

## **The Australian labour market: The more things change...\***

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It is a pleasure and privilege to be invited to present the 2014 Giblin Lecture. A pleasure to be back at the University of Tasmania where I have had many happy visits and to see again lots of people who have been my colleagues at various points over the past 25 years. A privilege to be presenting a lecture honouring Lyndhurst Falkiner Giblin.

Those of us who work as economists in Australia today owe a great debt to the pioneers of the profession in this country: Giblin, Copland, Clark, Brigden, and Shann. They built an extraordinarily solid foundation, and provided examples of what being an economist can mean that are still inspiring today. Of course they were all outstanding intellects and highly able; they made contributions to theory and measurement in economics; and they were concerned that the teaching and study of economics should prosper. The most valuable legacy I think they provided, however, was to demonstrate, right from the outset, the practical value of economics - How it could help to think about and contribute to solving many of the big problems facing society.

If you want an example of this, I don't think you can do better than look at Giblin's work on 'The problem of maintaining full employment'. This was a talk he gave in 1943 as his contribution to a series of lectures on 'Realities of Reconstruction'. The experience of the Great Depression still being fresh in people's minds, and having had a taste of full employment during WW2, Giblin forecast that what Australians would '...want more than anything else after this war is - prevention of unemployment' (p.4). But this would not be easy to achieve. Full employment in WW2 had been attained with many limits on economic activity and freedom; and where 700,000 Australians had worked in the armed forces. Giblin therefore thought that a problem confronted democracies such as Australia: Would it be possible to maintain full employment during the phase of adjustment from war to peace? And to Giblin this was a problem of the utmost importance, presenting a '...a very direct challenge to democracy' (p.5) at a time when there was still much questioning in the western world of whether democracy was the right political system.

Giblin's analysis of the problem starts out with an arithmetic exercise. He estimates the number of soldiers and workers for whom new jobs or activities will need to be found once the war finishes - a figure he puts at 850,000. Giblin then works through how many of these soldiers and workers can remain in the armed forces and munitions production, how many can return to sectors such as agriculture where labour rationing occurred during the war, how many would be needed for extra housing construction, how many will go to education and

training, and finally, what would be the effect of a likely increase in disposable income on job creation. Out of this exercise Giblin, correctly as it turned out, concluded that full employment was feasible.

The other potential difficulty, Giblin recognised, was that the adjustment of soldiers and workers into new jobs would take time – and that this adjustment process could cause problems for the Australian economy, such as high inflation, that might prevent full employment being achieved.

After the war Australian consumers would have accumulated savings that they would be seeking to spend, and there would be a high demand for Australian exports. Time lags in getting the capital equipment needed to produce the new mix of output being demanded, and in moving workers into the new jobs to produce that output, would however mean that the supply of output could not be increased so quickly. As Giblin wrote (p.15): ‘...in the immediate post-war period we shall have a large spending power and not much at first to spend it on...’. The policy solution, Giblin argued, was ‘...the necessity of controls for the transition period’ (p.17). To match the timing of increases in spending to the growth in output it would be necessary to maintain high levels of taxation, controls on investment and consumption, and the capacity to direct labour - although as Giblin also forecast, quite accurately ‘Controls are irksome, and there will be a very strong political outcry...’(p.17).

Giblin’s treatment of the labour market situation facing Australia at the end of WW2 is a masterful demonstration of the practical value of economics. It combines economic concepts and theory with a deep knowledge of the Australian economy and some simple empirical analysis to come up with important insights - directed at a major social problem with the objective of providing constructive proposals for policy.

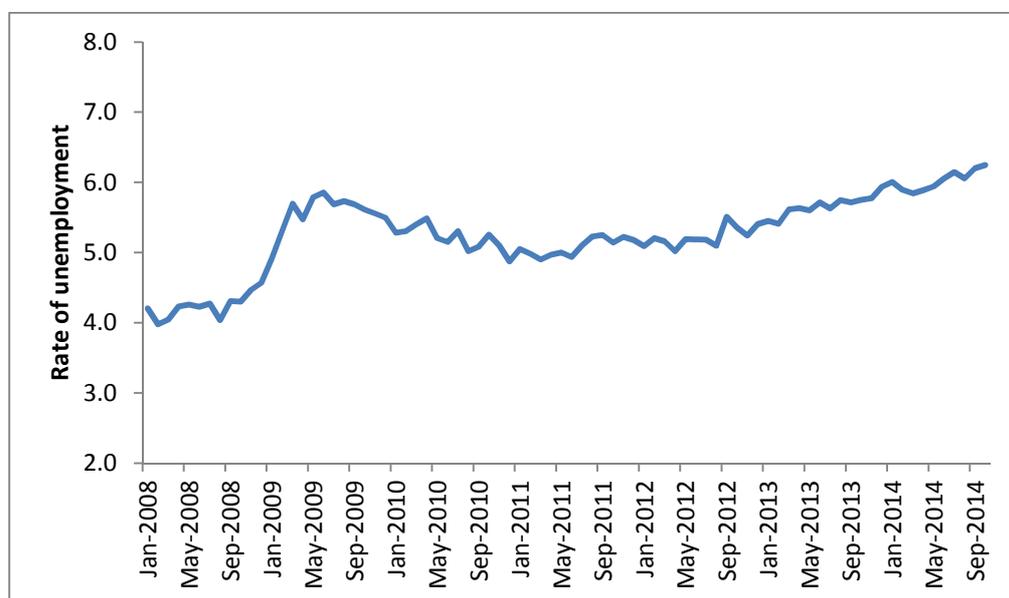
In this talk I am going to address the same topic as Giblin – the unemployment problem in Australia; and I am going to try to go about the analysis in the same way as Giblin – beginning by understanding the nature of the problem and finishing by saying what this means for policy-making. There will also be another major theme in my talk – the value of taking an historical perspective. I want to show how a big part of understanding the causes of what is happening to unemployment today is to know the history of unemployment in Australia.

While the problem of unemployment in Australia today could not be argued to have the same consequences for democracy, I do want to make the point that I have chosen my topic more than just for the reason that Giblin had examined the same topic. I have two reasons. First, I don’t think there has been enough attention – especially by policy-makers - to the current unemployment situation in Australia. Second, to my way of thinking, some of the discussion that has occurred has been misdirected – and I believe strongly that getting the policy right involves having a correct understanding of the problem we are dealing with.

The talk is in four main parts. First, I'll summarise developments in the rate of unemployment since the GFC in 2008. Second, I'll discuss the causes of the increase in the rate of unemployment that has occurred. Third, I'll specifically address what we can learn from history about the causes – primarily, that it confirms the current episode is primarily cyclical. Fourth, I'll evaluate several main policy options for dealing with unemployment.

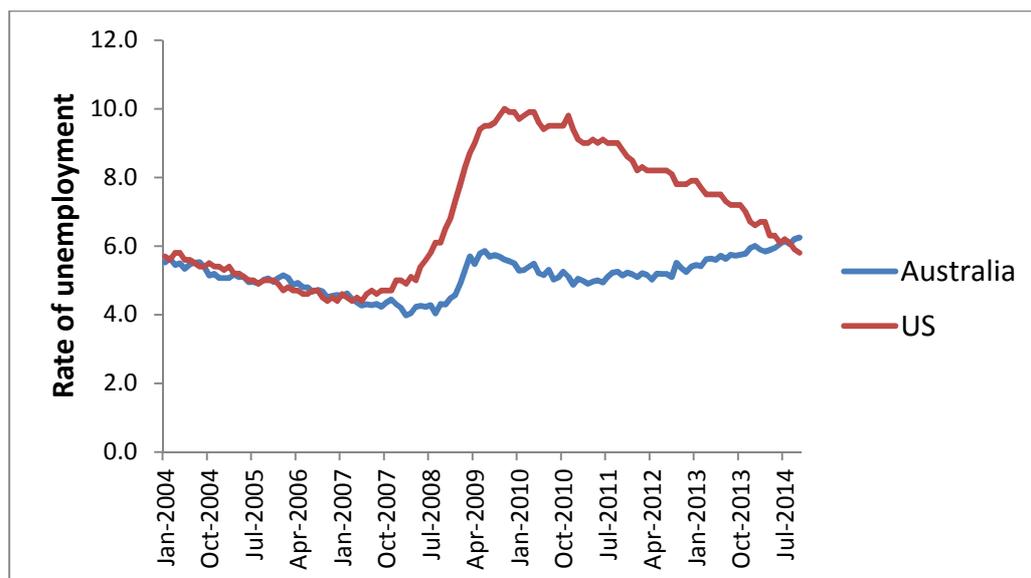
#### *Recent developments in the rate of unemployment*

During the long boom from late 1993 till the GFC in mid-2008 the rate of unemployment in Australia had decreased from over 11 percent to 4 percent. Immediately following the GFC it rose to almost 6 percent, but then fairly quickly fell back to 5 percent where it remained until late 2012. Over the past two years the rate of unemployment has again risen to be just over 6 percent. This can be seen in Figure 1.



