

21 September 2023

## Issues paper: Defining and measuring full employment

This is an edited version of an issues paper prepared by ACOSS for discussions with the Employment White Paper Task Force in September 2023, prior to the release of the White Paper.

### Summary

#### **ACOSS welcomes the Government's commitment to genuine full employment.**

ACOSS welcomes the Treasurer's recent commitment to '*create an economy where anyone who wants a job can get a job without searching for too long – a job with good pay and conditions.*'

- This restores full employment as a key objective for Government, following three decades – since the last *White Paper on Full Employment* released by the Keating Government – during which it was all but forgotten.

Full employment is vital to open economic opportunities for people excluded from the labour market, improve the quality of paid work and lift general living standards:

- ACOSS would add to the above definition of full employment that: '*people who seek employment but have been excluded (including those unemployed long-term) have a fair chance of securing a job with the right help.*'

#### **So far, the missing ingredient is a set of official targets to achieve it.**

Governments don't prioritise what they don't measure:

- There is a serious imbalance between the Reserve Bank of Australia's (RBA) hard inflation target of 2-3% and the absence of similar targets for unemployment and underemployment.
- We advocate official targets for unemployment, under-employment, and job vacancies.
- If these were set at levels equivalent to the full employment era of the early 1970s, then *unemployment would be around 2-3%, underemployment would be around 4-5% and there would be one job vacancy for each person unemployed.*<sup>1</sup>

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<sup>1</sup> Underemployment refers to the proportion of people in the labour force who are employed but have not been able to secure the paid working hours they seek. If there is a job vacancy for each person unemployed this does not mean every vacancy would have only one applicant, since applicants also include education leavers, people returning to the paid workforce after caring for a family member, and people who are changing jobs.

## **We must stop sacrificing jobs to fight inflation.**

Regrettably, the Employment White Paper is drafted at a time when unemployment and under-employment are rising off the back of excessive interest rate increases designed to curb inflation by reducing employment:

- The RBA estimates that unemployment must increase to around 4.5% - an additional 150,000 out of jobs - to keep inflation in check.
- This estimate of the so-called 'Non Accelerating Inflation Rate of Unemployment' (or NAIRU) comes from a backward-looking economic model that wrongly assumes that past labour market dynamics (where wages rise sharply as unemployment falls) still apply.

At the least, recent experience shows that Australia could keep unemployment at 3.5% and underemployment at 6% of the labour force without a so-called 'wage price spiral':

- The current outbreak of inflation has other causes and it best contained using less brutal means than high interest rates.<sup>2</sup>

## **As well as full employment, people locked out of the labour market need income support they can live on and decent employment services and training.**

As indicated above, lower levels of unemployment and underemployment than this are likely to be needed to achieve genuine full employment:

- Zero unemployment is not attainable since there will always be a modest level of short-term unemployment as people connect with suitable jobs.

Further, many people who have been unemployed for a long time (including many people with disability, older workers and First Nations people) need help to secure the right job, above and beyond strong demand for labour. This includes access to quality training and major reform of employment services:

- While they are searching, they need income support to cover the basics including secure housing, food, and the costs of job search. Jobseeker and related payments should be lifted from \$54 a day to at least the pension rate of \$78 a day.

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<sup>2</sup> These are outlined in our [Issues Paper for last year's Jobs and Skills Summit](#).

## Purpose

Governments don't prioritise what they don't measure. This brief makes the case for new measures of full employment and institutional arrangements to give it equal priority to price stability in monetary and fiscal policy.

## The problem

The RBA has a legislated mandate for full employment and price stability. While a target for price stability is enshrined in agreements between the Bank and the Treasurer there is no official full employment target.

For the past 30 years, price stability has been prioritised over reductions in unemployment (and labour underutilisation generally) especially at stages in the business cycle (such as now) when the *potential* to restore full employment is greatest:

- After pushing the rock up the mountain we give up well before reaching the peak.

This comes at a very high economic and social cost:

- Recessions and weak employment growth have entrenched high levels of prolonged unemployment and under-employment (impacting those with the least economic resources and opportunities), undermined job security and quality, suppressed wage growth and investment, and stoked political dissatisfaction.
- In a cruel twist, mass unemployment is treated as a personal failing and those affected must live on the lowest unemployment payment in the OECD.

