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DISCUSSION PAPERS

WAGE-DETERMINATION AND LABOUR MARKET ADJUSTMENT:
THE LESSONS OF ALTERNATIVE WAGE-FIXING SYSTEMS

Glenn Withers

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Abstract

Wage determination and labour market adjustment under alternative wage-fixing systems are reviewed. It is found that the Australian arbitration-based wage-fixing system does not produce a more egalitarian wage structure than other systems. Similarly the Australian system does not produce relative wage flexibility divergent from overseas systems. Indeed, no system examined is found to be particularly responsive to disaggregate market pressures. But at the aggregate wage level major differences do emerge, with U.S. and U.K. absolute wages being relatively inflexible in relation to labour market adjustment pressure and Swedish and Japanese wage levels being more flexible than Australia. Consensus and co-operative approaches to improved labour market performance, along Swedish or Japanese lines, are reviewed. Should consensus fail in Australia, the need for a wage-inflation tax is outlined.

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Wage Determination and Labour Market Adjustment:
The Lessons of Alternative Wage-Fixing Systems

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WAGE DETERMINATION AND LABOUR MARKET ADJUSTMENT:
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I. The Importance of International Perspective

Australian discussion of wage determination is parochial. There is, in Australia, an almost hypnotic fascination with the arbitral system and its trappings, with the result that appropriate perspective on wage-fixing and economic problems is lost. In particular this "navel-gazing" leads to the perpetuation of too many myths, whether held by Left, Right or Centre, such as:

- * arbitral wage-fixing is a vehicle for protecting the weak while moderating the strong
- * decentralised wage-fixing will necessarily make for a more responsive wage system
- * centralised wage-fixing will necessarily moderate inflationary pressures.

Each of these strongly held views is either plain wrong or subject to substantial qualification. And the best way to see this is to turn away from introspection and to examine instead Australian wage-determination in broader international perspective.

A productive comparison is with the U.S. and U.K. For example, the Australian Treasury ideal would be to free Australia of arbitration, and of labour and corporate concentrations. It is the U.S. that is the closest real-world approximation to this free-market ideal (putting aside Hong Kong). However abolition of arbitration would not necessarily de-concentrate labour and industry in Australia. Accordingly, decentralised collective bargaining U.K. style might well be more likely to emerge.

For these reasons U.S. and U.K. comparisons may be, and have been, taken as benchmarks. But, for other reasons that will become apparent, it will be advantageous to extend the comparisons to Sweden and Japan, as the paper proceeds and where evidence is available: Sweden representing centralised bargaining in the context of consensus-based incomes policies, and Japan representing integrated

enterprise bargaining (though any such simple description of the Japanese system is inevitably inadequate).

II. A More Equal Wage Structure?

A useful starting point is with the criterion of social justice. A major defence of the Australian arbitral system is that "the difference between the wages paid to weak and strong unions is likely to be smaller" (Portus, 1971). And this belief has no doubt been influential in explaining the past attachment of the community to the arbitral system.

The available evidence on wage structure is that compulsory arbitration in Australia has not produced a significantly more egalitarian wage structure, when compared to the wage structure under alternative wage-fixing systems. The evidence is contained in a series of studies, commencing with Hughes (1973), which compare wage structures between Australia, U.K. and U.S.A. This comparison is done on a number of different bases; industrial, occupational, socio-demographic, intra-firm etc. In all cases the basic conclusion is the similarity of pay relativities across the countries. There are glosses on this as regards some skill differentials and as regards the speed and extent of movement toward equal pay for men and women, but the dominant impression is of very similar wage patterns. This is particularly true for simple rank-order correlations but it also holds up well for numerical correlation, including that of coefficients of variation used to examine pay dispersion (Brown et al 1978, Norris 1980).¹

If the Australian wage-fixing system is largely unrelated to matters of social justice, in the sense that alternative systems do not produce notably divergent wage structures, then in terms of the "great trade-off" of equity and efficiency, the other major issue is that of economics.² Certainly much of the contemporary public discussion of the Australian wage-determination arrangements is conducted in terms of which arrangements would be most conducive to sound economic management and outcomes.