**Figure 1: Rate of unemployment, Australia, Persons, 2008/1 to 2014/10 (monthly; seasonally adjusted)**

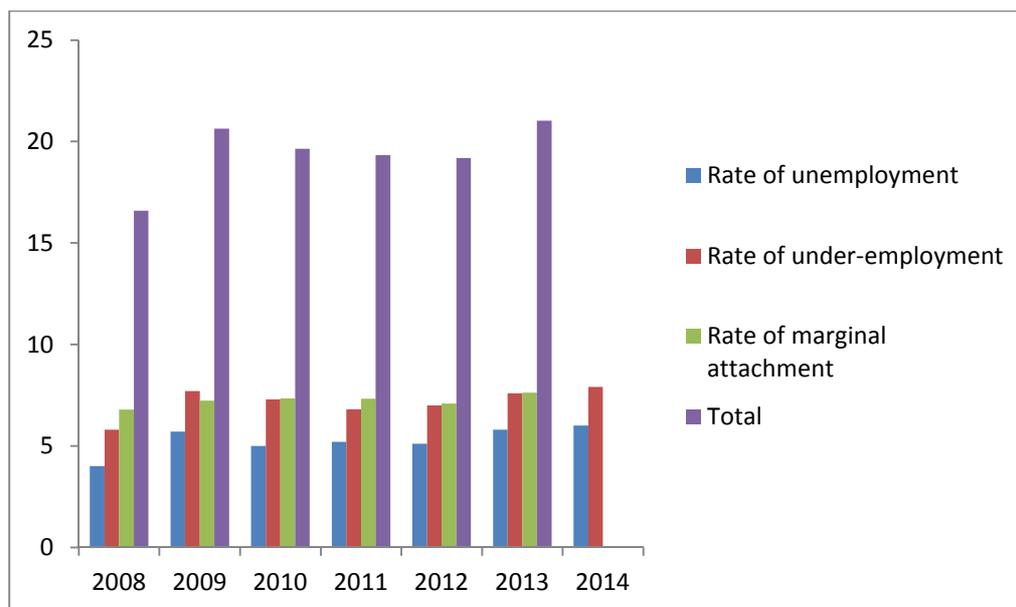
A rate of unemployment of 6.2 percent may not seem a severe problem; after all, it was above this level for 104 months out of 254 months since the peak of the previous recession in August 1993. Yet it has now been six years without there being any sign that the rate of unemployment might return to the level prior to the GFC; and over the past two years it has consistently increased. We now have a situation where, despite the much smaller initial impact of the GFC, the rate of unemployment in Australia is above the rate in the United States. Figure 2 shows the rate of unemployment for both countries from January 2004 to the present.



**Figure 2: Rate of unemployment, Australia and United States, Persons, 2004/1 to 2014/10 (seasonally adjusted)**

Furthermore, it does not take large increases in the rate of unemployment for there to be substantial costs for Australian society. First, there is the loss in economic output. For example, if just one-half of the current unemployed in Australia shifted into jobs where they added the same amount to GDP as the average productivity per worker in June 2014, it would add 3.1 percent to our total GDP. Second, we know that unemployment imposes substantial costs on individual well-being. Being unemployed means being at the bottom of the distribution of income, below-average health status, and lower life satisfaction (see for example, Borland and Kennedy, 1998, pp.91-97). For example, one recent study using longitudinal data from the HILDA survey found that switching from employment to unemployment made males 32 percent less likely to have high life satisfaction (6 to 10 on a 10point scale), and females 49 percent less likely (Carroll, 2007). And it is not just outcomes today that are affected by being unemployed – It casts a long shadow. Being unemployed today, or a longer history of unemployment, lowers the probability of being employed in future time periods (Le and Miller, 2001; and Knights et al., 2002).

It is also important to note that the rate of unemployment is only a partial indicator of under-utilisation of labour in the economy. Once account is taken of persons who are in employment but would like to work more hours, or who are marginally attached to the labour force, about 20 per cent of the potential workforce in Australia is currently having its labour inputs under-utilised. Figure 3 shows this measure for 2008 to 2014.



**Figure 3: Measures of under-utilisation of labour, Australia, Persons, 2008 to 2014 (September)**

#### *Causes of the higher rate of unemployment*

There are two main points I want to make about why the rate of unemployment in Australia has increased. First, I will show that the increase in unemployment since the GFC has been due to a slow-down in employment growth. Second, I will argue that the slow-down in employment growth appears to almost entirely reflect a slow-down in the rate of growth in economic activity in Australia. In other words, I don't believe that structural factors have thus far played a major role in causing the rate of unemployment to rise following the GFC.

The first point can be demonstrated via a decomposition of the causes of the change in the rate of unemployment between August 2008 and October 2014 that is presented in Table 1. It shows that the net effect of changes to employment/population rates since the onset of the GFC has been to increase the rate of unemployment by 3.7 percentage points. By contrast, changes in the labour force participation rates have reduced the rate of unemployment by 1.5 percentage points over that time. Disaggregating the effect of employment reveals that it is large decreases in the full-time employment/population rates for males and females which have been the source of the rise in the rate of unemployment; accounting for a rise of 5.1 percentage points. That effect has been partly offset by increases in the part-time employment/population rates (mainly for males) that have lowered the rate of unemployment by 1.4 percentage points.

	<b>Rate of UE</b>	<b>Males – FTE/POP</b>	<b>Males – PTE/POP</b>	<b>Males – LF/POP</b>	<b>Females – FTE/POP</b>	<b>Females – PTE/POP</b>	<b>Females – LF/POP</b>
2008/8	4.0	59.7	10.1	72.6	31.1	24.9	58.6
2014/10	6.2	55.0	11.5	70.8	29.5	25.2	58.5
Effect on change in rate of UE	+2.2	+3.8	-1.1	-1.4	+1.3	-0.3	-0.1

**Table 1: Sources of changes in the rate of unemployment – Australia – Persons – 2008/3 to 2014/10 (seasonally adjusted)**

Note: The decomposition is derived from:

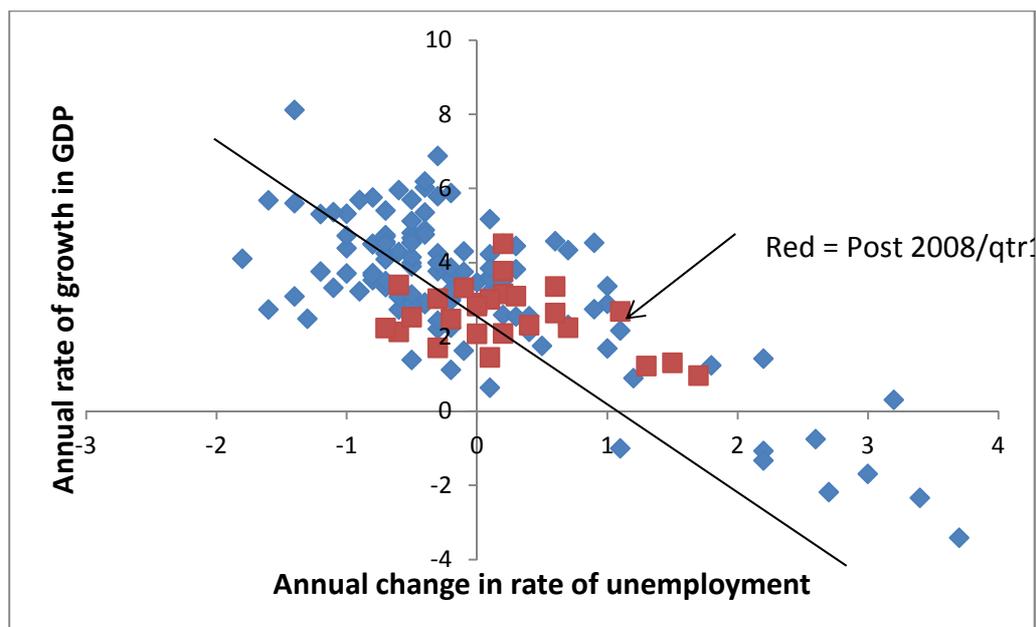
$$RUE_t \approx -\ln[\alpha_{mt}((FTE/POP)_{mt} \cdot (POP/LFP)_{mt}) + \alpha_{mt}((PTE/POP)_{mt} \cdot (POP/LFP)_{mt}) + (1 - \alpha_{mt})((FTE/POP)_{ft} \cdot (POP/LFP)_{ft}) + (1 - \alpha_{mt})((PTE/POP)_{ft} \cdot (POP/LFP)_{ft})]$$

