LABOUR MARKET FLEXIBILITY -
TO WHAT END?

by

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1. Introduction

Changing economic circumstances demand an adaptive social response. Under the impact of a sudden shock it is easier to overcome inertia, and thus remove institutional anachronisms which benefit nobody, than when change is gradual. There is no doubt, therefore, that when the macroeconomy is in a dire condition the time is ripe for consideration of a range of strategies, all aimed at improving productive efficiency. But how should we manage this change?

The laissez-faire position asks us to entrust ourselves totally to unfettered market adjustment. The existence of social cost is not denied, but since no alternatives are to be contemplated there is little attempt made to evaluate the quantitative and qualitative dimensions of this social cost.

At stake, however, are not only the social ramifications of poverty and the decline of morale, self-confidence and self-esteem, but also straightforward demands on economic resources which are not readily justifiable.

The mounting demand to allow markets a freer rein has recently focused on the labour market, often subsumed under the notion of the need for increased "flexibility" at the enterprise level. The question then is, when is it warranted to engage in a major institutional reform which grants a high level of flexibility at the enterprise level and which permits major changes in work conditions, including a large reduction in the size of workforce? What could be the consequences of such an institutional reform?

The issue can be discussed in terms of three possible scenarios. First, improved organization which eliminates pure waste while maintaining employment clearly represents an unambiguous improvement in productivity of the economy as a whole. In the language of game theory, we would be talking about a positive-sum game, with everybody being made better off.

In contrast, growth in output per worker resulting from longer working hours and an intensified pace of work, is a distributive, rather than productivity-enhancing, measure. If workers already work long hours and the conditions of work are arduous, productivity growth becomes a euphemism for pure and simple exploitation.

Finally, there is yet another class of change which generates genuine productivity increases that enable a genuine rise in economic welfare, but only for a sub-set of the population. Productivity growth then primarily takes the form of increased profits and wages for those remaining within the enterprise, but the shed workforce experiences acute deterioration of its standard of living. There is strong statistical evidence to indicate that such dualism has taken place in the UK during the 80s, where the rise in the output per worker has been associated with large scale retrenchments, while the wages of the workers who have retained their jobs, and firms' profits, have increased sharply (Rowthorn, 1989).
Large scale restructuring of production at the enterprise level which is not accompanied by substantial expansion in the product market will inevitably involve the shedding of labour. Unless such labour is absorbed in another part of the economy in reasonably dignified alternative employment, productivity gains will largely represent distributive plays, with the winners riding on the back of the disenfranchised.

We thus face a choice between two extremes. One is an exclusive reliance on enterprise level reform, with no comprehensive programme of relocation for the displaced workforce. This will, in all likelihood, generate a classical dual economy under the banner of market efficiency. The other is a social commitment to the comprehensive provision of retraining within the public sector.

However, the establishment of a public system of human resource transfer on the required scale and level of quality faces a major hurdle. Advocacy of equity and the adoption of interventionist measures entail swimming against the prevailing current.1

Economics has, unwittingly, contributed to this state of affairs, particularly through the 'equity/efficiency' dichotomy which is usually at the core of these debates and which often provides the impetus for rejecting equity agendas in the name of efficiency imperatives. Another obstacle which has played into the hands of supporters of blanket deregulation is the widely held belief, among both proponents and opponents of laissez-faire, that economic science tells us to place our unreserved faith in market adjudication, at least on 'efficiency' grounds.

Yet this is not only a strictly incorrect representation of pure microeconomic and general equilibrium theories, but also a rather biased description of the sentiment prevailing among economists about the pursuit of wide reaching laissez-faire regimes in practice.

Similarly, the equity/efficiency dichotomy is a flawed analytical construct. Unfortunately, however, its shortcomings have long ago been swept under the rug, and so the concept remains current.

The present paper is structured around three interrelated axes. First, it takes issue with this conventional dualism of equity and efficiency concerns. Second, it argues against the identification of efficiency with the pursuit of non-interventionist economic policy.