At key points in the business cycle, there is a tension between full employment and price stability:

- Microeconomic reforms (such as improved training and job opportunities for people unemployed long-term) can alleviate this tension.
- This important discussion – how to reduce so-called 'structural unemployment' – is beyond the scope of this brief.

Instead, we propose here that the Government and RBA should define and measure full employment in a way that strikes a better balance between the two goals.

- The RBA Review recommended that the Bank should have a dual mandate for price stability and full employment, yet it has only been assigned an official target for inflation.<sup>3</sup>
- As long as this is the case, full employment will remain a second-order goal for the Bank behind price stability.

## Direct Vs indirect measures of full employment

Full employment can either be defined directly (as a normative goal based on workers' and employers' experiences of the labour market) or indirectly (using indicators of capacity utilisation including wage and price inflation).

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<sup>3</sup> Reserve Bank Review (2023), [An RBA fit for the future](#).

## (1) Direct measures

Government officials have recently defined full employment in the following terms, with which we broadly agree:

*'The Albanese Government's ambition is to create an economy where anyone who wants a job can get a job without searching for too long – a job with good pay and conditions.'*  
[Treasurer Jim Chalmers, July 2023](#)

*"Full employment means that people who want a job can find one without having to search for too long"* [Reserve bank Deputy Governor Michelle Bullock, July 2023](#)

- Another goal could be added, that: *'people who seek employment but have been excluded (including those unemployed long-term) have a fair chance of securing a job with the right help.'*

In the full employment era (roughly 1945-75), the goal of ready access to employment was adopted but there was no explicit full employment target:

- Since there will always be a degree of unemployment as people enter the labour market or change jobs, full employment does not mean zero unemployment.
- In lieu of formal targets, there were rules of thumb such as unemployment below 2-3% and a job vacancy for every person unemployed.<sup>4</sup>

## (2) Indirect measures.

Another way to define full employment is the full use of our labour resources:

- This can be measured indirectly by observing changes in prices (wages and consumer prices) as unemployment declines.
- In the post war era of full employment, the authorities took a *test-and-see* approach, reducing unemployment and observing whether the economy reached full capacity and 'overheated'.

Later, a measure of the level of unemployment at which 'overheating' (accelerating inflation) was deemed likely was developed (the *Non Accelerating Inflation Rate of Unemployment* or NAIRU):

- This came into its own in the 'stagflation' era in the 1970s and 80s.
- In today's very different labour market conditions, much uncertainty surrounds the NAIRU, as backward-looking models wrongly assume that past labour market dynamics (where wages respond sharply as unemployment falls) still apply.<sup>5</sup>

Rather than rely on an unreliable measure in uncertain times, an alternative approach is to revert to *test-and-see*, for example:

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<sup>4</sup> If there is a job vacancy for each person unemployed this does not mean every vacancy would have only one applicant, since applicants also include education leavers, people returning to the paid workforce after caring for a family member, and people who are changing jobs.

<sup>5</sup> In other Anglophone nations such as the United States and United Kingdom, wages have risen faster than they have in Australia as inflation rose. This suggests that labour market institutions – especially our wage-fixing system – have a major impact on the way in which wages respond to inflation.

- Since an unemployment rate of 3.5% (and underemployment of 6%) has not triggered strong wages growth, this could be used as a full employment benchmark.

However, that path has been blocked for now by the RBAs (tightening) bias in favour of restoring price stability, albeit at a slower rate than in other OECD nations:

- The RBA has a hard target for inflation and a soft target (if any) for employment.
- An employment target based on a normative full employment objective would help redress this imbalance.

## Factors to consider when measuring full employment

### (1) Types of unemployment

Whether we set employment targets based on normative goals or a *test-and-see* approach, we need to distinguish between:

- Frictional unemployment (proxied by short-term unemployment?), which is inevitable to an extent though it can be reduced by improved job matching.<sup>6</sup>
- Structural unemployment (proxied by long-term unemployment and discouraged jobseekers?), which may be gradually reduced by a prolonged period of full employment but also requires structural reform (for example better employment services, employment experience and training).<sup>7</sup>
- A residual of cyclical unemployment which would be eliminated under full employment.

