Melbourne Institute News

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Strategies for Boosting the Labour Supply

For much of the past thirty years a central task of economic policy has been to manage demand so as to create enough jobs to employ a growing available workforce without adding to unemployment. Even so the unemployment rate was rarely below 6 per cent and at times it was above 10 per cent. In recent times, however, important aspects of the labour market element of the economic policy challenge have changed. Unemployment has fallen to thirty-year lows, despite an increase in the proportion of the working age population seeking work. This reflects the combination of a number of factors, particularly the dramatically improved flexibility of the economy following a period of sustained economic reforms and the impact on the domestic economy of the very strong growth in international demand for (and prices of) commodities. A number of commentators believe that the task now is less to create jobs to employ the growing workforce than to find enough workers to meet the emerging demand for labour.

At a recent Melbourne Institute Public Economics Forum in Canberra two speakers addressed the topic of skill shortages and how best to boost Australia's labour supply. This article provides a brief summary of the main points made and some concluding reflections.

Analysis presented by Dr Peter Burn of the Australian Industry Group (AiG) suggested that, on current policies, the maximum potential growth rate of the Australian economy over the next ten years is significantly less than the pace experienced in recent times. AiG estimate this ceiling is now about 3 per cent: the labour supply is expected to grow at about 1¼ per cent per annum on current trends, and labour productivity slightly faster (in the order of 1²/₃ per cent per annum). The forecast growth in labour supply reflects the net outcome of a number of factors.

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Strategies for Boosting the Labour Supply

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Although the number of people of working age is expected to increase, driven especially by strong net migration, average hours worked are expected to continue to decline, while little change is expected, overall, in the proportion of the working aged population willing to work. The latter is a change on recent experience since, overall, workforce participation has increased in recent years, especially amongst the over fifties. While this trend may persist, AiG argues there is little scope on current policy settings for stronger participation by females, which in any case has been trending up for many years, and the proportion of the population reaching retirement is increasing.

AiG expressed concern that, on current trends, there would be insufficient skilled labour available to maximise the benefits secured for Australia from the continuation of the commodities boom. AiG presented a number of options to avoid skill shortages, including higher net migration than currently proposed, greater investment in skills formation, more success in avoiding preventable illnesses amongst those of working age, measures to strengthen workforce participation of young people at risk, and further measures to speed the return to work after an injury. Some of these would also serve to raise labour productivity. Indeed, if taken in conjunction with measures to lift productivity, AiG suggested that such actions could raise Australia's growth potential back closer to 4 per cent.

Dr Andrew Leigh of the Australian National University was less concerned about the imminence of labour shortages, though he came to very similar policy prescriptions on at least one point. He expressed great scepticism about the historical reliability of forecasts of skills shortages, arguing that globalisation means that, if anything, such forecasts should be less reliable in the future than they have been in the past. He argued that basic economic theory suggests that increased demand for labour, or for labour with particular skills, will lead to increased wages in a properly functioning labour market. Labour shortages should only occur if wages are held down artificially below the market clearing level.

Higher wages encourage greater labour supply (either more hours worked or more workers prepared to acquire the necessary skills or more workers willing to work in the appropriate industries, or defer retirement etc). Higher wages may also encourage innovation and the substitution of capital for labour, raising labour productivity (without which higher real wages growth cannot be sustained), and raising living standards.

Indeed Leigh placed most emphasis on the importance of raising productivity on the grounds that sustained high rates of productivity growth will underpin high economic growth over the longer run. Since forecasts of specific skill requirements have such a poor track record, his preference is to invest in general human capital irrespective of which stage of the economic cycle the economy is experiencing. He argues that government policy should focus on increasing the 'quantity, quality and equity' of human capital formation. Well-targeted early childhood programs, raising the minimum school leaving age and raising the effectiveness of teachers were amongst his suggestions for reform.

How best to strike the balance between job-specific education and general education has long been a subject of debate. This issue is raised most directly in regard to vocational training, but is also relevant in the case of schooling and higher education. The less predictable the demand for particular skills and the faster the pace of technological advance the more pressing this issue becomes. This has implications for the design of curriculums. It may also have implications for how education and training are funded. There is room for more debate about these matters as we seek to define the desired parameters of the government's proposed education revolution.

The presentations from the April Melbourne Institute Public Economics Forum are available from <www.melbourneinstitute.com/forums/pub_forums.html>.

Where Are the Jobs?

The March 2008 release of labour statistics by the Australian Bureau of Statistics showed the unemployment rate edging up slightly to 4.1 per cent from 4.0 per cent in February.