Third, the paper argues that the rhetoric of 'efficiency' has obscured some obvious distributional aspects of deregulation and flexibility so keenly sought by employers in reaching employment agreements with individual employees. Whether the proponents of deregulation are fully conscious of the distributive consequences of their reform agenda or whether they are largely driven by ideological motives is entirely irrelevant to the nature of the argument put forward. The crucial point is that, unless society permits the government to embark on a comprehensive retraining programme at the required level of quality, improvement in living standards of the majority will be at the expense of a drastically disenfranchised minority.

1 Demands for deregulation of the labour market also appear to have drawn on the strength of the belief that the Australian system of wage fixing has been egalitarian and to an excess. However, this view does not tally with the historical record of wage fixing in Australia (Gill, 1988).
II. A Critical Look at the Equity/Efficiency Dichotomy and the Efficiency Attributes of Unfettered Markets

(1) The pitfalls of the equity/efficiency dichotomy

Efficiency is a readily defined concept — it simply says that efficiency is achieved when a given goal is reached with minimal cost. The efficiency of any mode of organization, therefore, cannot be defined until the goal of that organization is defined. In formal terms, a society achieves economic efficiency when the value of the social welfare function achieves its highest potential value given the set of (resource) constraints. Equity must form an integral part of the goal for which economic resources are deployed in any society which is at all concerned about this aspect of its system of production and distribution. A society which places a premium on equity and then proceeds to erect a system which is not at all designed to attend to equity fails to achieve allocative efficiency! Logically, equity and efficiency are, therefore, not opposites to be traded-off against each other.

The term ‘efficiency’, as it appears in the policy parliance, is really a misnomer. Continuous misuse of the term is unfortunate, because it endows that which denotes, at best, the aim of maximization of income per capita with the aura of a logically, and indeed even morally, compelling rationale. This latter is embedded in the notion of the efficiency maxima per se — to be inefficient is to be irrational and wasteful (it is easy to see why in a world where resources are scarce we are ethically bound to condemn wastefulness). But to attend to maximization of income per capita, in disregard of the distributional consequences (whether intra- or inter-generations) is surely not efficient except for extremely narrowly focused societies.

Economists are well aware of the fact that the conventional use of the term efficiency is a euphemism for what really denotes maximization of average income. However, the fact remains that it loads the debate in favour of the pursuit of higher income, playing down distributional goals. Traditionally, we have separated the questions of efficiency and equity, structuring production in terms of 'efficiency', which effectively boils down to maximizing average income. We then assume that the question of distributional equity can be addressed separately through the fiscal system. But this practice sweeps under the rug some disturbing problems.

First, there are limits to the fiscal system's ability to redistribute income, especially given the overall reluctance of politicians to raise taxes from the public. Secondly, it is inevitable that laissez-faire steps taken to maximize 'efficiency' will have distributional ramifications which cannot be redressed through the fiscal system. Even with the best will in the world, society cannot adequately compensate those individuals who find themselves serving as a buffer-stock for microeconomic productive efficiency. As I argue below, the generation of such buffer-stock is a likely consequence of the type of labour market reforms being advocated at present.

(ii) Economic theory on the efficiency of market adjustment

Let us set aside for a moment the question of equity and focus on the efficiency question in its conventional form, which identifies it with the maximization of average per-capita income. How compelling is the argument that laissez-faire, in its ability to deliver such a goal, is superior to any form of more interventionist economic regime? While there are economists who would
argue that this is indeed the case, it remains true that (mainstream) economic theory does not compel us to support this proposition.

Economic theory does have a concept of efficiency which is linked to a concept of perfect competition, but both concepts are confined to so-called equilibrium states. Theory proposes only that if the economic system satisfies a given set of (rather unrealistic) conditions and if it has actually reached a state where supply and demand are everywhere in balance, then and only then, have we reached an efficient allocation. In what sense? In the sense that a small departure from equilibrium which upsets the balance of supply and demand by a notch would generate loss for some individuals which could not be offset by the gain accruing to other individuals. A departure from equilibrium would thus diminish the size of the social aggregate. In contrast, movement converging on this equilibrium, if such a process could actually be implemented, would generate a surplus which if properly distributed would generate no losers and (at least) some winners.

