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Training and Employment Participation

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Employment participation is central to two critical problems presently facing Australia:

1. The severe structural mismatch in the labour market, with employers reporting that they cannot find workers with the skills that they need, while at the same time many people of working age report that they cannot find work, or cannot find as much work as they would like, or are working in jobs for which they are over-qualified.
 - Currently 50% of the workforce do not hold post-school qualifications, while according to the AIG, only 13% of the available jobs waiting to be filled are suitable for these workers

2. The ageing of the population will increase the rate of aged-dependency, and has been projected to result in a fiscal gap between government expenditure and revenue equivalent to 5% of GDP for the Commonwealth and another 4% of GDP for the States over the next 40 years
 - Treasury analysis shows that the best way to fix this problem is to increase the rate of employment participation so that GDP is higher because of the higher employment, thus increasing government revenues and lowering expenditures
 - Demographers tell us that if we could restore male employment ratios to their 1973 levels over the next 20 years
 - Aged dependency ratio would fall
 - And it would not return to today's level until 2052 – another 50 years

The solution to these two problems of labour shortages and increased age-dependency requires an increase in employment participation.

The potential for increased employment participation

- **(Table 1)** In the last forty years male workforce participation has fallen by 12 percentage points from 84% to 72%
- **(Table 2)** Most of this drop in male employment participation is accounted for by a drop of 10 percentage points in employment participation by those males aged 35-54. The employment participation of older males has fallen even further, but is less significant as there are fewer men in these older age groups.
- **(Table 1)** Employment participation by women has been increasing over the last 40 years, but it is still
 - well below the rate for men
 - lower than in many other developed countries
- **(Table 1)** Combining males and females, workforce participation is – as the government keeps telling us – at a record high, but employment participation is about the same as in the 1960s because unemployment is now about 3½ percentage points higher than then.
- Also much of the job creation in the last 20 years has been part-time jobs. This suits many people, but many women and some men want more hours work than they are currently being offered.
- The net result of these various changes affecting employment participation is that the average hours of paid employment for people of working age (15-64) is probably no higher than it was in the 1960s and 1970s
- Separately it has been estimated that in 2005 the total number of hours worked could have been increased by as much as 11%, if sufficient work were available for all those people who report that they were unemployed, or wanted more work, or were marginally attached to the labour force, or who could reasonably be induced to work if suitable work were available.
- Lots of potential to achieve the necessary increase in the labour supply by
 - Reversing the previous decline for men
 - Further increasing participation for women to levels in other countries

Causes of declining participation

- Changes in labour supply
 - **(Table 2)** Note the decline in male E/P ratio heavily concentrated in the decade or so between 1970 and 1983 when increased income support became available
 - Pensions and benefits increased by between 17 and 20 percentage points relative to the minimum wage between 1970 and 1978, some fall back between 1978 and 1982, but then went back up again and have stayed high ever since
 - The initial increase in income support relative to the minimum wage was in response to increasing unemployment and was not its cause. Also workforce participation fell even more substantially some years after the increase in income support. On the other hand, the continued high ratio reduces the incentive to obtain an unskilled job, and may be part of the explanation for continuing high levels of unskilled unemployment as the economy recovers.
 - Support the tightening of mutual obligation requirements, provided that these people can obtain work if they try.
- Changes in labour demand
 - More than half of male retirees aged 45-64 declare that their retirement was involuntary
 - Many of the 'voluntary' retirees would also be encouraged by employers when firms are restructuring

Implications of changing labour demand

- Job growth by occupation
 - **(Table 3)** Over the last 30 years Australia has created many skilled professional jobs, but negligible growth in manual jobs of the traditional 'blue collar' kind
 - Male blue collar jobs have declined from 63% to less than half
 - Over the last 30 years the number of male FT blue collar jobs almost certainly fell, and we know that in 2005 there were fewer such jobs than in 1989
 - Clerical and other service jobs have lost share and not kept pace with population growth
- Employment and education level
 - **(Chart 1)** The loss of job opportunities has mainly affected the chances of those males who left school early and who have not post-school qualifications. The rate of employment participation for both males and females without post-school qualifications is much lower
 - **(Chart 2)** Employment participation is particularly low for those males whose highest level of educational attainment is year 9 or less