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Also see the papers by Norris (1983) and Mulvey (1983) at this conference. Mulvey's findings are especially instructive since the new micro data available on earnings in Australia affirms a close similarity of Australian, UK and US human capital earnings functions.

2

Since the given topic is wage-determination and labour market adjustment, industrial relations matters proper are put aside and treated as implicit in much that follows.

This means two things—relative wages and absolute wages, and it is useful to look at each in turn.

III. Relative Wage Flexibility

The concern with respect to relative wage determination is whether the labour market cannot only help to clear present unemployment problems (mostly an aggregate concern to be examined later), but also can adequately adapt to such changes as continued high labour force participation of married females, further strengthening of "equal pay" principles, pursuit of shorter working hours, and also to changes in international trade patterns (mineral exports, manufactures competition) or major changes in international migration levels and patterns. Similarly, in the longer run, there is the question of whether the labour market is flexible enough to effectively absorb the technological changes and to foster and accept the education, management and training changes that may be necessary to sustain recovery and guarantee enhanced per capita real income growth or greater leisure.

In principle a well-functioning labour market could directly reduce inflation by removing wage spill-over and bottleneck effects, and it could directly enhance employment and growth by re-allocating labour to shortage and high growth areas. The economist's idealised image of such a well-functioning market is the auction market, whereby relative prices adjust quickly to accommodate changes in underlying supply and demand forces. Along these lines the Australian Treasury (1979), for instance, has concluded that:

the arbitral tribunals, awards, national wage cases and other paraphernalia of the Australian system (including, notably, unions and employers insulated from competitive forces) must, in important respects, have led to less favourable results than those which might have been attained under a more market oriented system (p.53).

Similar statements are now contained annually in Budget Statement No. 2. This is a view that the former Treasurer, Mr Howard, also currently represents within the Federal Opposition.

In practice how well does the Australian system of relative wage determination facilitate labour market adjustment? The studies in the Hughes tradition cannot help us greatly here since they do not look at wage changes and they do not relate wages to economic pressures for adjustment. The studies are helpful for looking at the equity content of wages not their efficiency content. However, recent studies by Blandy and Richardson (1982) and by Keating (1982) have suggested that

there may be more flexibility and adaptability in relation to economic need in the Australian labour market than previously thought. But there are problems with these studies. The Blandy and Richardson chapters are really only qualitative and selective and rely very much upon broadening the definition of wage adjustments to include "wage-like" instruments and "quality" changes. Indeed Gregory (1983) cites the study as showing "the relatively minor role played by changes in wage differentials across firms and industries" (p.26). Clearly the evidence in the Blandy-Richardson collection is ambiguous at best. The Keating work is more embracive and it is more formally quantitative than Blandy-Richardson and it concludes that only small relative changes have been needed to produce large labour shifts in Australia. But the study simply does not produce statistically significant econometric results that support the conclusions reached. Further the estimating model used assumes and builds into the estimation what must ultimately be tested viz. the existence of equilibration through relative wages. Finally, neither Blandy-Richardson nor Keating make international comparisons.

Accordingly the Bureau of Labour Market Research supported a study by Withers, Pitman and Whittingham (1983) which was economy-wide, cross-country comparative and quantitative, and which sought to test directly how much relative wages do respond to market imbalances under alternative wage-fixing systems viz. Australia, U.S., U.K. and Sweden.

The study proceeded by using tests of statistical causality to relate relative wage changes to labour market pressure in industrial and regional labour markets in each of the countries indicated. The test was really a "sophisticated" form of correlation analysis and essentially involved asking whether labour market pressure (measured by relative levels of unemployment and vacancies) adds anything to the statistical prediction of relative wage changes.

The test was applied to quarterly data from 1966 to 1981 for six or more industries in each of the four countries, and for regions and states in the U.S. and Australia. Over 40,000 data points were collected for the exercise, covering wages, employment, vacancies and unemployment.

The key relationship tested was that between labour market pressure (measured by unemployment rates or by unemployment/vacancy ratios) and rates of relative wage change. Extensive testing for lags in such a relationship were conducted and

the stability of any such relationships reviewed. A stable zero relationship meant simply that market pressure did not add to explanation of wage change.