where  $\alpha_{mt}$  = proportion of males in labour force at time t,

$(FTE/POP)_{mt}$  and  $(PTE/POP)_{mt}$  are the full-time and part-time employment/population rates for males, and  $(POP/LFP)_{mt}$  is the inverse of the labour force participation rate for males. The decomposition of the change in the rate of unemployment between periods t and t+1 is undertaken by sequentially varying components of the expression for the rate of unemployment (from period t to period t+1 values) in order as shown in the Table.

To demonstrate the second point I will examine the relation between changes to the rate of unemployment and the rate of growth in GDP in Australia. Using this relation, commonly known as Okun's law, it is possible to work out how much of Australia's recent unemployment experience can be attributed to its growth performance.

Figure 4 graphs the Okun's law relation for Australia from the late 1970s to the present. Each dot represents an observation of the annual change in the rate of unemployment and the annual rate of growth in GDP. Quarterly data from 1979/1-1978/1 to 2014/3-2013/3 are used. The solid line summarises the relation between the variables using a simple OLS regression model (see Appendix Table 1).



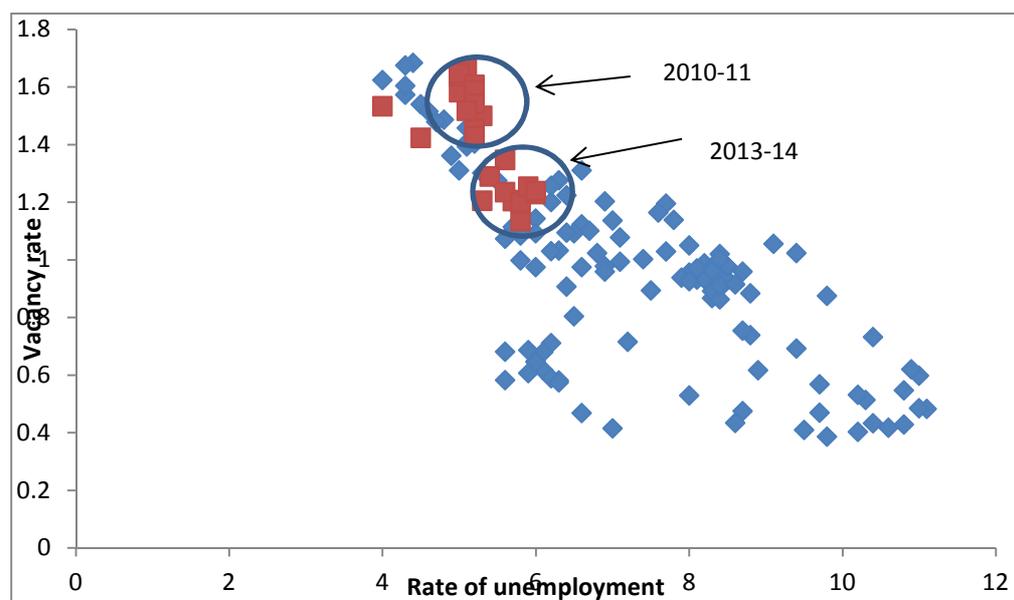
**Figure 4: Okun's relation, Australia, 1979/1-1978/1 to 2014/3-2013/3, Seasonally adjusted**

From the summary relation we can infer the annual rate of growth in GDP at which the rate of unemployment in Australia would remain constant: This is 3.2 per cent. So on average, when Australia's annual rate of growth in GDP is below 3.2 per cent the rate of unemployment will be increasing, and when the rate is above that level it is predicted to be declining. The summary relation also tells us that each extra percentage point of annual growth in GDP will be associated with a fall in the rate of unemployment of 0.40 of a percentage point.

With this information on Okun's law in hand, we are in a position to work out how much of Australia's recent unemployment experience can be attributed to its economic growth performance. In the period from 2008/qtr3 to 2014/qtr2 the average annual rate of growth in GDP has been 2.5 per cent. This means that for five and three-quarter years Australia's growth has been 0.7 per cent per annum below the level required for the rate of unemployment to be stable. Having the rate of growth below the stable unemployment level by 0.7 per cent for one year causes the rate of unemployment to rise by 0.3 of a percentage point. Putting all this together means that Okun's relation predicts that Australia's rate of unemployment in 2014/qtr2 should have been 1.6 percentage points higher than in 2008/qtr3. This compares with the actual change over that period of 1.9 percentage points. It should also be remembered that since the GFC the mining industry has accounted for a larger share of the growth in GDP in Australia than would usually be the case – and mining has a relatively low labour intensity. The main conclusion is that pretty much all of Australia's recent unemployment experience can be explained by its growth performance.

As a supplementary way of addressing the question of the effect of cyclical influences on the rate of unemployment I will examine the Beveridge curve. The Beveridge curve represents a negative relation between the vacancy rate and the rate of unemployment. It has been described as a ‘...production possibility frontier for the job matching capabilities of the labor market...’ (Daly et al., 2012, p.7). Movements along the Beveridge curve occur due to business cyclical fluctuations; for example, a downturn will cause a decline in labour demand, with a consequent decrease in the vacancy rate and increase in the rate of unemployment. Changes in matching efficiency are reflected in shifts in the Beveridge curve; for example, a decline in matching efficiency implies workers have more difficulty finding jobs at any given level of vacancies so that there will be an outward shift of the Beveridge curve.

Figure 5 shows the Beveridge curve relation in Australia from the late 1970s to the present. Observations from 2010 onwards are highlighted in red. It appears that in 2010-11 there may have been an outward shift in the curve, but in 2013-14 the observations overlay outcomes from earlier time periods. Hence, analysis of the Beveridge curve confirms that recent increases in the rate of unemployment are primarily cyclical.



**Figure 5: Beveridge curve, Australia, 1979/2-1978/2 to 2014/2-2013/2**

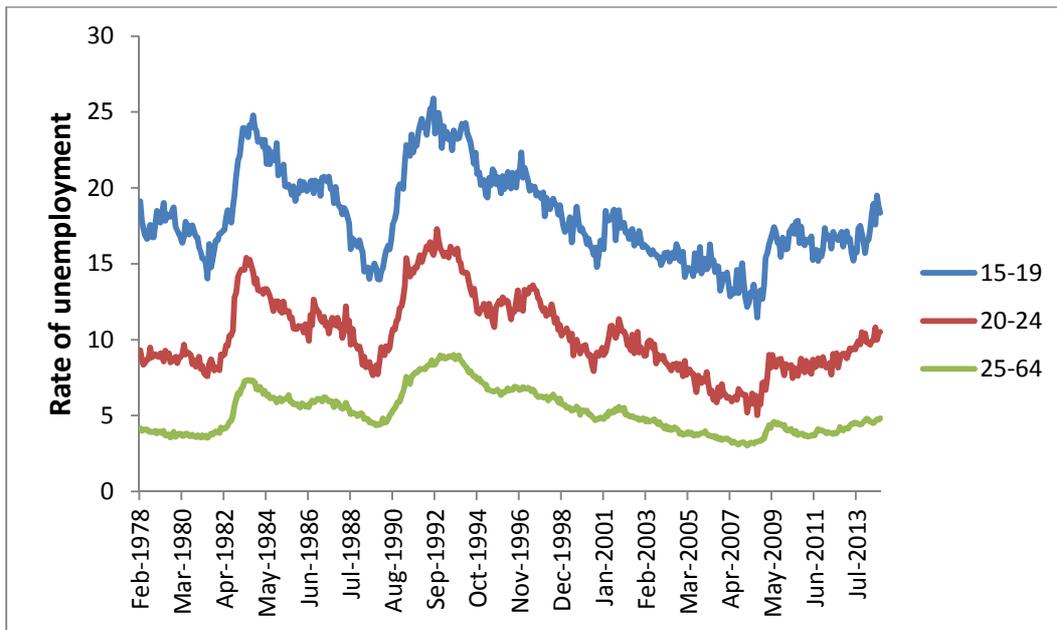
### *Drawing on history – Why this episode of higher unemployment isn't different*

We like to believe that we live in different times, that we have special problems to solve. More often than not, however, our problems are much the same as problems from the past. The current episode of increasing unemployment is an example, I think. There has been extensive recent discussion about the new problems facing us – high youth unemployment, high long-term unemployment, and regions where the rate of unemployment is sky-rocketing, together with claims that policy needs to be directed to address that particular aspect of the unemployment problem (see for example, Schneiders, 2014; Martin and Cook, 2014). What I want to argue is these problems are not new. Studying the history of the Australian labour market tells us that they are what happens when the overall rate of unemployment in Australia increases.

