

The 'effective' unemployment rate

Submission to the Senate Select Committee on Job Security

by

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The definition of unemployment used in the Australian Bureau of Statistics' regular surveys of the labour force – that a person is regarded as 'unemployed' if he or she, during the 'reference week' when the survey was taken:

- had not been 'employed' – that is, had not worked for one hour or more for pay, profit, commission or payment in kind, in a job or a business or on a farm; or for one hour or more without pay in a family business or on a farm; or who had a job but weren't at work for any of a specified number of reasons (to do with paid leave, normal shift or other work arrangements, industrial action, or workers' compensation);
- *and* had 'actively looked for work' (that is, having done at least one of seven things the ABS regards as 'actively looking') in the past four weeks *and* were available to start work in the 'reference week';
- *or* were waiting to start a new job within four weeks from the 'reference week' and could have started that week if the job had been available

has been used since the inception of the monthly labour force survey in February 1978 (ABS 2018) and is consistent with widely-used and long-standing international definitions of employment and unemployment (ILO 2013: 52).

This definition of unemployment is often criticized as being too narrow (Lewis 2017; Sheil 2019).

It's certainly not the definition used by Centrelink to determine eligibility for the JobSeeker payment: single people can currently earn up to \$1,217 a fortnight (or more if they have dependent children or are 60 or over), and partnered people up to \$1,123 a fortnight) from casual employment and still be eligible for at least some payment whilst looking for work (Services Australia 2021).

It's also increasingly recognized, by economists and others, as being an inadequate and incomplete measure of labour market 'slack'– especially given the greater flexibility which employers now have to manage variations in their labour requirements by adjusting hours worked, as opposed to 'head-count'.

Economists have long recognized the existence of 'discouraged workers' – people who, though not employed and willing and able to work, nonetheless do not 'actively look' for work and hence are not classified as 'unemployed' in the labour force survey (Bosworth 1986; Wilkins 2004; Dong 2010) – and hence have looked at variations in the participation rate in order to gauge changes in the extent of such 'hidden unemployment'.

It is now also commonplace for them also to look at concepts such as 'under-employment', which measures the number of people working part-time, but are working fewer hours than they are willing and able to because their employer(s) were not offering more hours, and add them to the official unemployment rate in order to arrive at a measure of 'under-employment' (Reserve Bank of Australia 2017; Baker and Ball 2018).

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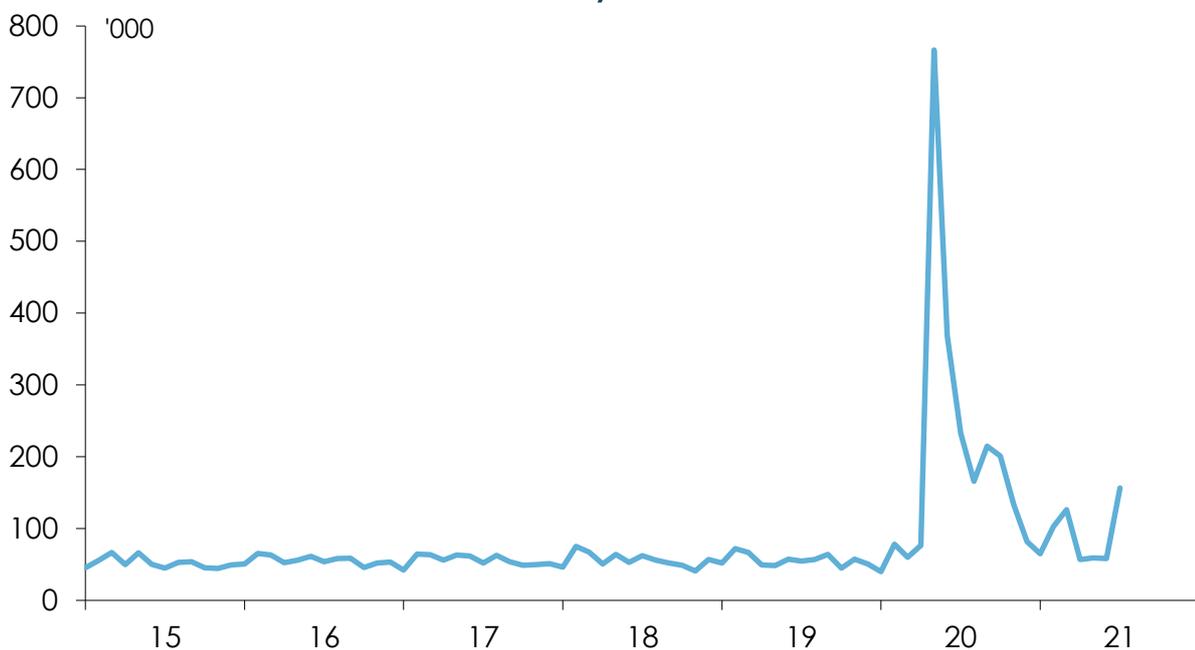
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With the onset of Covid-19, and the imposition of stringent restrictions on people's mobility, a much greater number of jobs have been at risk of being lost than would occur during a 'normal' recession – let alone during other phases of the business cycle. To minimize those potential job losses, governments in most 'advanced' economies (with the conspicuous exception of the United States) have instituted 'furlough' or wage subsidy schemes under which employers receive payments from governments in order to allow them to avoid laying off or retrenching their employees – even if, as a result of restrictions, there is no work for those employees to do.