All this is honest logic which leaves open the question of whether unfettered market adjudication can form a genuine shuttle system which will successfully transport us to such a promised land. The question of convergence to this putative efficient equilibrium (as distinct from the set of assumptions needed for the existence and uniqueness of such equilibrium) has recently been the subject of a voluminous literature which models the consequences of more realistic assumptions. This research, as one analyst has recently summarized it, shows

"how hard it is to tell a sensible disequilibrium story with a competitive ending [emphasis is mine]." - Hey, 1979, p.181.

Finally, there is one more area of analytical development which merits attention because it throws into question the conventional signs of market malfunction. Traditionally, when prices do not fluctuate frequently and readily in response to changes in demand, and where resources are not as mobile as many people believe they should be, there is a tendency to feel that efficiency is being compromised. However, recent theoretical developments within microeconomic (as distinct from general equilibrium) theory offer a host of propositions which substantially diminish the frequency with which prices and quantities can be expected to change. Most importantly, this literature explains in rational terms a whole array of practices which are castigated as manifestations of institutional rigidity, or the machinations of irrational individuals, when viewed in the framework of the basic microeconomic model. Such practices, this literature concludes, often manifest superior efficiency properties when examined in an orthodox frame of analysis which incorporates more realistic axiomatic assumptions describing the opportunity sets agents face.2

A logical outcome of the analysis is that efficiency, even when defined simply in terms of the maximization of income per capita, can be better served by a structure which sets limits on the prerogatives of market forces. Consequently, we face a troublesome identification problem. We must distinguish between benign and malignant departures from the simple elementary textbook description of (perfectly competitive) market adjustment. Likewise, we must distinguish between institutional arrangements which in all likelihood augment productive

2. These include the internal markets literature (Doeringer & Piore, 1971; Williamson, 1975; Wachtel et al., 1978; Gill, 1984), implicit contracts analysis (pioneered by Azariadis, 1975 and Baily, 1974), the 'efficiency wage' model (Stiglitz, 1980) and the 'exit/voice' framework (Hirschman, 1970; Freeman, 1976; Freeman & Medoff, 1979, 1984).
efficiency and those representing pure anachronism. These can in principle operate at all levels - enterprise, industry or economy-wide. It clearly follows that blanket dismantling of regulation could be worse than even anachronistic 'regulatory' structure.

In summary, the thrust of the theoretical literature is that there is very little likelihood that unfettered market adjustment offers a readily available adjustment mechanism, even if the pursuit of maximum average income per capita was the sole goal of economic life. It is much more likely that the optimal system will involve significant intervention. Such a system has yet to be designed.

III. Flexibility to What End - Efficiency or Distribution Agenda

(1) The distributive agenda

Flexibility is not intrinsically virtuous. It can be a virtuous agent when in the service of a virtuous cause, but it can also be a euphemism for a desire to attain the flexibility necessary for pure and naked exploitation of newly found economic bargaining power.

In an economy where unemployment remains as high as it has since the mid-70s, and where the prospects are that the situation will remain largely unaltered well into the future, employers are presented with a radically changed set of employment options. The high rate of turnover, so problematic for industry in the 60s through the early 70s, is matter of the past, at least as far as low-skill workers are concerned. The sharp decline in voluntary quit rates (and therefore labour turnover rates) among workers as unemployment levels soar has been a well established statistical observation (Kiessner & Goldsmith, 1987). Workers with long tenure at a given enterprise, supporting dependent children, and/or well into middle age, are encumbered by firm-specific skills which are non-transferable and by mobility costs which are involved in dislocating whole households. They are also confronted by the fact that, in the majority of cases, age becomes a major disadvantage by the time people reach their 40s (even though they are still a quarter of a century short of the mandatory retirement age).