#### **Unemployment of the young**

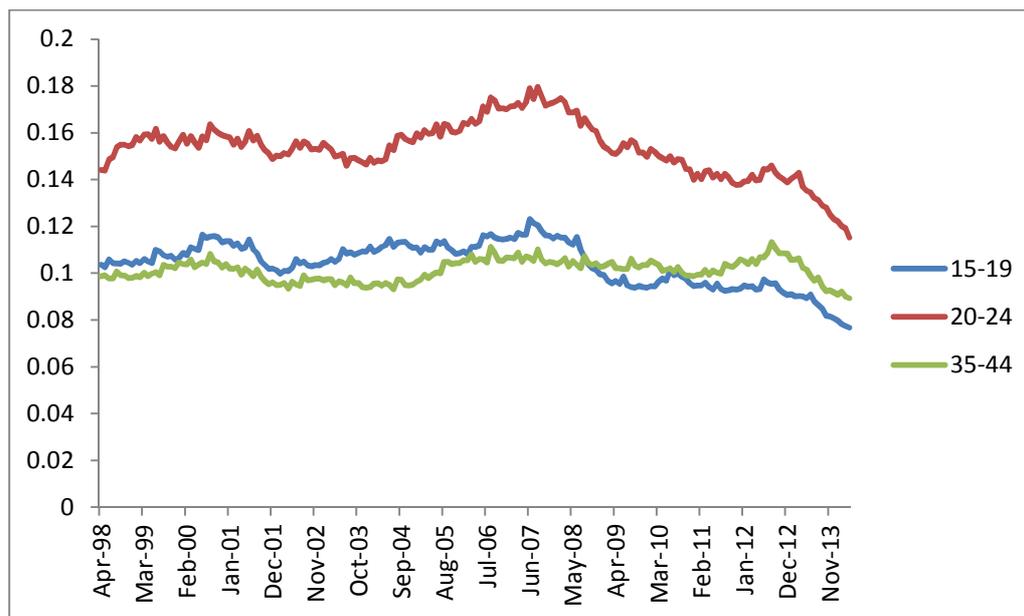
First of all, youth unemployment. It is certainly the case that rates of unemployment for younger age groups in Australia are higher than, and have increased by more than, for the general population in this current downturn. The rates of unemployment for 15-19 and 20-24 year olds are currently 18.4 and 10.5 percent respectively; compared to 4.8 percent for the population aged 25 to 64 years. As well, since August 2008 rates of unemployment have increased by 6.9 and 5.5 percentage points for 15 to 19 and 20 to 24 year-olds respectively; compared to only 1.5 percentage points for the population aged 25 to 64 years.

A long-run perspective, however, reveals this not to be unusual. Figure 6 shows the rates of unemployment for these age groups from the late 1970s onwards. It can be seen that rates of unemployment for younger age groups are always above the rate for the population aged above 25 years; and that they also display greater cyclical sensitivity – they increase more during downturns but they also decrease more during upswings. On this latter point, regression analysis reveals that for every one percentage point change in the rate of unemployment for the population aged 25 to 64 years, the rates of unemployment for the 15 to 19 and 20 to 24 year old age groups change by about 1.85 and 1.65 percentage points respectively.



**Figure 6: Rate of unemployment by age, Australia, Persons, 1978/2 to 2014/10, Monthly (Seasonally adjusted)**

There is a reason why the rates of unemployment for younger age groups display the greatest cyclical sensitivity. The main effect of an economic downturn is to slow the rate of inflows into employment. This is especially the case in the initial stages of a downturn or in a less severe downturn. At any point in time, the young, who are making the transition from education to work, account for a disproportionate share of job seekers. So when there is slowing growth in the rate of creation of new jobs, it is the young who are most adversely affected by the declining availability of new jobs. Looking at data on flows into employment provides evidence to support this point. Figure 7 shows the rate of flow into employment for groups aged 15 to 19, 20 to 24, and 35 to 44 years. There have been large decreases in the flows in employment for the younger age groups since mid 2008; but for the older group there has only been a decrease since late 2012.



**Figure 7: Rate of inflow to employment from unemployment and out of the labour force, Persons, Australia, 1998/4 to 2014/4 (monthly; 13-month average)**

Hence there is nothing out of the ordinary for younger age groups to have higher rates of unemployment, or for their rates of unemployment to increase more during an economic downturn. What is a little different thus far in the current downturn is the relative magnitude of the rise in the rates of unemployment of younger age groups compared to the older population. Table 2 shows the contribution of the change in the rate of unemployment for each of the age groups I have been examining to the increase in the overall rate of unemployment – both in the current downturn and in the recession of the late 1980s/early 1990s. It is apparent that increases in the rate of unemployment for the younger age groups account for a larger share of the increase in the overall rate in the current downturn than in the earlier episode.

	1989/8 to 1993/8	2008/8 to 2014/10
(a)Change in rate of UE:		
15-19 years	+1.0	+0.9
20-24 years	+1.0	+0.5
25-64 years	+3.5	+1.2
(b) Change in composition of LF	-0.4	-0.4
<b>Total</b>	<b>+5.1</b>	<b>+2.2</b>

**Table 2: Shift-share analysis of sources of increases in the rate of unemployment, Australia, Persons, Economic downturns**

Analysis of data on employment outcomes by age shows a similar picture. Table 3 shows the employment/population rate for the age groups I have been examining for the recession of the late 1980s to early 1990s, the subsequent upswing to the GFC, and the current downturn. Obviously it is not uncommon for there to be large declines in the employment/population rate for younger age groups – That happened in the recession of the late 1980s and early 1990s. Nor need such changes be permanent – There was strong growth in the employment/population rates of the younger age groups in the long boom to the GFC. But what is different in the current downturn is that while there have again been decreases in the employment/population rates for the younger age groups, this has not happened for the population aged 25 to 64 years.

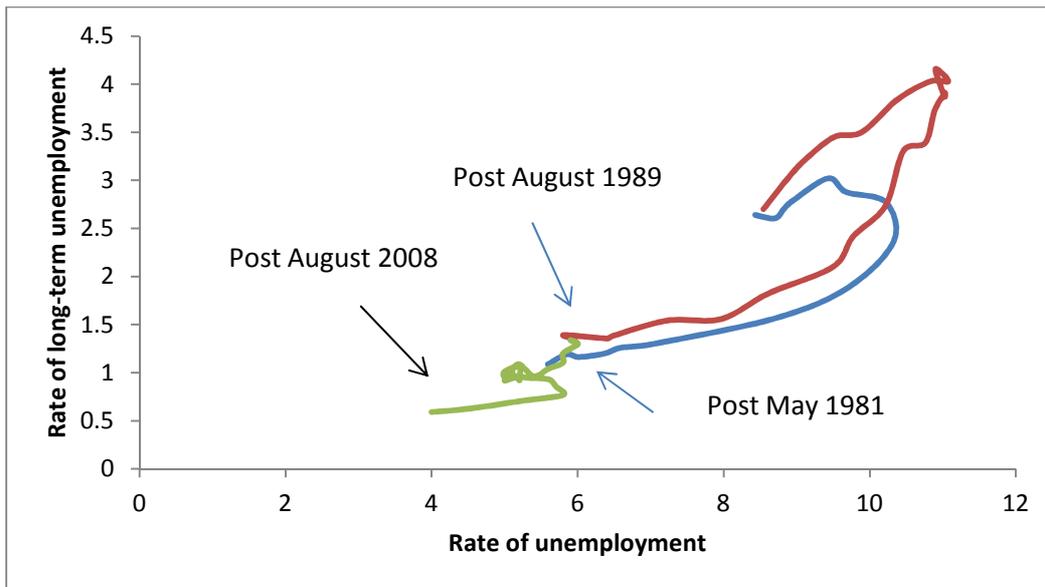
	<b>15-19 years</b>	<b>20-24 years</b>	<b>25-64 years</b>
1989/qtr3	50.4	76.8	69.6
1993/qtr3	39.4	67.5	66.9
2008/qtr3	49.2	76.1	75.4
2014/qtr3	43.1	69.7	75.2