This has resulted in an unusually large number of people being recorded in the monthly labour force surveys as being 'employed', but nonetheless working 'zero hours' because there was 'no work, or not enough work available' or because they had been 'stood down'.

This number had never been more than 80,000 in the five years prior to the onset of Covid-19: but it shot up to almost 767,000 in April last year (after the Government's 'Cash Flow Boost for Employers' scheme had commenced but before 'JobKeeper' had come into effect). It then gradually receded to something approximating its pre-Covid 'norm' by December, before rising again in February and January with the re-imposition of lockdowns in four states during those months; fell-back to 'normal' levels in the following three months, and then rose again sharply in June with the onset of the fourth lockdown in Victoria (Chart 1).

Chart 1: Number of people employed but working zero hours because there was no or insufficient work available or because they were stood down



Source: ABS 2021a and b.

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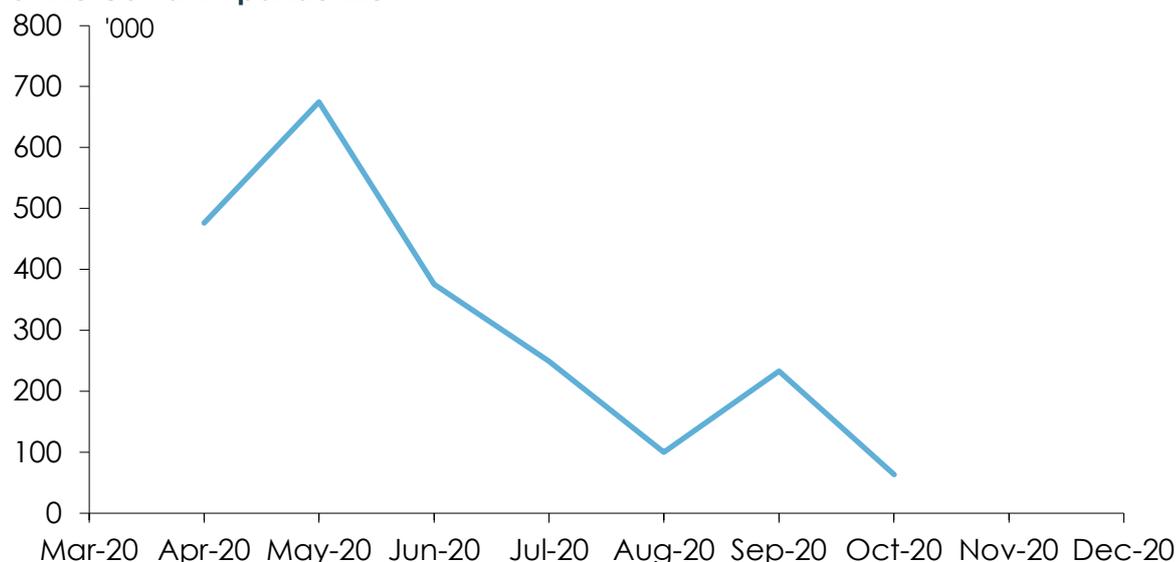
In the United States and Canada, people in this position are classified as 'unemployed' (ABS 2020) – which is one reason (though by no means the only one) why the unemployment rates in those countries rose considerably further (to peaks of 14.8% and 13.7%, respectively) than it did in Australia (7.4%). Had people in this position in Australia been classified as they are in the US or Canada, all else being equal Australia's unemployment rate would have peaked at 12.2% in April last year.