According to the forecasts produced by the Melbourne Institute's Applied Macroeconomics research team, over the course of 2008, growth in employment is expected to slow from 2.8 per cent in March 2008 to 2.3 per cent by December 2008 (see the April issue of the *Monthly Bulletin of Economic Trends*).

This translates to around 55,000 more jobs in June, around 39,000 more jobs in September and around 60,000 more jobs in December 2008.

But where are these jobs to be found? Which industry? Which state? The charts to the right show where the jobs are likely to be, disaggregated by industries and states.

Employment in the finance sector is expected to fall (see Chart 1) as the industry adjusts to the aftermath of the global credit crisis. A turnaround in employment prospects is expected in the agricultural sector, but not in manufacturing (see Chart 2).

The mining boom is expected to keep year-end growth in employment in Western Australia above the other states (see Chart 3), but job opportunities, more broadly, are better in the states of Victoria, Queensland and NSW (see Chart 4).

The Melbourne Institute's Monthly Bulletin of Economic Trends *prepared by Guay Lim, Michael Chua, Edda Claus and Sam Tsiaplias of the Applied Macroeconomics research program can be downloaded from our website <www.melbourneinstitute.com/research/macro/bulletin.html>.*

Chart 1: Growth in Employment by Industries

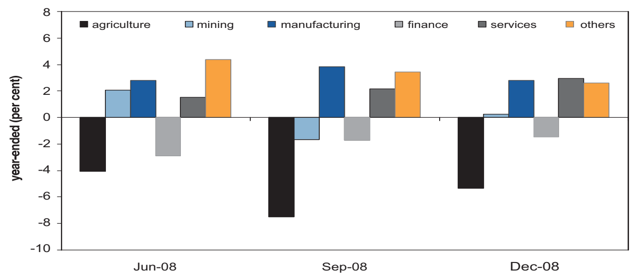


Chart 2: Change in Employment by Industries

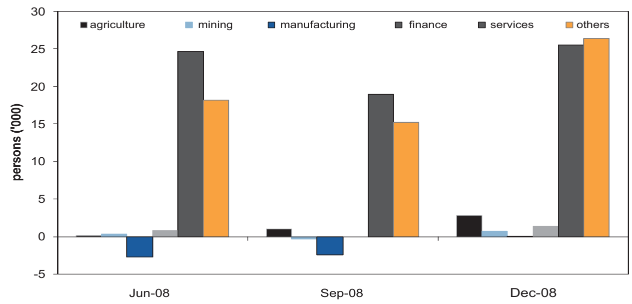


Chart 3: Growth in Employment by States

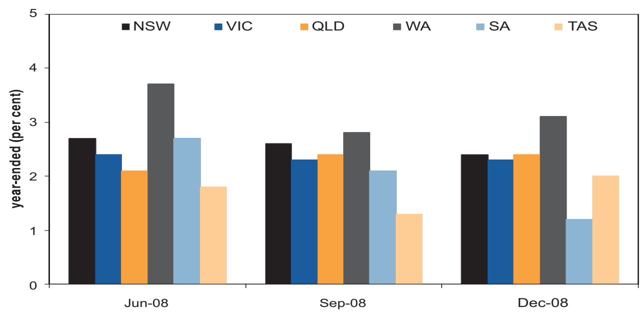
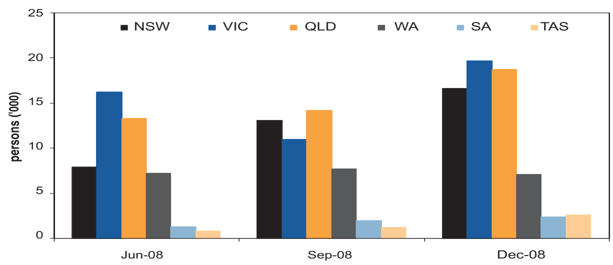
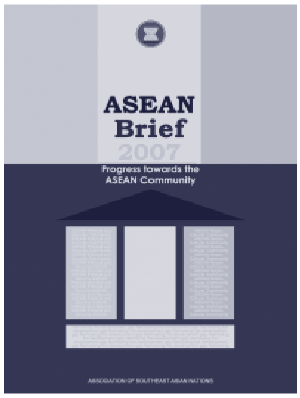


Chart 4: Change in Employment by States



Monitoring Report for the ASEAN Community

The Melbourne Institute has been tracking the progress of the ASEAN Community.



Over the past nine months, Associate Professor Elizabeth Webster, Dr Alfons Palangkaraya, Dr Jongsay Yong (from the Melbourne Institute), Professor Peter Lloyd (Department of Economics) and Dr Celia Reyes (the Philippines) have been working with the Statistics Unit of the ASEAN Secretariat to produce a report which tracks the progress of the ASEAN Community. The aim of the ASEAN Community is to achieve political security, economic integration and enhanced equity across the region.