The conclusion was that rates of change of relative wages were in fact determined quite independently of the micro-economic market balance, even allowing for substantial lags (up to 3 years) in such influences making themselves felt. And, most importantly, this result held irrespective of the institutional form of the wage-fixing system and applied as much to the relatively free market U.S. system as to the highly unionised and arbitration-based Australian system.

For the economic theorist the important implication of this is that 'sticky wages' should be recognised as inherent (i.e. "endogenous") to labour markets and not merely the product of external (i.e. "exogenous") institutional factors, such as a legal minimum wages. Models that assume that auction-type competitive labour markets somewhere underlie the existing labour system are merely committing a 'grass is greener' fallacy.³ In fact relative wages are evidently determined by forces more fundamental than national wage-fixing institutions and these forces are not those of simple competitive markets. Sophistry will permit this finding to be consistent with saying that "supply and demand" has a role, but only in a manner far removed from auction-style competitive market theory, and only as a camouflage for the more fundamental forces of scarce attributes, technology and social attitudes common to the countries considered and about which economics presently has limited knowledge. Phrases such as 'implicit contracts', 'internal labour markets', 'interdependent utilities' and the like begin to capture some of the problem, but these analyses are still in a primitive state. 58

The policy implication of the empirical findings regarding relativity movements is that policy directed at removing interventions in labour markets is misguided if it hopes thereby to produce substantially more efficient labour allocation through flexible and responsive relative wage movements.

The implications for academic theorising are developed further in Withers (1983). The argument is that implicit contract and internal labour market theory are an appropriate route for improved understanding of the micro-economic foundations of labour markets, particularly if such analyses can then be rendered consistent with the non market-clearing general "equilibrium" literature.

IV. Absolute Wage Flexibility

What of the absolute wage level? What can we say about aggregate wage determination and the wage-fixing system? What is the responsiveness of aggregate wages in relation to aggregate market disequilibrium?

The Phillips Curve of the 1960s saw wage inflation as being moderated by unemployment. But this relationship became increasingly difficult to find in Australia just when Treasury was, of course, relying on it most to defeat inflation by an army of the unemployed. But even before the mid 1970s economists were already finding it difficult to estimate significant unemployment impacts upon wage-inflation. Certainly no long-run trade-off could be found in the face of real wage maintenance (Hagger 1978). And, even in the short-run, the nature of the trade-off was hard to pin down. Its statistical significance and stability were elusive. By the 1980s the whole unemployment-inflation configuration had clearly shifted and now Bob Gregory (1983) has declared the Australian Phillips Curve trade-off, partial or otherwise, dead: aggregate wage determination in Australia does not now reflect the level of market imbalance.⁴

In the cause of greater absolute wage responsiveness, should we therefore change our wage-fixing system? Our present system seems now unresponsive to unemployment. To answer this, even in principle, we need to look again at the overseas evidence. Table 1 shows a clear commonality as regards the change in configuration between the 1960s and the 1970s. For all countries, the inflation-unemployment combination is worse. But, given this, is wage responsiveness different across countries? The evidence is provided in a study by a team from the London School of Economics. Grubb, Jackman and Layard (1983) estimate Phillips Curves for all OECD countries using annual data 1960-1980. What is impressive about this work is not only the benefit it provides by having a common model, common data period and standard definitions applied simultaneously to a range of countries, but also that the model used takes full account of the Phillips Curve history mentioned above. It not only examines the wage inflation-unemployment

4

Wage determination is a matter of "implicit contract" relationships between the firm and its long-term labour force, in Gregory's view. The only reason for wage growth moderating with unemployment increases is that the unemployment increase correlates with reduced profitability of firms. It is the profitability reduction, not unemployment, that explains wage moderation at that time. "Higher but steady levels of unemployment will not be a significant factor restraining the rate of growth of real wages" (Gregory 1983, p.18).

relation, but does so in the context of other variables that can shift the configuration, including the equilibrium unemployment rate and prices. (The former allows for institutional and structural changes affecting unemployment such as unemployment benefits and married women's labour force participation. The latter allows for price expectations and does so in a simultaneous way to allow for the "vicious circle" of wage-price feedback.) Finally the authors test for residual stability problems (and claim there are none), and accept previous findings that there is long-run neutrality, so that the model tests only for the short-run Phillips' Curve.

