and a moderation of the rise in labour force participation rates, but despite these partial adjustments the rise in unemployment has been very large:

Unemployment Rates
(Percentage of total labour force)

\begin{tabular}{|c|c|c|c|c|c|c|c|}
\hline
\hline
N. America & 8.2 & 5.9 & 7.1 & 7.5 & 9.7 & 9.7 & 7.5 \\
OECD Europe & 5.0 & 5.6 & 6.2 & 8.0 & 9.3 & 10.3 & 11.0 \\
Ireland & 6.3 & 6.1 & 6.1 & 8.9 & 10.7 & 13.8 & 15.8 \\
\hline
\end{tabular}

Source: OECD, Employment Outlook, Sept. 1984, Table 3 and Table 15
As the situation in Europe deteriorated relative to that in America, the situation in Ireland has deteriorated relative to Europe.

Interpretation

The contrast between Europe and America has been intensively studied by economists. For the purposes of this symposium it is convenient simply to quote extensively from a recent OECD survey.*

"Over the ten years to 1983 there was a net creation of 15.8 million jobs in the United States compared with 5.0 million in Japan and a net loss of 1.5 million jobs in Europe. While real GDP growth in Japan was about twice as high as in Europe and the United States, the disparity of employment performance in Europe and the United States arose despite similar rates of real GDP growth" (p.43)

The summary notes the following patterns of employment change by sector:

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Government</th>
<th>Private</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>-0.1</td>
<td>0.3</td>
<td>1.8</td>
<td>12.3</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>-1.5</td>
<td>-0.5</td>
<td>0.5</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>Europe(D,F,UK,I)</td>
<td>-1.6</td>
<td>-3.3</td>
<td>1.9</td>
<td>3.2</td>
<td></td>
</tr>
</tbody>
</table>

*OECD Employment Outlook, No.35, July 1984
It comments

"The impressive employment performance of the U.S. private service sector is reflected in a high ex post elasticity of employment with respect to sectoral output. Despite near-identical output gains, productivity in this sector hardly rose in the United States, while it surged in major European countries, rising by 17 per cent". (p.44)

"Neither differences in the growth of output and of part-time work nor differences in productivity levels provide a satisfactory explanation of observed employment disparity among major OECD regions .....(p.45)

This shifts attention to the behaviour of real labour costs, and here the survey notes a pronounced difference between regions:

Real Labour Costs
Cumulative Percentage Change, 1973-81

<table>
<thead>
<tr>
<th></th>
<th>Manufacturing</th>
<th>Private Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>15.9</td>
<td>-2.8</td>
</tr>
<tr>
<td>Japan</td>
<td>84.1</td>
<td>44.5</td>
</tr>
<tr>
<td>Europe</td>
<td>35.4</td>
<td>18.6</td>
</tr>
</tbody>
</table>
After a further discussion of the possible explanations for the employment disparity between regions, the study concludes that it has been due to four principal factors:

(i) strong real wage moderation in the U.S. private service sector, favouring the absorption of low-skilled labour, the supply of which has been rising faster than in Europe;

(ii) a comparatively small real labour cost gap in U.S. manufacturing and relatively weak incentives to substitute capital for labour; (The relative price of labour compared with capital rose by only 4 per cent between 1973 and 1981 in the U.S., but by 66 per cent in the U.K.);

(iii) a comparatively strong substitution of labour for energy in the U.S. due to more marked changes in relative energy prices;

(iv) and, to a lesser extent, technological catch-up effects reducing the gap between productivity levels in Europe and the U.S.; (p.47)

The contribution of general government (or public sector) employment to the overall growth of employment should be highlighted. The following data summarise the rate of growth in this type of employment by region.
Growth in General Government Employment
(annual average growth rates)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>0.5</td>
<td>2.0</td>
<td>1.2</td>
<td>0.5</td>
</tr>
<tr>
<td>OECD Europe</td>
<td>4.1</td>
<td>3.1</td>
<td>2.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Ireland</td>
<td>3.5</td>
<td>4.5</td>
<td>3.3</td>
<td>2.9</td>
</tr>
</tbody>
</table>


If these figures are related to the data on total employment growth given above, it is clear that there is a negative correlation between the growth of total and of public sector employment. Between 1975 and 1981 the contribution of general government to the growth of total services employment was only 9.0 per cent in the U.S., and total employment boomed. In countries such as Sweden, Denmark and Finland where virtually all the additional service employment was provided by the government, and total employment stagnated (OECD, loc.cit.).