- **(Chart 3)** Since 1981 (and probably before?), almost all the decline in Male Participation from 35 to 50+ is accounted for those with no post school qualifications
- Also most likely that the decline in male participation is concentrated among those who have not proceeded beyond years 9 and 10
- Good news is that school retention is much higher now
 - In 2001 only 3% of those aged 25 finished their education at year 9 or less compared with 30% at age 60
 - But this turnaround will not be sufficient on its own to restore employment participation so that there is no increase in age-dependency
- Regional impact
 - **(Chart 4)** In 1976 irrespective of where you lived you had much the same chance of being employed
 - **(Charts 4 & 5)** Today employment participation is very much less in the poorest neighbourhoods than in the richest neighbourhoods
 - This is consistent with the loss of unskilled jobs, which has been concentrated in poorer neighbourhoods
 - Even where unskilled jobs are created (waiters, cleaners, gardening) they tend to be located in neighbourhoods with higher socio-economic status, and go to the (part-time) children of higher income parents

Policy options and implications

- Improved incentives have been the focus of much past policy debate and initiatives to improve employment participation
 - Changes to superannuation arrangements are intended to encourage older workers to postpone their retirement
 - Considerable doubt about whether the new superannuation arrangements will make much difference to age of retirement,
 - much early retirement is forced
 - many people work to achieve a target retirement income – in which case the changes may allow/encourage people to retire earlier
 - these changes are very expensive for the Budget – billions of dollars but no accurate estimate
- Quite large changes to tax rates and social security withdrawal rates in recent years, but
 - the cost of these changes is also very high
 - Melbourne Institute estimated that the various changes in income tax rates, family benefit tax, and pension and benefit withdrawal rates that came into effect on 1 July will only

increase the *available* labour supply by less than 50,000 extra workers, or less than half a percent, at a full-year cost to the budget of \$11.4 billion in each year.

- Could be quite useful policy, but experience suggests that the actual impact of past superannuation and tax changes on employment participation is not encouraging
- Government has also expected that reductions in the cost of labour would improve employer demand for unskilled labour. But the Fair Pay Commission has increased minimum wages in line with the increase in other wages.
 - First problem is that the level of pensions and benefits effectively sets a floor to the minimum wage
 - The available evidence is that there is only a low elasticity of employment demand to a reduction in wages.
 - The Fair Pay Commission reports that estimates of this elasticity range from -0.2 to -0.8
 - IPART in its recent draft report (Section 3.1), using a high estimate of this elasticity of -0.8, estimated that say a 5% decline in the minimum wage relative to the average could draw roughly another 30,000 people into employment. These 30,000 people would enjoy a small increase in incomes, after allowing for taxes and loss of benefits, but the wages of some 1.25 million people already in employment would then fall by this same 5%.
- Government has also sought to tighten eligibility requirements for some groups of social security recipients so that they are under more pressure to look for work. In principle this notion of mutual responsibility can be useful. However, Australia is short of skilled labour, not unskilled labour.
- At least until the recent announcement of the Government's *Skills for the Future* package – about which I will say more in a moment – its policies have tended to eschew active labour market programs; although there has been some recognition that the most disadvantaged people lack opportunity and they have been given some limited labour market assistance
 - Even then the emphasis has been on work experience rather than training, and
 - any training has been too little to constitute a real second-chance education for the trainee
- Note, however, that the fall in E/P is mainly concentrated among unskilled people whose job opportunities have declined, so the priority should be to improve their opportunities rather than spend huge amounts of money to improve incentives, most of often for people who are already fully employed
 - And subsidized work experience in unskilled jobs risks further future unemployment for these unskilled people as the number of such jobs continues to decline
 - At the very least need to offer a mix of employment experience and training, but with more emphasis on genuine VET than has been the case so far in Australia