In addition to the large number of people who found themselves working 'zero hours', there was in the months immediately after the onset of the pandemic and the imposition of a nation-wide lockdown a large number of people who had become unemployed, but did not 'actively look for work' – because they were precluded from some forms of doing so (eg, attending interviews) by restrictions, because they saw little point in doing so given the apparent economic situation, or because they were (temporarily) no longer required to do so in order to receive the JobSeeker payment.

There is no formal 'count' of people in this position, but a rough approximation can be made by calculating the difference between the number of people who were recorded as being unemployed in the Labour Force Survey, and the number of people who would have been thus recorded had the labour force participation rate remained unchanged at its pre-pandemic level, and who (by assumption) would have been willing and able to work but for the restrictions imposed in response to the pandemic.

The number of people estimated to have been in this position rose from (by assumption) zero in March last year to a peak of almost 675,000 in May, then fell to less than 100,000 in August, rising again to 233,000 in September with the onset of the second lockdown in Victoria, but then falling to zero (by assumption) in November when the labour force participation rate returned to above its pre-pandemic level of 65.9% (Chart 2).

Chart 2: Estimated number of people who 'dropped out' of the labour force after the onset of the Covid-19 pandemic



Source: ABS 2021b.

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These people were recorded in the Labour Force Survey as having been 'not in the labour force'. Had they instead been classified as 'in the labour force' and 'unemployed' (in addition to those who were classified as 'employed' despite working zero hours for the reasons noted above and shown in Chart 1), then Australia's unemployment rate would have peaked at 15.2% in April last year (rather than at 7.4% in July as the 'official' measure did).

(Note that the US and Canadian unemployment rates, adjusted in the same way, would have peaked at 19.0% and 22.4%, respectively in April last year).

With these two adjustments to the 'official' unemployment rate as published by the ABS, the resulting figure can be interpreted as an 'effective' unemployment rate which, arguably, more 'accurately' captures the impact of Covid-19, and the measures deemed necessary to control it, on the labour market. This measure is shown in Chart 3 below.

A similar concept was used on several occasions last year by the Treasury (see, eg, Kennedy 2020 or Frydenberg and Cormann 2020: 2-26 to 2-27).

Chart 3: A measure of the 'effective' unemployment rate



Note: 'Economic reasons' are no or insufficient work available, or stood down. 'Discouraged job seekers' are those who would have been counted as 'in the labour force' and 'unemployed' if the labour force participation rate had remained at its March 2020 level (and assuming they had 'actively looked for work'). Sources: ABS 2021a and b; author's calculations.

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Note that this concept of the 'effective' unemployment rate does not include those who are working part-time, and who would have worked more hours had they been offered, because they are already included in the published measures of 'under-employment' and 'labour force under-utilization'.