The key empirical element in the model is the coefficient relating wage inflation and unemployment.⁵ If zero, any direct link between wage determination and market balance is broken. And the finding is that, for the U.K. and U.S., this relation is not significantly different from zero. However, for Australia the relation is small and marginally significant, and it is more significant for Sweden and very large and significant for Japan. This is a finding largely consistent with Gregory's observations for Australia, but it puts those in suitable international perspective i.e. the U.S. and U.K. systems of wage-fixing are even worse than Australia in terms of aggregate wage responsiveness, the Swedish system is a little better and the Japanese system is a lot better.⁶ These findings hold irrespective of whether the wage test refers to nominal or real wage rigidity.

V. Whither Wage-Fixing?

On the empirical evidence available there is nothing to choose between wage-fixing systems as regards equity and microeconomic efficiency. But there may be some small advantage in Australian over U.K. and U.S. arrangements in aggregate wage responsiveness, but less so than for countries like Sweden and, especially, Japan.

5

This differs from the Withers et al (1983) tests regarding disaggregate wages since, by being expressed in relative terms, the disaggregate analysis can ignore price effects—a major factor for aggregate analysis.

6

These results are also affirmed, using causality testing of wage responsiveness, for U.S., U.K. and Japan by Gordon (1982).

The question is in which direction would Australia go without arbitration? It can be argued that the arbitration system itself institutionalises conflict. It requires formal adversary relations and it limits the incentive to resolve industrial problems at the work-place level. Accordingly removal of arbitration but retention of present consensus-directed incomes and prices policies could move us more in the Swedish direction.⁷

On the other hand removal of arbitration without incomes policy could well move us more in the British direction. After all British collective bargaining does take place largely at the work-place level, so that bargainers are very much aware of the consequences of their positions, as Treasury would advocate. But the underlying industrial ethos is clearly such that improved outcomes can hardly be said to result. It is also possible that the Australian industrial ethos is sufficiently British that consensus-policies imposed from above will have poor foundations and attempts to emulate Sweden's past relative success will only collapse into a more British style of wage-fixing with short-term fits and starts of incomes policies imposed on the decentralised collective bargaining, all to no great effect (Gruen 1983).

Can the underlying industrial ethos be improved? Can conflict be replaced by co-operation at the work-place? The elimination of arbitration might help a little. But further major institutional innovations would be necessary in Australia for real improvement. Dan Mitchell (1983) has argued strongly for a system which he terms "gain-sharing". This requires linking wages to profits rather than to inflation, and preferably at the enterprise level. Certainly the Japanese bonus system—a form of gain-sharing—helps to explain its greater wage responsiveness and its avoidance of stagflation. Such a system could be implemented at the macro-economic level simply by the Arbitration Commission indexing awards partly

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Sweden's greater wage responsiveness is also associated with a superior wage inflation-unemployment position (Table 1). This too could be emulated in Australia since it is likely to be largely based upon employment subsidies. The Hawke government has moved in this direction with the Community Employment Program. But its scale is still limited relative to Swedish manpower schemes and, in what is a rare display of socialist zeal for the Hawke government, it is restricted to public and non-profit sector employment. Yet marginal targetted private employment subsidy schemes can increase employment and reduce unemployment at half the cost of either public sector schemes or tax cuts (OECD 1982). The recent pessimistic impression of job-subsidy schemes given in Gregory and Smith (1983) is misleading since it refers only to the limited pre-CEP job-subsidy schemes where, by definition of the limited scale of the programs, and with the partial exception of the RED scheme, little overall impact on unemployment could be expected.

to overall profitability and/or unemployment and not just to prices. As Mitchell says "In effect, the Commission can write a desired Phillips Curve slope into its awards" (p.39).