- Also there is a longer-term need for continuing education so that people who are currently employed can adapt to the inevitable future changes in technology. As a preventative measure we will need to provide life-long learning for people so that we do not risk the next generation leaving the workforce prematurely as has happened over the last thirty years.
- Quite strong evidence that increased education and training increases the chances of finding employment – but it needs to be more than what is provided at present to job seekers
 - See the evidence already cited on how skilled people are able to find jobs.
 - Evidence is available from the OECD for other developed countries on how training does actually work in practice to increase employment participation of unskilled people (see recent IPART draft report, section 4.1, for a brief summary)
 - Karmel & Woods of the NCVET (Adelaide) found that
 - in the last decade from 1993, the male E/P rate increased by 5.6 percentage points from the depths of the recession. Much of this increase in E/P is a natural part of recovery from recession, but 1.4 percentage points of this increase can be attributed to the increase in skill qualifications
 - For females their E/P rate increased by 13.1 percentage points, of which 5.5 percentage points can be attributed to the increase in skill qualifications.
 - In particular E&T makes a bigger difference to E/P among older men
 - Perhaps because professional jobs make less demands on motor skills and physical strength
 - But skilled women are even more likely to continue working
 - And qualifications obtained recently are more likely to increase employment participation by older workers than if they obtained their qualifications at a young age (K&W). This is especially true of higher level qualifications at the Certificate III or IV level or above
 - Note conclusion by the Australian Treasury (2004) that “*improving skill levels – particularly for the low-skilled – is a key element of improving overall participation levels*”
- Thus the best policy option is to place most emphasis on increasing the number of people able to take up the new jobs that are being created, but these do require new skills and a continuing willingness and capacity to learn
- I therefore welcome the Australian Government’s new package, *Skills for the Future*, and its emphasis on raising the skills of the adult workforce and the importance of upgrading skills over the course of an individual’s working life. I believe this package represents an important new beginning by this government, and I am pleased to endorse the priorities now recognized in this package.

How much training and what kind?

However, I now want to consider what more will be needed over the next two decades if we are to lift employment participation and thus avoid future skill shortages over the next few decades as the population ages. My remarks will draw heavily on the recently released draft report by IPART on the Skills Base in NSW and the Future Challenges for Vocational Education and Training (see IPART web site).

My starting point is that the ageing of the population will inevitably lead to a lower overall participation rate if nothing is done because older people on average have a lower participation rate.

(Charts 6, 7, & 8). Access Economics has modelled a “target scenario” based on the increase in age-specific participation rates that would be necessary if there were to be no such decline in the overall participation rate over the next 20 years

This target improvement in participation must necessarily come from people who would otherwise be unemployed or not in the workforce.

IPART has therefore examined the success of VET programs in getting previously unemployed people into jobs. Our conclusion is that a 50% success rate can reasonably be expected with relatively longer and more intensive training. Accordingly our modelling assumes that the training for those people re-entering employment in the target scenario would on average involve 650 hours of training, similar to a traineeship, and the average cost would be just under \$9000 per trainee in today’s prices.

By comparison, the Australian Government’s new work skill vouchers will be worth up to \$3000 each, and it is suggested that they could be used to purchase Certificate II courses, whereas IPART’s funding assumes Certificate III or IV courses and/or a mixture of formal training both on and off the job.

On the basis of the evidence obtained by IPART about the success of intensive training, the Access Economics target scenario has projected that the number of VET places should increase at an annual average rate of around 2.6% between 2005 and 2025 to achieve the target employment. This compares with an average annual rate of increase of around 1.4% if past trends and policies were maintained over this twenty year period, as projected in the Treasurer’s IGR scenario. **(Table 4)** By 2025 under the target scenario there would then be almost 600,000 extra VET students compared with a continuation of those past policies, or an increase of 26%. And the number of hours of VET provision would increase by 35%. The extra numbers of students and hours would build up over time, but the IPART package is deliberately front-loaded, so that in 2010 the extra number of VET students projected in the target scenario would already amount to another 215,000 VET students **(Table 4)**.