Fallacies

Among the fallacies that have gained some ground in Ireland during the recession are:

* the idea that the contrast in employment expansion between the US and Europe is not amenable to economic explanation but should be attributed to cultural or sociological factors;

* the idea that because public sector employment has in the past increased in most countries its continued growth is a prerequisite of further gains in total employment;

* the idea that Ireland should abandon a low wage strategy as part of its employment policies because it can always be beaten at this game by countries at lower levels of development;
* the idea that we have to be able to predict "precisely where the jobs will be";

* the idea that putting people on public sector pay rolls is necessarily a substantive change from leaving them registered as unemployed.

The first argument need not detain us, because it is tantamount to ceding a central issue in economics to colleagues who claim no expertise in this area.

The importance of public sector employment as an engine of growth is not borne out by the data summarised above. Even if there were a positive correlation between employment in the two sectors in the past, this would not necessarily be relevant to the future. When the public sector is recruiting and offering secure employment to a significant proportion of labour market entrants, it is hardly surprising that these vacancies are readily filled. This may well make it more difficult to recruit in the private service sector. The growth of public sector employment will also tend to pre-empt areas of economic activity that might otherwise have been met through private enterprise. To the extent that the increased public sector employment is financed by increased taxation, there is some offset due to reduced private spending on domestic output, as well to the deadweight costs imposed on the economy by a high level of taxation.

For all these reasons, the growth of public sector employment in the past overstates its contribution to total employment growth and has little relevance to the situation where tax rates and borrowing levels are vastly higher than when the expansion of the public sector began.

The relevance of low wages to an economy such as Ireland, with its rapidly growing labour force, locational and other disadvantages, is obvious, but seems to become lost in a welter of speculation about what we might gain from a more glamorous approach to economic
development. The behaviour of labour costs relative to those of capital has been perverse in Europe as a whole compared with the U.S. since 1970. In Ireland our package of industrial incentives has contributed to this anomaly.* We do not appear to have experienced the downward flexibility of youth wages that has been important in aiding the absorption of the baby bulge into gainful employment in the U.S. (OECD, op-cit, Chapter V). Instead, we are trying to mimic the flexibility of the American labour market through a variety of public sector interventions (levies and subsidies, special employment schemes, etc.) while maintaining high wages in the (shrinking) internationally competitive sector.

The question "where are the jobs?" will only be answered by the interaction of supply and demand over time. No one can accurately anticipate the outcome of this dynamic process. On the demand side, preferences appear to favour sectors such as entertainment, recreation, financial services, etc. There are many areas where there is already clearly scope for additional recruitment. Observation of the Irish economy reveals that many queues persist even during recessions, in areas ranging from banking to specialist medical consultations - I am sure we all have our own favourite examples. We should be studying ways of freeing up these markets so that they can realise their job creation potential. However, much of the extra employment is likely to be on less favourable terms than apply to existing jobs. The manufacturing and related sectors of the economy appear to find it convenient to subcontract as far as possible to non-establishment employees and to hire on a part-time, non-tenured basis. Flexibility is being restored to the labour market in this manner.

On the supply side, the cessation of public sector recruitment has given large numbers of labour market entrants a heightened incentive to exploit opportunities for private sector employment. The result will be a fall in the relative cost of the services provided by this sector (if it is not offset by a rise in the tax burden). These are the conditions that sparked the boom in service employment in the

*See J.D. Fitzgerald, "International Comparisons of the User Cost of Capital", IAUTE, Renvyle 1983.
U.S. during the last ten years. The demand for part-time, adaptable employees has been met through a very responsive supply of women employees.