### (2) Structural changes in the labour market

When measuring full employment, major structural changes in the labour market since the last full employment era should be considered:

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<sup>6</sup> Beveridge, the architect of the British public employment service in the early 1900s, aimed to reduce frictional unemployment caused by the fragmentation of hiring markets (e.g. queues for casual jobs on the wharves). Today, it is possible that digitisation of job matching has (or will) reduce frictional unemployment.

<sup>7</sup> The ABS measure of *long-term unemployment*, while consistent with ILO conventions, does not capture the full extent of *labour market exclusion*. For example, many people with disability or chronic illness withdraw from the labour market and return to it during a given year. Similarly, many people with low educational qualifications are only able to obtain part time or insecure jobs. These and other factors explain the disparity between ABS estimates of long-term unemployment and DSS administrative data for long-term receipt of unemployment payments.

- Women are no longer excluded, though not yet equally included;
- Growth in part-time employment, and many people's preference for it;
- Growth in the temporary migrant workforce, especially in entry-level jobs;
- Variability in the number and regularity of paid working hours is as important as variability in the number of jobs, both for those affected and for macroeconomic management;
- Over the past decade, underemployment has grown faster than unemployment, so unemployment is no longer a reliable proxy for labour underutilisation.
- Entry level jobs have become more precarious, increasing 'churn' of workers and vacancies at that end of the labour market.

## Possible full employment measures

### (1) Broad measures of underutilisation

An under-utilisation target should take account of both unemployment (lack of jobs) and under-employment (lack of paid hours). This can be done either by:

- Setting targets for both unemployment and underemployment:  
For example, based on experience on the full employment era and more recent relationships between unemployment and underemployment, this could be 2-3% of the labour force for unemployment plus 3-4% for underemployment;<sup>8</sup> or
- Setting a hours or volume-based target:  
The Economic Inclusion Advisory Committee suggests a goal of around 5-5.5% of paid working hours available plus hours sought.<sup>9</sup>
  - A challenge for the latter approach is ease of public understanding since this is much higher than the current unemployment rate.

### (2) Vacancy rates and flow measures

The above measures could be complemented by more direct measures of people's prospects of securing employment or adequate paid working hours quickly, such as:

- The ratio of unemployed people to vacancies (which was close to one in the full employment era and reached that level again recently);
- The time taken by people who are unemployed to secure employment;
- The time taken for people who are underemployed to secure the paid working hours they seek;
- The proportion of each year in which people are either unemployed or underemployed.

### (3) Job suitability and quality measures

The above measures do not take account of the suitability of jobs for people, or their quality. To an extent, labour market policies (for example workplace relations) are more

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<sup>8</sup> If the *test and see* approach is adopted, the lowest sustained unemployment rate in recent years (3.5%) and the lowest underemployment rate (6%) could be used, but that would not necessarily represent genuine full employment as defined here.

<sup>9</sup> Economic Inclusion Advisory Committee (2023), [2023-24 report to the Australia Government](#).

effective tools to improve job quality and suitability than macroeconomic policies. However, these issues cannot be ignored when measuring full employment:

- We can no longer assume that fulltime jobs for all is a policy goal. Many people with caring roles prefer part-time employment, along with young people studying full time and many older workers.<sup>10</sup>
- Precarious employment can distort the above measures. For example, the high degree of 'churn' in entry-level jobs referred to above increases the job vacancy rate without improving overall labour market outcomes.
- Improving job quality and suitability is a major reason for adopting full employment policies in the first place, since employers are much more likely to offer good quality jobs with decent pay and regular working hours if it is harder for them to recruit people.

## Institutional arrangements

Full employment targets would be developed by the Government in consultation with the community. Recommendations in the Employment White Paper would be the first step in this process:

- They would be incorporated into any agreement on the conduct of monetary policy between the Government and the RBA, noting the RBA Review recommendation that it should have a dual mandate – full employment and price stability – and that these two goals should have equal priority.<sup>11</sup>
- A government agency – e.g. Treasury or Jobs and Skills Australia – would report regularly and publicly on progress in meeting the full employment targets.

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<sup>10</sup> This is often a constrained preference – many women seek part time employment because those are the only jobs on offer and because care of children and other family members is not equally shared within the family.

<sup>11</sup> This is implied in any event in the RBA Act.