Such workers cannot simply quit their jobs at the slightest deterioration in their pay and work conditions. These pay and work conditions can be pulled down by the combined amount of the value of their specific skills and the mobility (including retraining) costs before quit becomes a significant threat. If the prospects of an alternative job are rather abysmal, this margin is even bigger. This margin represents 'economic rent' which can be extracted from the employee leaving his/her supply of labour intact. Economics proposes that this economic rent can be extracted by the employer in a sufficiently deregulated industrial environment. Stripped of their bargaining power in a largely de-regulated environment, such workers become vulnerable to exploitation.

The shift of economic rents from one group to another is a distributional matter having little to do with 'efficiency' as conventionally understood. This is a poignant matter. As the macro labour market deteriorates, as alternative employment opportunities become more scarce, the economic rent accruing to a worker increases. When the chance of an alternative job becomes nil, the total difference between the current wage and the unemployment benefit represents an economic rent. It matters little whether demands for radical deregulation
of the labour market are driven primarily by ideological
"worship of the market" or by conscious desire to
redistribute income, the fact remains that redistribution
of what are primarily economic rents is a very real
possibility which must be recognized in any design of
labour market reform.

(ii) Re-employment of the displaced worker

Available statistics reveal that the duration of
unemployment increases with the age of the worker. Two
distinct sets of causes underlie the difficulty faced by
older workers when trying to regain gainful employment.

One is the very uneven rate of growth between the
manufacturing sector (where most shed labour originates)
and the retailing, services and the finance sectors
(where the bulk of employment has occurred). Most middle-
aged blue-collar workers will therefore have to leap
across wide occupational chasms.

The second factor is the limited ability of the private
sector (using on-the-job-training) to equip workers with
skills other than those related to the idiosyncrasies of
production in the particular firm.

On the other hand, when workers must be equipped with
general (transferable) skills, the risk of what is known
as 'poaching' becomes crucial. Further risks emanate from
what economic theory describes as (trainee) 'quality
uncertainty'. A firm which engages in substantial
training undertakes risks which demand that expected

3. This phrase was coined by one of the architects of
Arrow-Debreu general-equilibrium model in a critique of
the New Right's position on the role the market should
play in economic affairs (Arrow, 1974, p.16).

benefits exceed the expected cost by a margin which
depends on the perceived degree of uncertainty. Large
scale training, in contrast, enjoys reduced uncertainty,
because of the 'risk pooling' effect. Furthermore,
suitable training facilities may be entirely unavailable
within the confines of the individual firm.

Qualitative constraints aside, the scale of training
capacity which is made available by enterprise is highly
dependent on the scale of production. On-the-job-
training is thus a derivative activity whose volume is
guided strictly by the level of activity in the product
market, a fact which explains the perennial shortage of
skilled workers whenever the economy &parts from the
trough of the trade cycle.

In addition, the long term unemployed often need
counselling (including psychological rehabilitational
help) as demonstrated, for instance, by programmes such
as Jobtrain. Indeed, Jobtrain attests to the need to
equip job-seekers with a battery of skills which form an
effective entry ticket into private sector employment. In
other words, there are training needs which cannot be met
by firms not only because on-the-job-training does not
always provide the required capacity, but also because it
simply lacks the required facilities themselves.

Empirical observations

Statistical data tracing the labour market experience of
workers displaced by plant closures and large-scale
redundancy retrenchments remain meagre. However, what
evidence we do have corroborates the theoretical
expectations I have outlined above. I would like to draw
on two particular studies. The first is an Australian
study which deals with a recent case, while the second is
an American study which deals with an earlier episode in the 60s.

Despite the lapse of time the parallels between the two cases are striking. The two groups of workers share demographical characteristics: middle aged men and women, many members of ethnic minorities, with low levels of literacy. They were retrenched after a long tenure with one firm, and most of them possessed non-transferable skills; in fact most of the workers in both groups were formally described as either semi-skilled or unskilled.

The Australian study is Richard Curtain's longitudinal analysis of the fate of the workers who were retrenched in Bankstown with the closure of one of Email's plants in 1982 (Curtain, 1985, 1987). The American study focuses on the aftermath of the closure of 6 meat packing plants of the Armour company, at the time (1959-60) the second largest meat packer in the US (Shultz & Weber, 1966).