This project has been more than just a research exercise. There have been extensive consultations with government and non-government stakeholders in each of the ten ASEAN countries—in all about 150 people were engaged in face-to-face consultations. The ten national ASEAN statistical offices were active partners in the project. They acted as focal points for each country and took responsibility for conducting a series of local workshops involving the (sometimes disparate) data providers in order to maximise the quality and calibre of the data. While much of the data collected are already collected by the ASEAN Secretariat or other international data bodies, they are often not in the appropriate format required to monitor the outcomes of the ASEAN Community. In addition, the numbers given for an indicator occasionally differ across data providers and these need to be examined and clarified.

Two main outputs have been completed. The first is the eleven-page *ASEAN Brief* aimed at senior politicians and advisors. This report, which was tabled at the ASEAN Summit in Singapore on 18–19 November 2007, shows at a glance the overall progress towards the ASEAN Community. The second is the full report. This provides the complete set of indicators together with more detail on each country.

It is intended that both of these reports will be updated biennially. There is limited value updating the reports more often since much of the social and community data come from surveys that are conducted infrequently. The indicators selected for inclusion in the reports focus on long-term economic, social and political outcomes rather than interim programs and objectives. This is to ensure that the monitoring framework has resonance and relevance for many decades to come. The project has been funded by AusAID.

For a copy of the ASEAN Brief visit <www.melbourneinstitute.com/asean/asean_brief.pdf>.

Health Economics at the Melbourne Institute

The first Health Economics Workshop by the new research program was held in March 2008.

Organised by the new Health Economics research program at the Melbourne Institute, speakers included Professor Carol Propper from the University of Bristol, in addition to speakers from the Melbourne Institute and the Department of Economics. Topics covered were varied and included the impact of 'targets and terror' on waiting lists in the UK NHS (Professor Carol Propper), the performance of public and private hospitals (Dr Paul Jensen), how obesity may be caused by parents 'bad habits' (Professor Kostas Mavromaras), the relationship between cannabis use and mental health (Dr Jenny Williams), and the impact of sanitation on child health in Indonesia (Associate Professor Lisa Cameron).

Housing Affordability: What Are the Facts?

Housing affordability is once again on the radar screens of Australian families, the media and the policy community that advises and or scrutinises the Rudd Government.

Affordability of housing has long been a subject for economic and social debate. Particular attention has been paid to equitable access to housing of specific income groups like first home buyers, low income households and those with little financial option but to rent. Real house prices have risen strongly in recent years—much faster than incomes—and after a prolonged period in which they have been relatively low, mortgage rates have been rising since 2002.

What Determines the Price of Housing?

Housing is a long-lived asset that delivers a stream of services to the occupiers. Purchasing a house has become the dominant form of wealth accumulation for the household sector. Tax law in particular is relatively favourable to the purchase of housing assets including using debt finance. In the September quarter of 2007, the ratio of household debt to disposable income was just under 160 per cent, which is three and a half times its level some 30 years ago.

Housing supply is relatively fixed in the short run. Sharp changes in demand for housing are reflected initially in higher prices. In deciding whether or not to invest, developers and prospective landlords often consider the risk-adjusted return on housing compared to other asset classes. Tobin's well established 'q' approach predicts that new construction will occur if the construction cost is less than the purchase price of established assets after transaction costs, holding charges etc. Increased house prices following a spike in demand will thus encourage increased supply, over time.

The speed of the supply response will also be affected by how quickly new housing can be constructed on Greenfield sites and the pace of redevelopment of existing housing precincts. These can be affected by the efficiency of development approval and planning processes and any constraints to the expansion of a city (whether physical or legislative). The degree of investment in community infrastructure also has been found to impact on house prices; and on the desirability of land on the urban fringes compared to 'well located' land closer in. Increased supply is also more likely when the price of assets is expected to increase in the foreseeable future.

Demand for housing is influenced by income, population growth, growth in the number of households, the availability of credit on favourable terms, favourable tax concessions, expected returns relative to those available from alternative investments and the cost of credit. Empirical studies suggest that housing is income elastic; that is, expenditure on housing grows faster than income.

Australia's long economic boom has boosted average incomes, including by reducing unemployment. Moreover recent innovations in the financial markets coupled with a sustained period of low inflation and low interest rates have facilitated higher demand for housing at any given level of income than in earlier decades. However, it is important to remember that an increase in demand for housing will not necessarily lead to a commensurate increase in the number of dwelling units required: some may become manifested in increased expenditure on different types or better quality dwelling units.