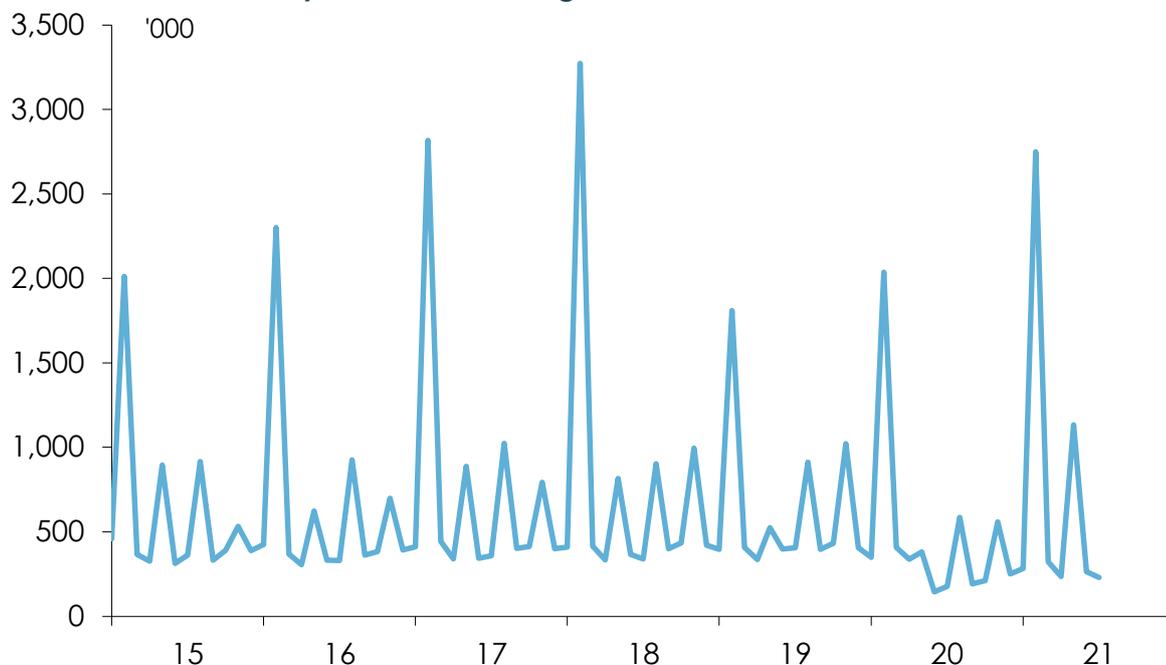
It is possible to make further extensions to the 'effective' unemployment rate described above and depicted in Chart 3, by considering two other categories of people whom the ABS Labour Force Survey classifies as 'employed' even though they worked zero hours during the 'reference week'.

Traditionally the largest group of people who are recorded in the Labour Force Survey as being 'employed' despite working zero hours during the 'reference week' have been those who were taking annual leave, holidays, flexitime or long-service leave during the 'reference week'.

The ABS doesn't seasonally adjust the count of these people, so it typically reaches a large peak in January each year – although the size of that peak varies considerably from year to year depending on how close the 'reference week' is to New Year's Day: in years when the 'reference week' is early in the month of January, the number of people employed but working zero hours because they are taking leave is usually higher than in Januaries when the 'reference week' is later in the month.

A similar though smaller effect can show up in April, depending on how close the 'reference' week is to the Easter holidays (Chart 4).

Chart 4: Number of people employed but working zero hours because they were taking annual leave, holidays, flexitime or long-service leave in the 'reference week'



Source: ABS 2021a and b.