**Table 3: Employment/population rate by age, Australia, Persons**

I can't be sure, but my guess is that this is to do with the severity of downturn. Increases in unemployment in the current episode mainly reflect the effect of decreasing inflows to employment which disproportionately adversely affect the younger age groups. Whereas in the recession of the late 1980s and early 1990s there was also an increase in the outflow from employment (for example, Borland 2008) – which would have a greater relative impact on older age groups.

### **Long-term unemployment**

Long-term unemployment has increased during the current downturn. But again, it always does during major episodes of economic downturns. Unemployment initially increases as extra people commence new spells of unemployment. That causes an increase in short-term unemployment without changing long-term unemployment. As the downturn continues, however, there will be extra unemployed whose spells continue for longer periods of time, and when that happens, the rate of long-term unemployment also increases. This pattern can be seen in Figure 8, which shows the rates of unemployment and long-term unemployment in Australia from the beginning of the past three major downturns in Australia. At this stage I think it would be difficult to argue that, controlling for the rate of unemployment, the rate of long-term unemployment is tracking at a higher level than in the previous downturns.

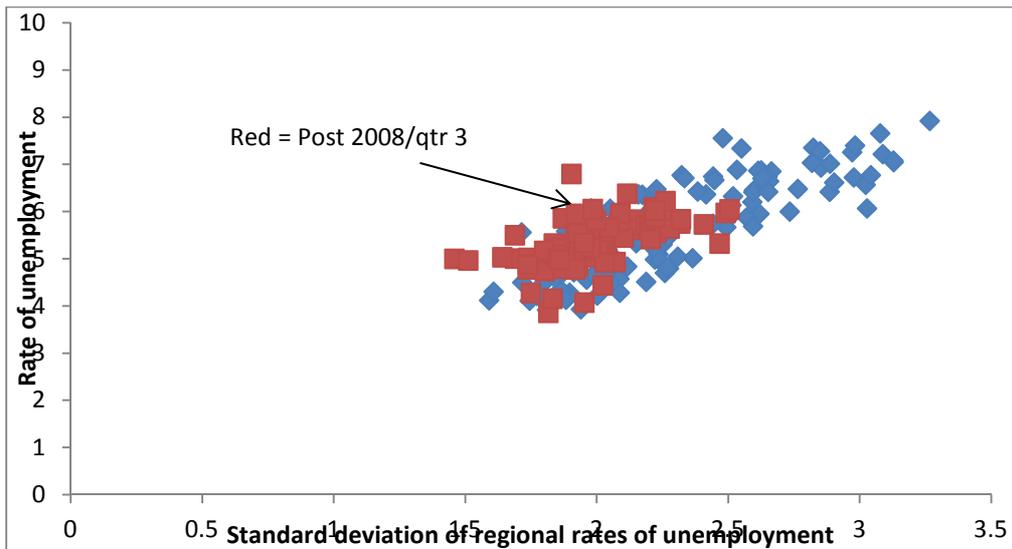


**Figure 8: Rates of unemployment and long-term unemployment, Australia, Persons, Downturn episodes**

### Regional unemployment

The distribution of the population by skill level across geographic regions is not even. Because low-skill workers are disproportionately adversely affected by a downturn in economic activity, it follows that the rate of unemployment will vary over the business cycle by different amounts in different regions – by more where there is a greater concentration of low-skill workers; and by less where there is a greater concentration of high skill workers. Therefore the extent of dispersion in the rate of unemployment by region will be positively correlated with the overall rate of unemployment.

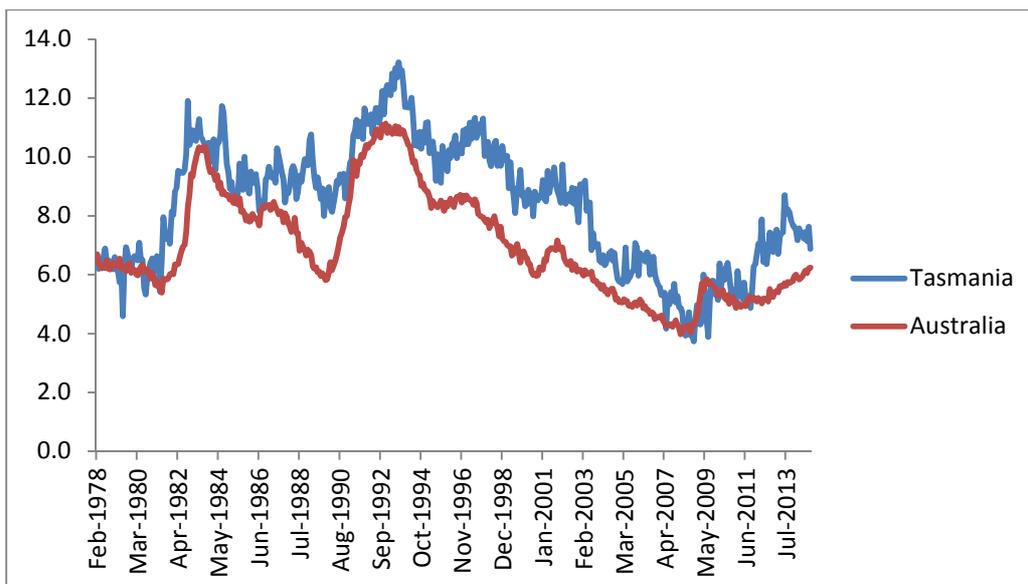
Figure 9 confirms this story for Australia. It shows the rate of unemployment and standard deviation in rates of unemployment between Statistical Area 4 regions in Australia for each month from October 1998 onwards. What is also evident is that there clearly has not been an increase in the extent of regional dispersion in rates of unemployment since the GFC.



**Figure 9: Rate of unemployment and standard deviation of rates of unemployment between Statistical Area 4 regions, Australia, Persons, 1998/10 to 2014/10 (Monthly)**

### Tasmania

At this stage, you might be thinking – what about Tasmania? Is the Tasmanian labour market a special problem in this downturn? I don't claim to be an expert on the Tasmanian economy, but my analysis suggests that the answer is 'no'. This might seem a puzzling answer when you look at recent developments in the rate of unemployment in Tasmania, shown in Figure 10. You can see that, after reaching par with the overall rate for Australia in late 2008, the Tasmanian rate has increased to be around 7 to 8 percent in the period following the GFC, whereas the Australian rate is just at about 6 percent.