But the Commission presides. It does not rule nor indeed do the other central parties. It could be predicted that aggregate gain-sharing would not get far due to lack of co-operation since there would still be no necessary co-operative spirit at the constituent level, and one cannot be optimistic at the prospects for improvement at this level either. Sweden, which is a seemingly more cohesive society than Australia, is currently experiencing a disintegration of its wage-fixing system over attempts by the union movement to develop union-managed investment trusts funded by compulsory employer levies. This particular move to formal gain-sharing is being strongly resisted, exposing either the breakdown or non-existence of genuine co-operative relations in Swedish industry too.

Certainly Sweden's poor productivity growth record indicates that all along it may have had no real advantage over Australia. Its cumulative productivity growth for the 1970s is below both Australia and Britain (Table 1).

The apparently superior system is that of Japan.⁸ But presumably it is not the system but Japanese society, of which the operation of the system is merely a reflection. Thus the British wage-fixing system is also effectively enterprise-based (though not company-wide) and it incorporates elements of life-long employment and wages paid by experience—the "Three Sacred Treasures" of the Japanese system. Yet, unlike Britain, the Japanese wage level is more responsive (perhaps the bonus element) and it is accompanied by major productivity growth, which equally reflects its cohesive social arrangements and makes adjustments so much easier. Thus Japan delivers not only wage responsiveness but also, unlike Sweden, high productivity growth, both presumably being a product of a social cohesion and commitment to mutual advantage that is not easy to emulate.

But there are lessons for others there including the need to recognise in discussions of the effects of high "real wages per efficiency unit of labour" (to use a Treasury phrase⁹), that such high unit labour cost reflect both wages and productivity. To seek to lay blame for high unit labour costs upon wages and to

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Though note that much Japanese achievement in obtaining low levels of unemployment is due to high levels of female hidden unemployment.

9

Murphy and Brooker (1983).

seek a solution solely in alteration to wage-fixing arrangements, is to miss both the possible futility of wage tinkering and the equal or greater importance of facilitating productivity growth. Creative bureaucracy in Japan does not consist in hankering after a non-existent competitive labour market, but rather in contributing constructively to the enhancement of productivity growth.

Partial answers to enhanced productivity growth for Australia can be offered including product market deregulation (especially tariffs and quotas), tax reform (toward a direct expenditure tax and indirect tax cuts), and industrial training reform. But these are clearly only partial answers. As Hahn (1982) has put it:

Economic theory does not provide an answer to Weber's famous question why Britain rather than China should have been the first to have an Industrial Revolution. Nor, indeed, has economic theory much helped in accounting for the Japanese post war sprint or for the relative British decline. Plainly there are here crucial elements which go beyond market signals and market behaviour (p.19).

It is important in economics to emphasize clearly what we don't know, as much as what we do know. It was Joan Robinson who pointed out that a major purpose of studying economics was to learn how to avoid being deceived by economists. Unfortunately it is in the area of productivity growth that we know least but it matters most.

VI. Explicit and Implicit Wage-Tax Policies

If the path to co-operative prosperity is elusive, and continuing conflict more likely for Australia, can anything else be done? One remaining option is to accept our industrial ethos as unalterable in the short-run (without forgoing efforts to remedy this in the longer-run) and to try to minimise the present costs. The present prices and incomes policy does try to do this. But what happens when consensus fails? The government has not told us, anymore than the then Fraser Government could tell us what was to happen after the wage pause. But there is one answer, and had Prime Minister Fraser been effectively advised of it and adopted it, he might still have been in office today. One suspects that it was lack of an answer as to what happens after the wage pause that most caused Mr Fraser to lose his cool and to appear as a man cracking under pressure and lacking in direction and constructive purpose.

The policy innovation is nevertheless one that could be adopted by either side of politics instead of falling back on blunt and ineffectual demand management when temporary income restraints fail. The policy is that of an employer wage inflation tax,¹⁰ and it could even be a useful adjunct that might enhance the survival prospects of the present (Hawke) prices and incomes policy.