These two redundancy cases differ in one important respect. Email's workers were helped only with lump sum redundancy payments. The workers were then left to fend for themselves. In contrast, in addition to severance pay, Armour workers were provided with intensive training tailored to individual needs (new crash courses were set up when necessary), counselling and job placement assistance. In addition, the program provided financial assistance during the training period. This difference in treatment did bear different results.

In Email's case, almost one third of the retrenched workforce were still without work and wanted a job when interviewed two years after their retrenchment date (Curtain, 1985, p.12). Those who found gainful employment often experienced a

"...slide from skilled to semi-skilled, or from semi-skilled to unskilled work." (ibid., p.54).

Eighty per cent of the respondents experienced a deterioration in both their earning level and physical work conditions. Personal and familial emotional problems were also evident (ibid., pp.50-51).

Curtain concludes

"The effects of redundancy, therefore, are not only to do with direct displacement of a significant proportion into unemployment for a considerable length of time. There is also the indirect displacement of skilled into low skilled and low-paid jobs...it is not easy for blue collar workers from manufacturing industry to switch to other sectors where employment has grown over the last decade." (ibid., pp.54-5).

In the US the establishment of the Automation Fund Committee was motivated by the fear that, left to fend for themselves, Armour's retrenched workers would fall victim to the experience Curtain describes above. The authors were adamant that retraining was a precondition for re-entry into gainful employment:

"The displaced Armour workers had dim employment prospects in anything but a tight labour market." (ibid., p.7).

4. e.g. in the US in Oklahoma City the median age was 40 for male and 45 for female. Half of the group of trainees had less than eight years of education.

5. Labour market conditions were not too different. Local unemployment levels in the American cases were as high as five per cent, somewhat lower than Australia's in the 80s, but on the other hand, the Sydney Metropolitan area offers a larger pool of opportunities than the relatively smaller towns involved in the American case.

6. They estimated that only 10 per cent of the workforce in a large meatpacking plant possessed "identifiable skills which can be utilized in other industrial situations without supplementary training..." (ibid., p.7).
And again,

"... formidable handicaps may be imposed by the fact that many displaced workers, who have been long accustomed to a specific job, have no particular skill to offer to a prospective employer in another industry. If workers are not to be relegated to the unskilled labour pool, some form of skill development must be brought into play [emphasis is mine]."-ibid., p.196.

The experience which Shultz and Weber amassed in the course of this ambitious project with which they were closely associated is surprisingly pertinent to the economic realities of the 80s.

Clark Kerr, then President of the University of California and George Shultz, then Dean of the Graduate School of Business at the University of Chicago, were the co-chairmen of a committee (jointly staffed by the employer and by two trade unions) overseeing a comprehensive retraining programme which prepared workers for a whole range of jobs not only within but also outside the manufacturing sector.

This programme and the funds which were made available by the employer were established under the collective bargaining contract in 1959 as part of a redundancy package negotiated between the unions and the employer. The 1959 contract was reached after a period of industrial conflict which was precipitated by a series of plant closures by Armour, beginning in 1951. The authors conclude that

"Collective bargaining has helped produce a greater awareness of the magnitude of the problem where casual indifference might have prevailed...It has sought some acceptable basis for distributing the costs and benefits of the new technology among those who are directly affected."-Shultz & Weber, 1966, pp.46-47.

The experience of this project is documented in the fascinating book co-authored by George Shultz and Arnold Weber. Kerr, in his foreword to the book, summarized the accomplishment of the programme in the following words:

"...one can only express surprise and gratification at how much a relatively modest sum... can still accomplish in the right hands."-Shultz & Weber, 1966, p.viii.

However, Shultz and Weber caution,

"Retraining is not an automatic process; rather, it requires painstaking attention to the supporting arrangements and the conduct of the courses."-ibid., p.136.

The second factor emphasized by the authors is the availability of adequate financial support for trainees to ensure entry into the retraining programme and to minimize the drop-out rate. Success, the authors say, can be achieved

"...only when training facilities are available and financial support for trainees is forthcoming."-Shultz & Weber, p.136.