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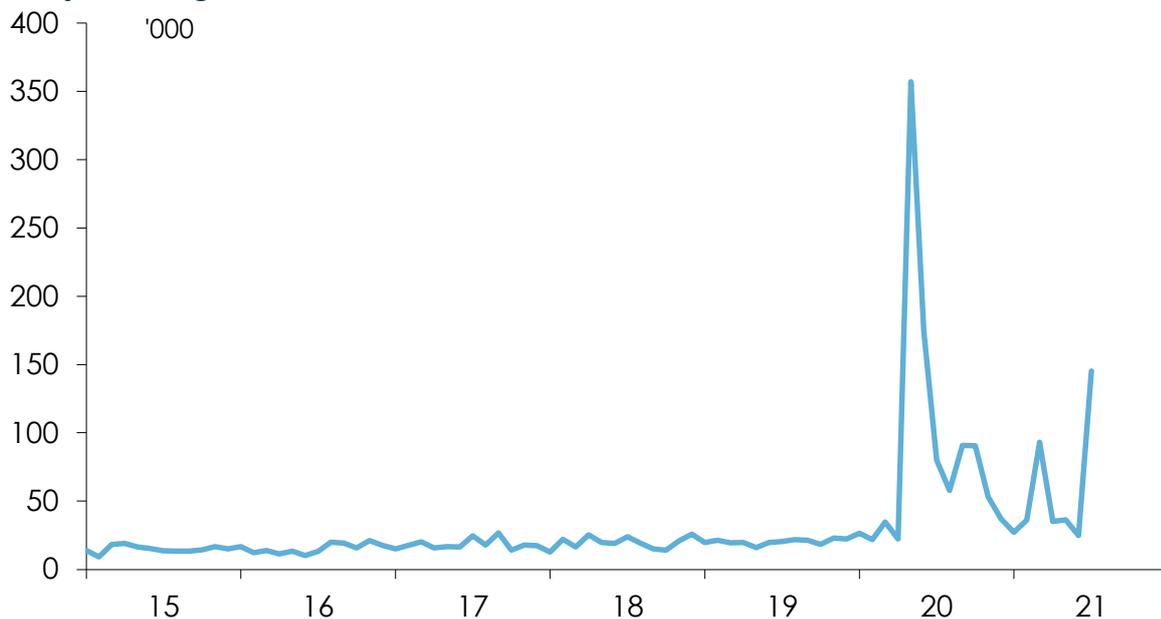
Since the onset of the pandemic, the number of people recorded as being 'employed' but working zero hours because they were taking some form of leave during the 'reference week' was noticeably larger than 'usual' (even allowing for the timing of the 'reference week') in January 2021, and again in April this year – suggesting that a significant number of people may have taken some form of leave (at the request of their employers, or on their own initiative) as a way of managing payroll costs during the pandemic.

However, since this data is not seasonally adjusted and (unlike the data on people working zero hours for 'economic reasons') exhibits a significant but irregular seasonal pattern (as shown in Chart 4), it is not possible to determine with any great confidence how many people might be taking leave (and hence working zero hours) for what are in effect 'economic reasons'.

Hence nor is it possible to include an estimate of the number of people in this position in a measure of the 'effective' unemployment rate.

In the June 2021 labour force bulletin (ABS 2021c), the ABS published data on a third category of people working zero hours but nonetheless counted as 'employed', namely, people who worked zero hours in the 'reference week' because they "began, left or lost a job" during that week¹. This series is shown in Chart 5.

Chart 5: Number of people employed but working zero hours because they began, left or lost a job during the 'reference week'



Source: ABS 2021a and b.

¹ Estimates of the number of people fitting this description have previously been published in one of the 'data cubes' included in the more detailed labour force survey bulletin released a week after the most closely-followed publication (ABS 2021c), but this was the first time such estimates had been highlighted in the initial release of data from the monthly labour force survey.

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The number of people included in this category had never, since it commenced in July 2014, been more than 27,000 in any month until April 2020, when it leaped to 357,000. It then declined steadily, though remaining above its pre-Covid level until May this year, before jumping again to 145,000 in June, entirely as a result of a surge in this category in Victoria (see Chart 5 above).

This suggests that this category also includes a significant number of people whose labour market experience has been affected in some way by the pandemic. Additionally, unlike the count of the number of people working zero hours because they are taking some kind of leave, this series does not appear to display any pronounced seasonal pattern. Hence it is reasonable to include the number of people assigned to this category of 'employed' in a measure of the 'effective' unemployment rate.

When the number of people thus defined is added to the other categories of 'effectively' unemployed people described above, the resulting 'effective' unemployment rate rose from 6.0% in March last year to a peak of 17.8% in April, and then declined steadily (apart from a brief increase in September last year with the commencement of the second lockdown in Victoria) to 5.7% in May this year, before rising to 7.1% as a result of the fourth lockdown in Victoria (which co-incided with the 'reference week' for the June labour force survey) – as shown in Chart 6.

Chart 6: An expanded measure of the 'effective' unemployment rate



Note: 'Economic reasons' are no or insufficient work available, or stood down. 'Discouraged job seekers' are those who would have been counted as 'in the labour force' and 'unemployed' if the labour force participation rate had remained at its March 2020 level (and assuming they had 'actively looked for work').

Sources: ABS 2021a and b; author's calculations.

