Youth unemployment

Remarks at a panel discussion on

‘Booms & Busts: Navigating a Future as if Young People Matter’

at the

Youth Futures (Virtual) Summit

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by

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Thank you for the opportunity to be part of this important discussion today.

Let me begin by acknowledging that I'm speaking to you today from my home which is situated on the traditional lands of the Muwinina people, and pay my respects to elders past, present and emerging of the *palawa* people of *lutruwita*, as Tasmania is called in *palawa kani*, the language of the Tasmanian Aboriginal people, and to Indigenous Australians everywhere, including in particular those participating in this summit.

I've been asked to speak in this session about unemployment, which is of course one of the most significant challenges facing young people today – as it has been for young people in every generation since the second half of the 1970s, but in new and different ways.

I'm going to draw heavily on a recently published paper by Dan Andrews – no, not the one who you see on the TV every day bragging about how much revenue the Victorian cops have raised from fining people for breaches of lockdown regulations – but rather Dan Andrews an economist who, at the Organization for Economic Co-operation and Development and more recently 'on loan' to the Australian Treasury, has done some really path-breaking, opinion-shaping research on issues like productivity and wages growth.

Dan, together with three other Treasury economists, published a paper in June called *The Career Effects of Labour Market Conditions at Entry* which you can find on the Treasury's website under 'Publications'.

The key finding of this research is that entering the labour market for the first time during a recession has significant adverse short- and long-term consequences for a person's subsequent experiences in the workforce:

- a person who enters the labour market for the first time during a recession is more likely to be unemployed, and for longer, than a person who enters the labour market at other times;
- such a person, when he or she does find a job, is more likely to be working at "low productivity" firm, which means they will get paid less; and
- a person who enters the labour market for the first time during a recession is less likely to change jobs – which means he or she is more likely to miss out on one of the main ways by which people get pay rises during their first ten years in the workforce (ie, by changing jobs) – a particularly significant finding given that almost 80% of lifetime wage rises occur during the first ten years of a person's working life.

More specifically, Dan Andrews and his colleagues find that people who enter the workforce for the first time in a year in which the youth unemployment rate has risen by five percentage points – which happened during and after the global financial crisis and again during the coronarecession – earn 8% less in their first year in the work force, and 3½% less in their fifth year in the workforce, than people who entered the workforce for the first time in a 'better' year. And this 'scarring' effect lasts for ten years.

There are four additional aspects of this research which are worth noting:

- this 'scarring effect' – the long-term loss of earnings experienced by people who start their working lives in a 'bad' labour market – has been bigger since 2000 than it was before the turn of the century: ie, it has affected the most recent generations of young people more than previous generations of young people;
- the 'scarring effect' seems to be greater for university graduates than for people without tertiary qualifications, which seems to suggest that the 'value' of tertiary qualifications can depreciate quite rapidly if they're not 'put to work' promptly after graduating;
- within university graduates, the 'scarring effect' is less for graduates of so-called 'G8 universities' than for those of other universities, and for 'mature age graduates' (those with some prior work experience) than for younger graduates;
- the 'scarring effect' is worse for women than for men.

All of this is consistent with the findings of the National Youth Commission inquiry that unemployment for 15-24 year-olds is consistently higher than that of 25-64 year-olds; and that traditional pathways to employment for young people have eroded over the past couple of decades.

The National Youth Commission has made some important recommendations arising from its work, in its proposal for a Youth Futures Guarantee, some of which I'll come back to in a moment. But I want to pose one additional important but challenging suggestion which I think flows from the research I've been talking about.

And that is that policies which favour small businesses, simply because they are small – such as taxing their income at a rate which is 5 percentage points below the rate that other businesses have to pay, or exempting them entirely from payroll tax, or giving them but not larger businesses preferential access to loan guarantees or tax breaks for capital expenditures – policies which have become very fashionable during the past decade and which appear to enjoy bi-partisan support - are actually part of the problem, not part of the solution. That is, they don't solve the problems we're talking about here: they actually make them worse.

You've probably heard politicians say that "small businesses are the engine-room of the economy" or words to that effect. And that sort of rings true to many people, because we tend to think of small businesses, especially ones in our own neighbourhoods, as "nice" and deserving of our support: whereas "big business" is "mean and nasty", the "top end of town", treat their workers badly, and what's more don't pay their "fair share" of tax.

All commonly-held views. But not true.

Contrary to the conventional wisdom, employment at small businesses (defined in ABS statistics as those with fewer than 19 employees, and including those with no employees) has *fallen* by 5.4% over the last 12 years.

Whereas at medium businesses (those with between 20 and 199 employees) employment has risen by 55%; and at large businesses (those with 200 or more employees) the number of jobs has risen by 48%).

Over the last five years – during which small businesses have paid a lower rate of company tax than larger ones, supposedly in order to encourage them to create jobs – employment at small businesses has *fallen* by 0.1%: whereas at medium-sized businesses employment has risen by 17%, while at large businesses it has risen by 13%.

Nor is it true that small businesses are more 'innovative', as is often claimed. On the contrary, ABS statistics show that small businesses (defined in the same way as before) are *less likely* to introduce new products or services, or to engage in any form of process innovation, than medium-sized or large ones.

And research by the Australian Taxation Office's 'tax gap' project shows that small businesses account for almost exactly *half* of the gap between total income tax paid and the income tax which the ATO estimates would be paid if there was 100% compliance with the tax law (as the ATO interprets it). By contrast, 'large corporate groups' account for only 9% of that gap; and high net worth individuals (and their associated entities) only 3% of it.

While the vast majority of small businesses do of course do 'the right thing' when it comes to tax, nonetheless in aggregate small businesses pay only 88% of the tax which the ATO reckons they should: whereas large corporate groups pay 95%, and high net worth individuals 93%, of what the Tax Office thinks they should.

What *should* happen, in my opinion, is that if there are to be tax preferences for *any* kind of businesses, they should be for *new* businesses, not small ones.

Here are seven reasons for saying this:

(1) new businesses are much more likely to be in industries which have good long-term prospects than existing small businesses (many of which have been in the same industry for generations);

(2) new businesses are more likely to create jobs;

(3) new businesses are more likely to innovate – indeed, the desire to bring to market a new product or service, or a new way of making an existing product or delivering an existing service, is one of the most common reasons for starting a new business;

(4) new businesses are more likely to be started by young people;

(5) partly for that reason, new businesses are more likely to employ other young people;

(6) tax preferences (or other measures of financial support) for new businesses will cost less than preferences for small businesses, since there are and always will be a lot fewer new businesses than small ones; and

(7) since there's no way a new business can prevent itself from becoming an older one (other than by going out of business) you don't have the 'perverse incentives' inherent in any preferential treatment for small businesses that sees them stop growing at just below the point at which they cease to become eligible for small business preferences.

So, in addition to the ideas mentioned in the Youth Futures Guarantee paper – like better exposure in the education system to the 'world of work'; targeted wage subsidies; better-focussed employment services; permanently higher youth allowances; and financial incentives for completing Year 12 (which I particularly support because 'drop-out' rates are so high here in Tasmania, owing to the flawed structure of our high school system) – we need to revisit the way our tax system seeks to encourage employment creation, innovation, and investment.

We need to stop preferentially treating small businesses, simply because they are small: and instead start encouraging new businesses, which are much more likely to help create the sort of future we want, especially for young people.