A number of variants of such a scheme could be considered, but the approach that could integrate well with the present Australian Prices and Incomes Accord would be to impose a tax on employers, on hourly wage increases above a prescribed norm. The norm could be arrived at after consultations with the business community and the union movement so that, as a product of consensus, the tax would apply to the total wage bill of excess wage increase firms. Only a minority comprising "mavericks", would be penalised. Those adhering to the norm would receive no change in financial position. Others with below-norm increases in their wage bill could receive a tax-benefit (remember the norm is specified in terms of wage bill not wage rates), so that the policy could combine anti-inflation and pro-employment incentives. Despite some assumptions to the contrary, it would be an administratively simple system operating readily through existing PAYE or company tax mechanisms.

Finally, the wage inflation tax would be a permanent institution, so avoiding the problem of what happens when the other elements of an incomes policy end? It could remain in place indefinitely because it permits unions to freely carry on bargaining and employers to decide what is best for them. There is no ongoing regulatory bureaucracy or political interference, only a greater incentive to reduce above-norm wage bill increases and to expand employment instead.

Such a system would seem worthy of consideration in place of retreat into monetarist restraint. The evidence expounded earlier shows that resource allocation would not be affected significantly by such a scheme, since relative wage changes have no clear general re-allocation role, and it also shows that demand management cannot any longer, if it could before, reduce inflation via unemployment in Australia. Even the massive unemployment levels of the 1930s, in a time of more limited social welfare rights, did not reduce real or nominal wages in countries like the U.K. and Australia (Glynn and Booth 1983, Bonnell 1981).

¹⁰

Greater detail of how such a scheme might operate in Australia is provided in Withers (1982) and Gregory (1983). Chapman (1983) provides a real-wage insurance alternative.

A wage-inflation tax scheme is, in fact, already implicit in the warnings that unions who pursue extra wage claims will be denied national wage increases and that the Prices Surveillance Authority will preclude price increases which are the result of wage settlements outside the centralised system.

This penalty system could be formalised properly and so provide an answer for Mr Willis' claim that "little or nothing of a positive or constructive nature, however, is heard from the critics as to what might be put in place of the well-established concepts of conciliation and arbitration". A wage-inflation tax would mean that something is in place if and when consensus fails. But perhaps the government is being subtle. It is already imposing an implicit wage-inflation tax by stealth as part of the Prices and Incomes Accord. In this way interest group opposition may be more muted relative to an explicit introduction of a wage-inflation tax. Success will still depend upon whether the sanctions adopted by the Arbitration Commission and to be accorded the Prices Surveillance Authority have "teeth". And this will not necessarily be apparent until employment recovery begins to re-exert pressure on the wage system. Nevertheless these sanctions are operating in the right direction.

Table 1 Economic performance indicators: selected OECD countries
(percentages)

	Australia	USA	UK	Sweden	Japan	OECD Average
<u>1960-67 (annual average)</u>						
Price Inflation	2.3	1.8	3.4	4.0	5.6	2.7
Unemployment Rate	1.9	5.1	1.4	1.5	1.3	3.1
Real GNP Growth	4.9	4.6	2.9	4.5	10.2	5.1
Balance of Payments/GNP	-2.3	0.7	-0.2	-0.1	-0.1	0.3
<u>1967-73 (annual average)</u>						
Price Inflation	5.5	4.5	6.6	5.4	6.7	5.1
Unemployment Rate	2.0	4.5	2.4	2.2	1.2	3.4
Real GNP Growth	5.4	3.6	3.4	3.6	9.5	4.9
Balance of Payments/GNP	-1.4	0.1	0.0	0.4	1.1	0.3
<u>1973-81 (annual average)</u>						
Price Inflation	12.0	7.9	15.6	10.3	9.1	10.2
Unemployment Rate	5.2	6.8	4.7	1.9	1.9	5.4
Real GNP Growth	2.5	2.3	0.9	1.8	3.7	2.5
Balance of Payments/GNP	-2.2	0.1	-0.8	-1.8	0.1	-0.4
<u>1973-81</u>						
Nominal Wages, p.a.	13.1	8.2	17.0	12.1	11.0	11.5
Productivity, cumulative	11.0	1.0	12.0	3.5	26.0	13.0
Employment, cumulative	7.5	17.5	-6.0	10.5	12.0	7.0
Real Wage, cumulative	13.0	0.5	11.0	12.0	38.0	17.0

Source: OECD, Historical Statistics, Paris, 1982.