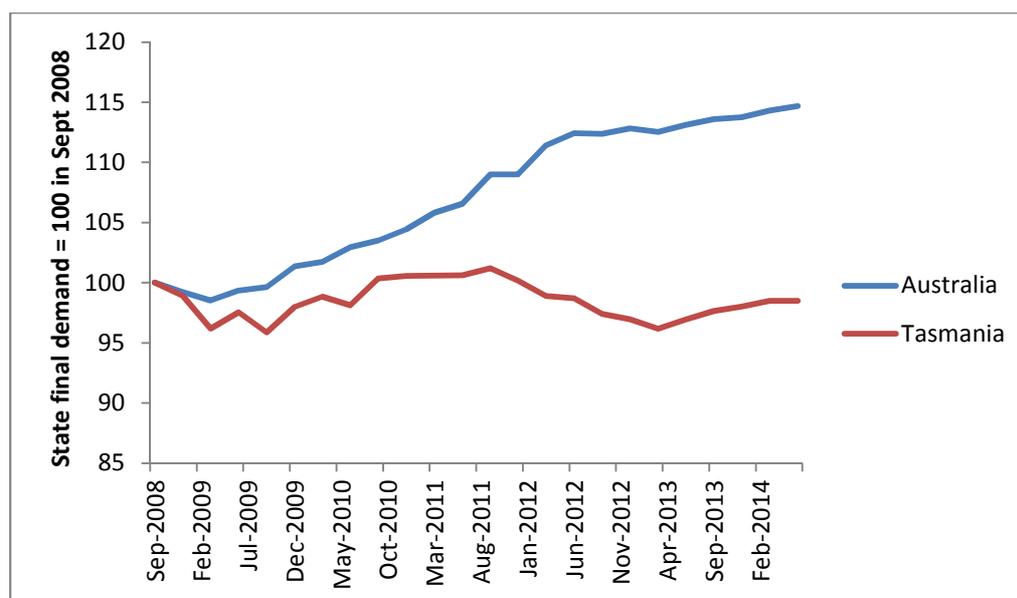
**Figure 10: Rate of unemployment, Tasmania and Australia**

To understand why there has been a larger increase in the rate of unemployment in Tasmania than Australia I have repeated the decomposition exercise from earlier. This is shown in Table 4. It can be seen that there has been the same pattern of changes explaining the increase in the rate of unemployment in Tasmania as for Australia. What is different is the magnitudes of the effects. The higher rate of unemployment in Tasmania has been due to decreases in full-time employment that would have caused a very large increase in the rate of unemployment; but this has been offset somewhat by a quite a large decrease in the participation rate for males.

	<b>Rate of UE</b>	<b>Males – FTE/POP</b>	<b>Males – PTE/POP</b>	<b>Males – LF/POP</b>	<b>Females – FTE/POP</b>	<b>Females – PTE/POP</b>	<b>Females – LF/POP</b>
<b>Tasmania</b>							
2008/3	3.9	57.3	11.8	.712	26.7	24.9	.543
2014/3	7.0	46.9	13.5	.656	24.0	28.9	.562
Effect on change in rate of UE	+3.1	+8.8	-1.5	-4.5	+3.4	-3.5	+1.5
<b>Australia</b>							
2008/3	3.9	59.3	10.1	.719	30.7	25.0	.581
2014/3	6.0	54.8	11.8	.708	29.4	25.9	.588
Effect on change in rate of UE	+2.1	+3.6	-1.4	-0.8	+1.0	-0.7	+0.5

**Table 3: Sources of changes in the rate of unemployment, Australia, Persons, 2008/qtr3 to 2014/qtr3**

Why has there been this larger decline in employment in Tasmania than Australia? The available evidence suggests that it is to do with differences in rates of growth in economic activity. The decline in the rate of growth in economic activity has been more pronounced in Tasmania than Australia. Figure 11 shows an index of state final demand for Tasmania and for the sum of states and territories in Australia since the third quarter in 2008. State final demand has declined slightly in Tasmania since the GFC, whereas in all states and territories it has increased by about 15 percent.



**Figure 11: State final demand, 2008/qtr 3 to 2014/qtr 2 (Quarterly; seasonally adjusted)**

*How should policy-makers respond?*

In this section of the talk I want to consider three types of policies that might be used to seek to deal with the problem of high unemployment: macroeconomic policy; industrial relations reform; and active labour market programs.

Throughout the talk I have argued that the increase in the rate of unemployment following the GFC has occurred due to a cyclical downturn. It follows that the main way we can lower the rate of unemployment is through an increase in the rate of growth in economic activity. And the main way that government can assist in achieving this outcome is via macroeconomic policy.

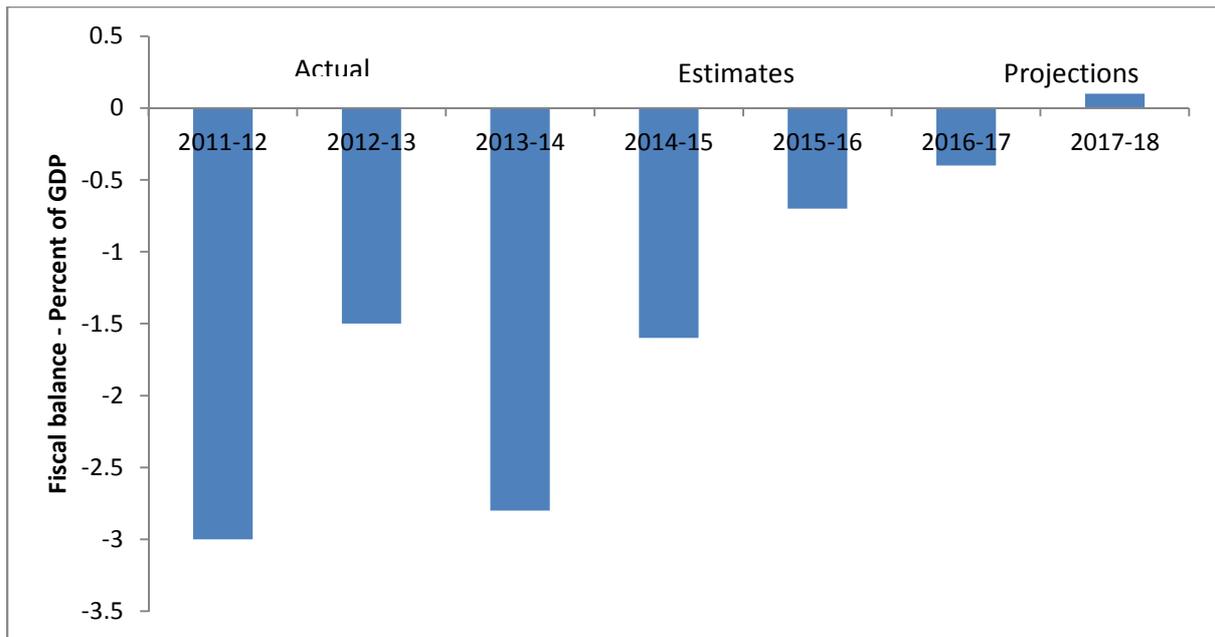
I have the feeling that our current unemployment situation has snuck up on policy-makers. In the period immediately following the GFC we avoided the large upward spike in the rate of unemployment that was the fate of the US and many European countries – and since then we have never come close to having a rate of unemployment of over 10 percent as happened in the early 1980s and early 1990s. I think these factors probably explain why there has been a lack of urgency about addressing the problem. But as I noted previously we have been going for six years without it looking like the rate of unemployment will return to the pre-GFC level; and the US now has a lower rate of unemployment than Australia.

How could macroeconomic policy assist? First, the Reserve Bank could look at further reducing interest rates to stimulate economic activity. The main objection to this policy seems to be that it will not cause any extra ‘good’ investment, such as businesses’ increasing their productive capacity, but instead cause more ‘bad’ investment in housing thereby compromising macroeconomic stability by adding to or causing a bubble in the price of

housing. There are several points to make in response. One is to question whether business investment will be unresponsive to lower rates of interest. This is difficult to know – But over the past couple of years it does seem that some turn-around in business credit has begun to happen (Stevens, 2014a). A second is to ask whether house prices in Australia (or in particular markets) are being driven by structural or speculative influences. Even the RBA seem somewhat diffident on this issue – This week, for example, Glenn Stevens told a CEDA dinner that the Bank did not see currently dynamics in the housing market as ‘...an immediate threat to financial stability’ (Stevens, 2014b). A third point is whether the Reserve Bank should be using interest rate policy to influence the housing market. This is the classic Tinbergen problem of having more targets than instruments. The RBA is attempting to achieve two objectives – managing aggregate demand in the Australian economy and ensuring stability in the housing market; and it cannot be assured of achieving both objectives with just one instrument – interest rate policy. It is obvious that the RBA understands this point – Hence the recent discussions about a greater role for other types of policy to regulate the housing market. In a speech on ‘The economic scene’ in September the RBA Governor Glenn Stevens has suggested that ‘The real issues are governance, risk-sharing and pricing – areas where other policies have to be right’ Stevens, 2014a). What seems important for dealing with unemployment is that economic policy-makers, including the RBA, make a serious move as soon as possible to use these alternative policy approaches for regulating housing markets, thereby releasing interest rate policy to be targeted more at the objective of stimulating economic activity. However, I would have to say that I don’t sense much urgency by those policy-makers in approaching that task.