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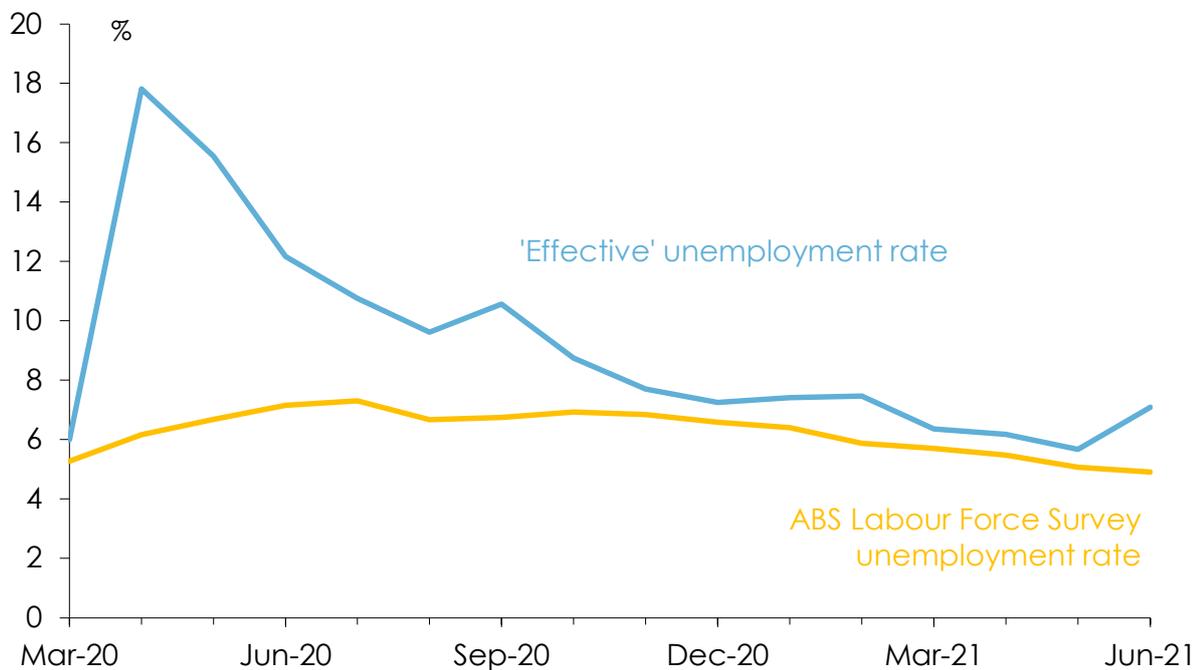
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The ABS has recently noted (2021c) that the category of people who worked 'fewer than usual' hours because they 'began, left or lost a job' during the reference week included some employers and owner-managers (especially in Victoria) who subsequently indicated that they were away from work for 'other reasons' in June this year. These two categories are to be reviewed and updated in the July labour force survey release, to be published later this month.

Chart 7 shows a more direct comparison between the 'effective' unemployment rate including people counted as 'employed' even though they worked zero hours for 'economic' reasons or because they 'began, left or lost a job', and people who (between April and October last year) had 'dropped out' of the labour force.

Chart 7: 'Official' and 'effective' unemployment rates



Source: ABS 2021a and b; author's calculations.

It is notable that the 'official' unemployment rate declined by 0.2 percentage point between May and June – inclusive of a 0.3 percentage point decline in Victoria – despite Victoria experiencing its fourth lockdown at the same time as the June labour force survey was being conducted.

That was because employers and employees responded to the lockdown by reducing hours worked (which fell by 8.4% in Victoria, and by 1.8% nationally, in June) – including to zero in many cases – and by taking leave, rather than by eliminating jobs altogether.

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It is likely that a similar response will be seen – albeit on a larger scale – in the July, and possibly also the August, labour force survey results, given the continuing lockdown in the Greater Sydney area of New South Wales, as well as in Victoria (again), South Australia and (most recently) south-east Queensland.

The 'effective' unemployment rate should give a more meaningful insight into the impact of these lockdowns on the labour market than the 'official' rate.

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