The last issue I have listed concerns the strategy of relying on increasing public sector employment as a means of alleviating unemployment. To return to first principles, employment has two characteristics: (i) it provides people with a source of income and (ii) this income arises from providing services for which the public reveals a preference either directly through the market or indirectly through payment of taxes. "Jobs" that do not satisfy the second condition are a covert form of social welfare and the underlying problem of unemployment is not resolved by transferring people from registered unemployment to this type of disguised unemployment. The fact that some of those already on the public sector payroll may be in this situation does not invalidate this point - rather it suggests that the magnitude of the unemployment problem may be greater than we realise.

One of the perennial conundrums in the area of employment policy is the extent of useful social and environmental tasks that could be done by the unemployed. There is a tendency to confuse tasks for which we all express vague sentimental support with those that we are willing to pay to have done either directly through the market system or indirectly through higher tax payments. It is all too easy to exaggerate the value that we as individuals or collectively place on certain social or environmental tasks for which we express verbal support. On the supply side, the extent to which suitable people can be recruited from among the unemployed is not clear. The experience of the proposed Social Employment Scheme should be carefully monitored to elucidate these issues.
Conclusion

In concluding I would like to return to the wider context. As the 1980s progress, the growth of the labour market in the OECD will reflect the 1960s baby bust rather than the post-war baby boom. In the U.S., the U.K. and West Germany demographic factors are already causing a deceleration of the growth of the population of working age. The West German case is particularly striking (Figure 3) - in the absence of net immigration the labour force will be roughly stationary from now to the end of the century. In Ireland the potential growth of the labour force will in the absence of net emigration, remain high well into the next decade, but at least the number of entrants has stabilised and their share in the working age population is declining. The rapidly declining number of young job seekers in the three labour markets of most interest to us (the U.K., the U.S and W. Germany) - whose combined labour forces total about 150 million workers - cannot fail to have a profound effect on the prospects facing young people in Ireland by the end of the century.

This comment should not be construed as advocacy of emigration from Ireland. What is propounded is that it would be unwise not to take into account the possible implications for the Irish labour force of the following combination of circumstances -

* a decelerating growth in labour supply in the U.K., U.S. and West Europe brought about by a sharp fall in the number of school leavers;

* a continuation of the rapid rate of growth of the Irish labour force, with the number of school leavers remaining at about its present level;

* a widening of the existing gap in unemployment rates between Ireland and OECD-Europe and between Ireland and the U.S.;
declining average living standards among young job seekers in Ireland due to some combination of high unemployment and falling real (after tax) earnings.

Unless we can dramatically improve on the performance of our labour market in the immediate future, the adjustment between supply and demand is likely to be increasingly by way of net emigration. We are very constrained in the extent to which we can alter this prognosis because many of the prescriptions that have from time to time been advocated as ways of alleviating the unemployment problem involve actions (such as reducing real wages, cutting social welfare payments or imposing a heavier tax burden) that would intensify the incentives to emigration. We are forced by this logic to acknowledge the importance of improving the overall performance of our economy as the most effective way of ameliorating the prospects for our labour market.
Figure 1
DECOMPOSITION OF GROWTH OF TOTAL LABOUR FORCE

Rate of growth of total labour force (changes from previous year)

Contribution of the changes in working-age population

Contribution of the changes in labour force participation rate

OECD/EUROPE

NORTH AMERICA

Year

1970 71 72 73 74 75 76 77 78 79 80 81 82 83

-1.5 -1.0 -0.5 0 0.5 1.0 1.5 2.0 2.5 3.0 3.5 4.0

1970 71 72 73 74 75 76 77 78 79 80 81 82 83

-1.5 -1.0 -0.5 0 0.5 1.0 1.5 2.0 2.5 3.0 3.5 4.0
Figure 3
Trends in Working Age Population

Entrants: Population Reaching School Leaving Age
Exits: Population Reaching Retirement Age

"Labour Force Participation: An Analysis with Projections",
by James H. Chan-Lee, January 1984