[And an aside here: It is interesting to see the political economy playing out in the time after RBA statements. In aftermath of the September 2014 Financial Stability Review both the Australian Bankers’ Association and Property Council of Australia warned against further macro-prudential controls citing lack of current problems with lending profile and possible perverse outcomes such as reducing supply. It reminded me of the comment in William Coleman et al.’s book (p.231) on Giblin’s The Growth of a Central Bank that throughout the book the private banks ‘...combined noisy professions of conventional morality with a steady-eyed devotion to their own advantage’.]

The second way macroeconomic policy could assist is through fiscal policy. Here what seems important is that the Budget deficit should not be wound back too quickly. Despite the justified controversy about the distributional impact of this year’s Budget, I do think that the Treasury seem aware of this concern about the overall macroeconomic impact of the Budget. Estimates from the Budget papers, displayed in Figure 12, show that the Budget fiscal balance is being converted from deficit to surplus relatively slowly. However, to the extent that the interest rate policy remains in its current setting, there could be value in maintaining a deficit for longer. Perhaps we will see this is happening once new estimates of fiscal balance are available that take account of factors such as lower than expected prices of iron ore.

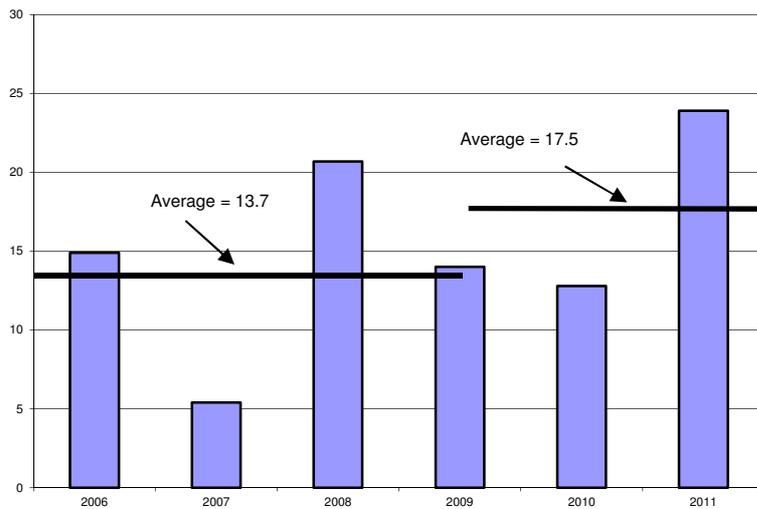


**Figure 12: Fiscal balance, Australia, 2011-12 to 2017-18**

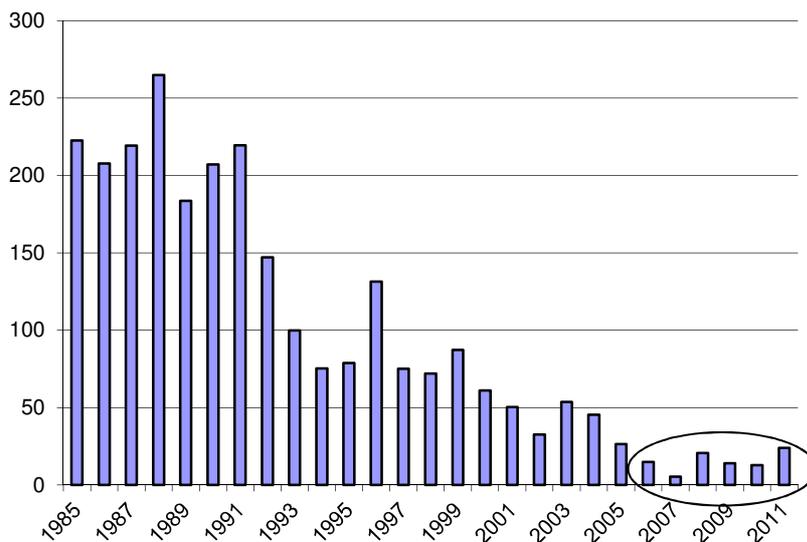
One area of policy-making, which received considerable attention a couple of years ago, then faded, but is beginning to make a comeback, and I'm sure will get stronger once the Productivity Commission gets the Terms of Reference for its review on the topic, is industrial relations reform. A couple of years ago I gave a talk (Borland, 2011) where I described industrial relations reform as 'a pot of gold at the end of the rainbow'. I think that is still the case, and I don't think that industrial relations reform provides a major opportunity to reduce the rate of unemployment.

During the 2000s there was considerable consternation about the industrial relations system in Australia – first Work Choices and then Fair Work. In my talk in 2011 I examined five types of aggregate-level outcomes in the Australian economy and labour market during the 2000s: wage inflation; the distribution of earnings; labour productivity; how the labour market adjusts; and strike activity. From this review I concluded that there was : '... little evidence of effects from the Work Choices or Fair Work reforms made to Australia's industrial relations system in the 2000s...[and] the limited effects of reforms in the 2000s can be explained by the nature of those reforms – being primarily oriented to changing the relative bargaining power of employers and employees, rather than to enhancing overall economic performance'.

I can't resist showing you one set of graphs from the talk – not the most important, but quite striking in their illustration of false claims being made about the effects of the industrial relations system. Figures 13a and 13b make the point that, while it was being claimed at the time that the Fair Work Act had been disastrous for strike activity in Australia, a longer-term perspective reveals that the effect of the legislation was minimal, at least compared to other influences that had driven long-run decreases in industrial disputes since the 1980s..



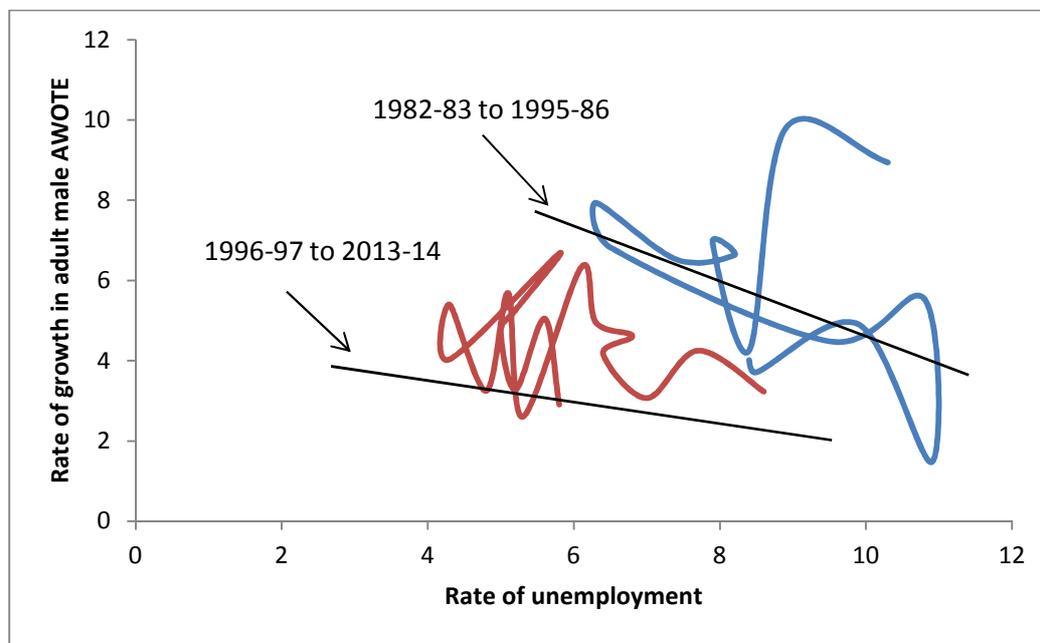
**Figure 13a: Industrial disputes, Days lost per thousand employees, Australia, 2006 to 2011**



**Figure 13b: Industrial disputes, Days lost per thousand employees, Australia, 1985 to 2011**

Instead I argue that it was the shift to enterprise bargaining in the mid-1990s that is the industrial relations reform that has brought most benefit to Australia – mainly via improved macro-economic outcomes in Australia. An example is the trade-off between unemployment and inflation. Figure 14 graphs a Phillips curve relation with data on the annual rate of change in average weekly ordinary time earnings for full-time males and the rate of unemployment in Australia from 1982-83 to 2013-14. It appears that a shift inwards and flattening of the Phillips curve relation occurred in the mid to late 1990s. This represents an improvement for the Australian macro-economy: a shift to a lower inflation environment where wage growth

seems less sensitive to demand conditions. The timing of the shift to enterprise bargaining and change in the macro-economic environment suggests the possibility of a causal relation; although it is important to recognise that firmer anchoring of inflation expectations via the introduction of inflation targeting may have played a role. And there has also been work in the US, where a similar change in the Phillips curve has occurred, which suggests that perhaps the Phillips curve has not shifted (Gordon, 2013).