What Does HILDA Say about Housing Affordability?

A family is conventionally defined as suffering housing stress when housing costs consume more that 30 per cent of household income. Most reported measures of stress are approximations. They relate to averages and/or some median measures or to the circumstances of a 'typical' first home buyer. Using HILDA survey data collected annually between 2001 and 2006, researchers at the Melbourne Institute instead compared actual housing costs with actual income. They found that 13 per cent of those owning or purchasing their home experienced stress in 2006, up just over 3 percentage points from 2001, while the proportion of renters in stress was broadly unchanged at just under a quarter.

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Housing Affordability: What Are the Facts?

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However, further analysis of the HILDA data also revealed that for those purchasing their dwelling:

- The overall increase in apparent housing stress reflected the position of better off households rather than the poorest. There was little change between 2001 and 2006 in the proportion experiencing housing stress for households in the lowest (equivalised) income quartile but a significant increase amongst those in each of the next three quartiles.
- Most households move out of stress: less than half of those initially in housing stress remain stressed a year later and less than a third were in that state two years later.
- Purchasers kept repayments reasonably constant as interest rates first fell and then rose during the period. The gap therefore progressively closed between actual repayments and the rising minimums required by lenders. Even so, at the end of 2006 half of households were still paying off their mortgage faster than required; the proportion behind in their repayments was less than 5 per cent.

These data capture costs only for the principal residence. Thus the deterioration in the position of middle and upper income groups is not because they acquired second properties or rental properties. Instead it probably reflects the strength of their demand for housing and their choices to borrow to secure better quality or better located properties.

Turning now to renters, HILDA data show that the proportion of renters in mortgage stress in 2006 was significantly less than in 2001 for those in the lowest two equivalised income quartiles and generally stable for other groups. Given the very strong increase in real house prices in that period, this may seem surprising. The explanation seems quite complex. The bottom line, however, is that real rents did not increase much, if at all, over this period whereas incomes did. More recently real rents have begun to increase sharply, which may reflect in a deterioration of rental affordability in future waves of HILDA.

Moreover, the analysis shows that housing stress is far more prevalent for poorer renters than for homeowners. In 2006, for example, 40 per cent of renting households in the lowest income quartile were experiencing stress, which was three and a half times that of poorer homeowners.

These results are reported more fully in a paper by Gary Marks and Stephen Sedgwick in the June issue of the *Australian Economic Review*, which includes a Policy Forum on housing affordability. Both this paper and another by Judith Yates argue that the evidence suggests that the policy focus is best placed on poor renters rather than homeowners.

Professor Stephen T. Sedgwick,
Director of the Melbourne Institute and
Editor, Policy Forum, *Australian Economic Review*

ARC Linkage Grant Success

In collaboration with colleagues, Melbourne Institute staff had some success in the recently announced ARC Linkage Grant results for funding commencing in July 2008 until 2011.

Project Title	Total Amount	Grant Recipients and Partners
Improving Employment Outcomes in Early Psychosis: Social and Economic Benefits of Early Intervention	$380,286	Dr Eóin Killackey (School of Behavioural Science, The University of Melbourne); Professor Henry Jackson (School of Behavioural Science, The University of Melbourne); Dr Rosanna Scutella (Melbourne Institute); Dr Yi-Ping Tseng (Melbourne Institute); Professor Jeff Borland (Department of Economics, The University of Melbourne) with the ORYGEN Research Centre
Obesity Prevention among Low Income Families: Economic and Strategic Modelling	$144,344	Dr Catherine Burns (School of Exercise and Nutrition Sciences, Deakin University); Professor Kostas Mavromaras (Melbourne Institute); Professor Anthony Scott (Melbourne Institute); Ms Lisa Gold (School of Health and Social Development, Deakin University); Dr Mark Lawrence (School of Exercise and Nutrition Sciences, Deakin University) with VicHealth

Australian Economic Review

The June issue of the *Australian Economic Review* (vol. 41, no. 2) contains a range of interesting articles, including a particular focus on housing in the Policy Forum, discussed in the previous pages of this newsletter.

Invited Article

Globalisation, Growth and Crises: The View from Latin America, *Sebastian Edwards*

Contributed Articles

How and Why Has Teacher Quality Changed in Australia? *Andrew Leigh and Chris Ryan*

Leaving Home: What Economics Has to Say about the Living Arrangements of Young Australians, *Deborah A. Cobb-Clark*

Targeting Urban Congestion: Equity and Second-Best Issues, *Harry Clarke*

Policy Forum: Housing Affordability: What Are the Policy Issues?

