Frontier of full employment is a long way off

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Those predicting a labour drought and wage explosion should study the right statistics.

TIM COLEBATCH

THE markets have locked in an interest rate rise in March. Some say we can lock in another in May. But higher interest bills are only part of what is about to hit us.

The Reserve Bank's statement on monetary policy last week was a declaration of war on inflation: a war it plans to fight by forcing a sharp slowing in activity that will slash growth and hike unemployment.

The Reserve forecasts that, even without more rate rises, the global slowdown and the braking force of past rate rises would slow growth in non-farm GDP to 2.75% by June, and hold it there for a year before it slowly edges up. The unemployment rate would rise "modestly". Yet inflation would remain unacceptably high, above 3%, with the risk that higher inflation expectations become entrenched.

So the Reserve told us bluntly that it plans to raise rates. And that will push growth even lower, and raise unemployment less modestly.

The statement is full of reasons why and, given its mandate to keep inflation between 2% and 3%, the Reserve needs to be on guard. The world economy might slow enough to do its job for it — but it might not. The Reserve kept interest rates too low for too long between 2002 and 2004 because people kept seeing a global slump around the corner. It didn't happen then, and might not happen now.

But one part of the Reserve's case fails the reality test. It is the view that, as Macquarie Bank economist Rory Robertson put it, "the RBA pretty well declared the experiment of running the economy with unemployment in the 4% to 5% range to be a failure".

He's not wrong. The Reserve still tends to see the unemployment rate as *the* key indicator of the labour market, to assume it measures the reserve army of workers, to conclude that they are running out, and to assume this will unleash a wage explosion.

Those assumptions are wrong.

In the past four years, Australia has added more than a million jobs. Yet unemployment has fallen by just 94,000. More than 90% of our net jobs growth has come from immigration, demographic factors and (most importantly) rising workforce participation.

The point is subtle, but crucial. The unemployment rate has fallen from 5.6% to 4.1%, not because unemployment has fallen but because employment has risen — among people who previously were not officially part of the labour force.

Some were mothers with young children, some were students, some were "discouraged workers", some were overseas. Booms do that.

JOBS v UNEMPLOYMENT

Employment per 100 people of working age versus the unemployment rate (%).

1 Iceland	78.5	2.3*
2 Denmark	69.9	3.1
3 Sweden	69.5	5.6
4 Switzerland	68.0	3.6*
5 Norway	67.5	2.1
6 United States	67.5	5.0
7 New Zealand	67.2	3.4
8 Canada	66.3	6.0
9 Finland	65.0	6.6
10 Portugal	64.7	8.2
11 Czech Republic	64.2	4.7
12 Austria	64.1	4.3
13 Britain	64.0	5.3
14 AUSTRALIA	**62.4**	**4.3**
15 Spain	62.1	8.6
16 Japan	61.4	3.8
17 Ireland	61.3	4.5
18 Korea	61.0	3.1
19 Germany	59.8	7.8
20 Netherlands	59.5	2.9
21 Luxembourg	59.2	4.8
22 Greece	58.7	8.2*
23 France	58.2	7.8
24 Belgium	54.6	7.2
25 Italy	54.0	6.0*

SOURCES: OECD EMPLOYMENT OUTLOOK 2007 (ANNUAL DATA FOR 2006 CONVERTED TO FULL-TIME EQUIVALENTS BY THE AGE); NATIONAL STATISTICAL AGENCIES.

* DENOTES LATEST AVAILABLE DATA.

The Reserve Bank might be at war with inflation, but the labour market is not the enemy. PICTURE: REUTERS

Is our reserve army of workers running out? Far from it. At last count, in September 2006, we had more than 1 million people the Australian Bureau of Statistics classed as "wanting to work but not actively looking". We had another 576,000 "underemployed", mostly people in part-time jobs who want full-time work. And, of course, we had half a million unemployed.

Ignore these groups, and you do not understand the labour market. They are the reserve army from which our new workers come.

International comparisons underline this. The panel alongside shows two measures: the employment rate (employment per 100 people of working age) and unemployment. Among the 25 rich members of the OECD, those with incomes per head twice the world average (in real buying power), Australia is roughly in the middle on both.

There are big differences in part-time employment between countries so, to compare apples with apples, we have converted the OECD employment data into full-time equivalent jobs (very roughly: two part-time jobs equal one full-time job). And in 2006, Australia's employment rate ranked just 14th out of the 25.

We had the equivalent of 62.4 full-time jobs per 100 people of working age. That was well below the US (67.5) and New Zealand (67.2), let alone Sweden (69.5), Denmark (69.9) and Iceland (78.5). There is a frontier of full employment, but we are nowhere near it.

On unemployment too, we are roughly in the middle: equal 9th out of 25 in December, with an unemployment rate of 4.3%. There was quite a gap between us and the top eight, such as New Zealand (3.4), the Netherlands (2.9), Iceland (2.3) and Norway (2.1). Yes, central banks there also worry about inflation; two have interest rates higher than ours. But the facts are clear: we are far from full employment.

What about wages? The Reserve admits that the best measure, the bureau's labour price index, has been stable for years at around 4%. That's not surprising. Most workers have little bargaining power; there are exceptions, but they are exceptions. The Howard government stripped unions of their weapons, and their role. The Rudd Government plans to give them back their role, but not their weapons.

The Reserve highlights a measure it knows is less reliable: the national accounts estimate of wage growth per employee, which shot up 5.9% in the year to September. That is unrealistic; the Reserve has mistaken statistical noise for music.

Let's note three points. In that year, on official figures, 83% of new jobs were full-time (inflating average wages). Two-thirds of new jobs were for managers, professionals or associate professionals (inflating average wages). And the June quarter saw a flood of employer payments into superannuation (inflating average wages).

On Wednesday the bureau publishes the real music: its December quarter labour price index. That will show us if wage growth remains consistent with the Reserve's inflation target. So far, it has. The labour market is not the problem.