**Figure 14: Rate of growth in adult male AWOTE and rate of unemployment, Australia, 1982-83 to 2013-14**

The final area of policy-making I want to discuss is active labour market programs. These programs are targeted at individuals who are unemployed or at risk of unemployment, with the immediate aim of increasing their likelihood of employment, by changing their search behaviour, or increasing their productivity or job readiness. Since the onset of mass unemployment in the mid-1970s active labour market programs have remained an important part of Commonwealth government policy for dealing with unemployment. Currently the government spends 0.3 percentage point of GDP on the programs – and you will be aware, for example, of the prominence that is being attached to the Work for the Dole program as a method of improving labour market outcomes for the unemployed.

I want to make two main points about these programs (for an extensive review, see Borland, 2015).

First, labour market programs do not add (at least certainly not substantially) to the number of jobs in the economy – hence they are not a direct solution to the problem of unemployment. Instead the main way that they can improve economic performance is by making a larger

number of people who are unemployed job ready and more skilled for when extra jobs become available.

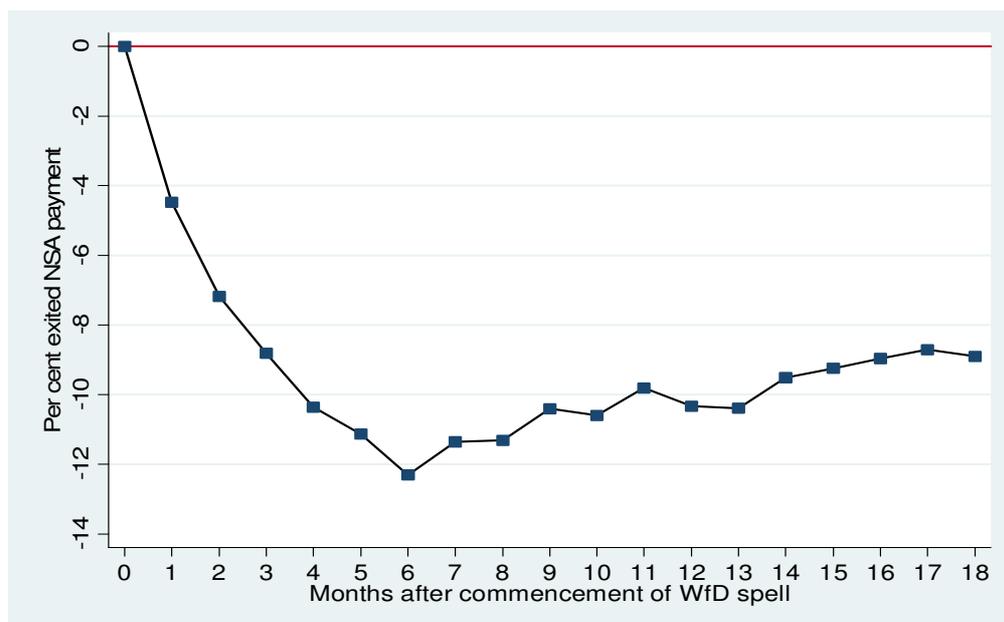
For example, suppose the program in which an unemployed person has participated was a program to make them more effective in their job search. Because they are better at job search (maybe a more professional CV and improved interview technique) they get a job they would not otherwise have obtained. But there is still the same number of jobs in the economy as before. So the fact they got the job means that someone else missed out on the job – All that has happened is that there is a switch in who is unemployed.

There is a variety of evidence that supports the argument I am making here. One very important piece of evidence comes from a recent randomized controlled trial of a case management program in France – important because it applies the method of randomisation which is the gold standard for doing this type of study (Crepon et al., 2013). The trial found that a higher rate of employment for program participants eight months after commencement in the program was entirely offset by a lower rate of employment for non-participants, what is known as a displacement effect. Hence there was no evidence of an increase in total employment due, for example, to improved matching. This implies that the potential benefits to society from a job search verification program would be solely from redistribution; by changing the identity of the unemployed to achieve a more equal distribution of time spent in unemployment between the workforce.

Second, there are active labour market programs that are likely to improve job readiness and increase skills, and there are programs that are not. So choosing which programs to implement is an important decision for policy-makers. We now have two decades of rigorous evaluations of impacts of active labour market programs in the US, Europe and Australia.

The main results can be summarised briefly as:

- Job search counselling and verification can increase employment of participants, especially in stronger labour market. There is mixed evidence on whether public sector or private sector provision of these services achieves better outcomes;
- Wage subsidy schemes that pay an employer a subsidy for taking on an unemployed job-seeker can improve long-term employment outcomes for participants. The subsidy works mainly by the unemployed person being retained in their job after the end of the subsidy; that is, employers are being paid to sort between the unemployed. However, employers are only willing to take on unemployed who seem relatively job ready (eg., short-term unemployed); and wage subsidy programs work best when effectively targeted (primarily a limited duration of payment, and jobs that can provide an opportunity for permanent employment);
- Public sector job creation has little effect. As an example, Borland and Tseng (2011) examine the pilot phase of the WfD program in the late 1990s using exact matching. They conclude that participation in the WfD program caused a large and significant adverse effect on the likelihood of exiting unemployment payments – for example, in the first 12 months after commencement in WfD participants spend on average 2.2 fortnights longer on unemployment payments than non-participants. This is shown in Figure 15.



**Figure 15: Proportion of NSA payment recipients exiting NSA payments – Difference between WfD participants and matched control group – Aged 18 to 24 years - By month after commencement of WfD spell**

Source: Borland and Tseng (2011)

Our evaluation of the Work for the Dole program is consistent with an array of international research. For example, from a review of 97 studies of labour market programs Card et al. (2010, p.F453) that ‘...our analysis suggests subsidised public employment programs are relatively ineffective...[and] the least successful programs are public sector jobs programs’. There are structural explanations for why public sector job creation programs do not have positive effects. First, they do not provide a substantial improvement in skills of the unemployed. Second, they do not provide a pathway to permanent employment.

- Classroom training is found to have mixed outcomes, with some studies showing that, where the programs are successful, they have an increasing effect over time.

I think that a reading of the evidence tells us that existing models of job search counselling and assistance and wage subsidy programs are good ways to assist unemployed who are less disadvantaged – But that we need a new model for assisting those unemployed with higher levels of disadvantage. Funding should be used to create jobs that involve training that is linked to the job; and where that job involves a pathway to permanent job. This best done at a decentralised level via relationships between businesses who are willing to provide opportunities for the unemployed and the not-for-profit/service provider who can do the work of giving the unemployed the basic capabilities that employers require to take them on. It follows that government funding of services for the unemployed needs to facilitate decentralised and local solutions. It is likely to involve tailored intervention and may be relatively expensive. However in doing the benefit-cost calculation it is important to remember that the payoff may be to create a productive worker for the next 45 years.

Let me conclude with a summary:

First, Australia's current unemployment situation is serious and deserves serious attention from policy-makers.

Second, increases in the rate of unemployment since the GFC are primarily due to a lower rate of growth in economic activity.

Third, it follows that when the overall rate of unemployment in Australia decreases, other problems such as high youth unemployment, long-term unemployment and growing dispersion in unemployment between regions, will also be ameliorated.

Fourth, the main way to reduce the rate of unemployment is via macroeconomic policy. We need to be able to make greater use of lowering interest rates to stimulate economic activity; and need to worry about not switching to a budget surplus too quickly.

Fifth, industrial relations reform is unlikely to have an appreciable effect on the rate of unemployment.

Sixth, labour market programs can be part of the policy solution – but need to be chosen and targeted carefully.

Thank you!

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**Appendix table 1: Okun's relation, Australia, 1979/1-1978/1 to 2013/2-2012/2**

Dependent variable: Annual change in rate of unemployment

<b>Explanatory variable</b>	<b>Coefficient</b>
Constant	1.296 (0.115)
Annual rate of growth in GDP	-0.404 (0.031)
Adjusted R-squared	0.542
Observations	141