Editor's Introduction, *Stephen T. Sedgwick*

Housing Affordability Crisis: Fact or Fiction?, *Chris Lamont*

Australia's Housing Affordability Crisis, *Judith Yates*

Is There a Housing Crisis? The Incidence and Persistence of Housing Stress 2001–2006, *Gary N. Marks and Stephen T. Sedgwick*

For the Student

Behavioural Economics, *Ian M. McDonald*

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Economics Forums

Too Little Too Late? Caring for and Preparing Young Children for Life

Recent years have spawned a rich debate about how we support children (and their parents) in the years prior to the commencement of formal schooling. What does the evidence show to be the most effective approaches to the provision of childcare, early childhood education and parental leave? What are the consequences of alternative approaches for the workforce participation of parents, especially women, and for the psychological, social and educational development of children? Do the needs of parents, children and the economy converge or diverge in these years? What is meant by 'quality' early childhood education and care or 'integrated' services; and how best to secure them? How should public policy respond to the needs of parents and their children in these years? These and related issues will be explored at the next Melbourne Institute Economics Forums to be held in Canberra and Melbourne on 24 June and 1 July respectively.

Professor Collette Tayler, Chair of Early Childhood Education and Care at the Melbourne Graduate School of Education (and co-author of the OECD's study *Starting Strong II: Early Childhood Education and Care*) will examine the issues from the perspective of the developmental needs of children. Associate Professor Guyonne Kalb, Principal Research Fellow at the Melbourne Institute, will look at the evidence from the perspective of parents, the labour supply and the economy. Guyonne has published a number of articles and working papers on the issues of childcare and labour supply. Dr Matthew Gray, Deputy Director, Research, at the Australian Institute of Family Studies, will discuss the evidence on the impacts of childcare on children and the extent to which the impacts differ for children from disadvantaged backgrounds and those from more advantaged backgrounds. He will also discuss the potential role of childcare in promoting social inclusion for children at risk. Matthew has published widely on social and economic policy issues.

Melbourne Institute Public Economics Forum

12.00 – 1.45pm, Tuesday 24 June 2008, Hyatt Hotel Canberra

Chair: Dr Jeff Harmer, Secretary, Department of Families, Housing, Community Services and Indigenous Affairs

Melbourne Institute Economics Forum

12.30 – 2.00pm, Tuesday 1 July 2008, Park Hyatt Melbourne

Chair: Mr Tony Cole, Business Leader for Investment Consulting in Asia Pacific, Mercer (Australia) Pty Ltd

Registration forms are available from <www.melbourneinstitute.com>.

2008 Melbourne Institute Working Papers

9/08 – ‘A Univariate Model of Aggregate Labour Productivity’
Robert Dixon and G.C. Lim

8/08 – ‘Be Wealthy to Stay Healthy: An Analysis of Older Australians Using the HILDA Survey’
Lixin Cai

7/08 – ‘Transitions from Casual Employment in Australia’
Hielke Buddelmeyer and Mark Wooden

6/08 – ‘Application Pendency Times and Outcomes across Four Patent Offices’
Paul H. Jensen, Alfons Palangkaraya and Elizabeth Webster

5/08 – ‘Is Hospital Treatment in Australia Inequitable? Evidence from the HILDA Survey’
Stephen Goodall and Anthony Scott

Working Papers can be downloaded for free from <www.melbourneinstitute.com>.

New Melbourne Institute Research Fellows

Recently the Melbourne Institute appointed two new Research Fellows to work within the Labour Economics and Social Policy research program.

Cain Polidano joined the Melbourne Institute in late March 2008 and has a Masters Degree in Agricultural Economics from the University of Sydney and is completing his PhD in applied microeconometrics at Monash University. His PhD topic is on motivations and health and employment benefits from formal volunteering.

Prior to commencing his PhD, Cain spent eight years working as a Research Economist with the Productivity Commission and the Australian Bureau of Agricultural and Resource Economics. In this time he undertook analysis across a broad range of policy areas, including corporate governance and regulatory analysis, greenhouse gas abatement, energy policy, international trade, land-use change and labour market reform.

Weiping Wu joined the Melbourne Institute in late March 2008. She is completing her PhD in applied microeconometrics at Monash University.

Weiping’s main research interests are microeconometric models with applications to labour, migration and health economics. Her PhD thesis, titled labour market assimilation of immigrants in Australia, examines some issues of occupation transition in the early stage settlement, the consequence of underemployment on psychological wellbeing, and the long-term effects of labour market achievement on subjective wellbeing. Weiping is currently involved in projects on spatial mobility and social exclusion, superannuation and household saving behaviour.

Melbourne Institute News

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