They end with a happy note. Their involvement with the programme, they say, suggests that

"...it does seem feasible to retrain displaced workers who have limited educational background. Such training may not result in immediately high earnings, but it does seem to help in finding new jobs and in giving a new occupational orientation."-ibid., p.171.

7. The authors warn: "the price of low [financial] support in a lengthy programme is a high dropout rate (p.139).

8. They also warn their readers, stating that "Public attitudes toward financial aid to unemployed people who are taking training have puritanical tinge. It is frequently assumed that aid will promote malingering and subsidize the idle. This argument is just as erroneous when applied to retraining programmes as it has been elsewhere. Training is an arduous experience for the unemployed worker, and can scarcely be considered institutionalized malingering." (p.150).
Indeed, the results can be described as remarkably successful. The drop-out rate was just 10 per cent. Unemployment among workers completing the training was virtually nil. Many workers managed to cross solid occupational borders, despite advanced age, low literacy levels, and extremely specialized and narrowly based employment histories.

Sweden has proven that the Armour story can be replicated on a national scale, and sustainably so. In particular, large numbers of timber workers from Sweden's deep north were lured south into the metal industry plants, with a combination of carrots (generous dislocation grants, intensive retraining, readily available housing and a promise of employment) and sticks (less generous unemployment benefits for those reluctant to engage in the combined geographical and occupational move). Most of them were transferred from lumber workers into fitters and turners and other metal trades, in specially tailored (full time) "crash courses", often within periods shorter than one year (often as many as two per cent of Sweden's workforce have been in retraining in any single year). Upon completion of the courses they have been hired by the burgeoning metal engineering industry which has supplied over half of Sweden's export earnings throughout most of the post-World War II era.

Sweden's national manpower programme, it must be emphasised, forms one arm of a more comprehensive policy designed to secure economic restructuring which aims at minimizing the cost of resources involved in the process of economic adjustment while progressively compressing the pay structure. Thus the retraining programme in Sweden is not used as a step for eliminating existing unemployment, but rather as a preventative measure. Similarly, it is not a vehicle for dispensing ales to needy, but rather an arm of a major redistributive strategy aimed at the entire income structure.

IV. Conclusion

Economic reform is often genuinely needed. However, demands for reform can also arise from the distributional aspirations of social groups who feel that economic and political circumstances favour their bargaining power. Thus, although reform rhetoric invokes the 'public interest' and productive efficiency as the objects of change, a desire for redistribution of economic rents also plays its role. Whether proponents of blanket de-regulation of the labour market are actually aware of these opportunities, or whether they are primarily motivated by ideological motives, the fact remains that the creation of a disenfranchised minority is a very likely outcome of reforms envisaged by proponents of radical de-regulation.

This paper has focused on the equity/efficiency dichotomy which is at the core of the framework within which labour market reform, and social policies in general, are often discussed. In particular, issue has been taken with the notion of efficiency embedded in this dualism. The paper has also taken issue with the proposition that (mainstream) economic theory compels us to embrace unfettered market adjustment whenever maximization of average income per capita is the sole goal of socio-economic organization.

9. Sweden obviously does not subscribe to the Anglo-Saxon system of apprenticeship training as the mainspring of skilled worker training.
Finally, the paper has concluded with the proposition that a public system of human resource transfer is vital, not only because it takes the edge off the distributional consequences of economy-wide sectoral restructuring, but also because it constitutes an adjustment path that in the final account would make smaller demands on economic resources. Empirical observations have been brought to bear on the analytical arguments underpinning the need for a public system of human resource transfer. In particular, the paper has argued that the experience of retraining workers displaced by the Armour company in the US and Sweden's experience with comprehensive retraining programmes at the national level, attest that everybody can be retrained provided they are endowed with sufficient quantitative and qualitative educational support.

Unless society permits the government to embark on a comprehensive (and on-going) retraining and placement programme at the required level of quality, improvements in the living standards of the majority will be at the expense of a drastically disenfranchised minority.

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