This additional training will need to focus principally on:

1. Re-entrant training that targets people who are currently unemployed or not in the labour force. This training is designed to update and improve their vocational and employability skills, and it is this component that is mainly front-loaded so that it builds up rapidly
2. Continuing training (life-long learning) that targets people who are already employed, to enable them to maintain and upgrade their skills to meet the challenges posed by technical and structural change. This continuing training will help prevent a repetition of the experience of the last couple of decades, with falling employment participation being caused by older workers dropping out of the labour force as their skills became out-dated – and this seems to be a welcome and particular focus of the Australian Government’s new initiatives
3. Refresher training that targets people who are not fully using their qualifications, to enable them to maintain their skills and move to jobs that make better use of their qualifications

All the training should emphasize the employability skills that have been nominated by employers and now endorsed by governments. Also in a world of rapid change there is more need for generic skills

- For example, 20% of adults have poor literacy skills, and computer literacy is even lower

Overall, the VET system should be preparing itself for a shift away from its very large focus on youth and in future with an ageing society there will need to be more emphasis on the training of mature workers.

Interestingly Access Economics projects that even with quite strong economic growth the number of jobs in the traditional trades will decline over the next 20 years. Consequently the demand for apprenticeships and traineeships is expected to decline significantly over the next 10 years as a share of total training, and then to decline more moderately from 2015 to 2025, because of increasing retirements. Governments need to be wary of over-reacting to what is probably a temporary shortage in the traditional trades. We need to avoid the past experience where between 15 and 20 per cent of people with VET qualifications are employed in jobs that require lesser qualifications.

For this reason another key concern is to ensure that not only is the supply of skills increased in future, but that the new skills are used. The IPART report accordingly argues that it is therefore important to also focus on workforce development which will foster new approaches to employee relations, job design and career development. The aim is to facilitate the adoption of high performance practices, through the pursuit of high-value-added and innovative product and service strategies, so that workers have satisfying jobs that allow employers to increase productivity by making full use of their employees’ capabilities. The report considers that TAFE should forge new partnerships with industry that enable it:

- to encourage the development of high performance workplace cultures,
- to disseminate new work practices and organisational approaches that support workforce development, and

- to form new networks to share these new practices and approaches.

In this way TAFE can act as an agent for change.

Costs and Benefits

(Table 5) Access Economics projects that by 2025, the cost of the VET necessary to achieve the target scenario of no decline in overall employment participation will amount to \$9.8 bn in today's prices. This amounts to an extra \$2.5 bn over the projected cost of continuing past policies that can be expected to lead to a fall in employment participation. Naturally this additional cost builds up over time, but because of the deliberate front loading it is already \$1 bn per annum by 2010.

(Table 6) The counterpart of this additional cost, however, is that employment participation is higher, with an extra 100,000 jobs by 2010, and 900,000 extra jobs by 2025, compared with the Treasurer's IGR scenario which projects a continuation of previous trends and policies. This extra employment from increased training compares with my earlier estimate of only 30,000 extra jobs from reducing the minimum wage by 5% relative to the average, or only 50,000 extra jobs from the recent measures to improve incentives, but which cost \$11.4 bn pa.

Furthermore in the long run, because employment and GDP are so much higher, the additional training largely pays for itself. **(Table 7)** Thus Access Economics projects that GDP in real terms would be 2% higher by 2010 and 12% higher by 2025, if employment and GDP rose as projected as a result of the additional training. This in turn means that the cost of VET would then rise only slightly from 0.5% of GDP today to 0.6% of GDP in 2025, even after allowing for the cost of training to rise faster than prices in general. Most importantly this extra GDP should generate substantial extra tax revenue [say 12% in real terms in 2025 compared to the Treasurer's IGR scenario], which should go a long way towards covering the projected Commonwealth and State fiscal gaps, even without allowing for lower government expenditures on social security.

These benefits from additional training will accrue to the trainees themselves, employers, and both federal and state governments. All should help pay. However, the funding for re-entrant training for those presently unable to find work will need to be shared between the Australian and state governments, possibly in proportion to their respective fiscal benefits. In the initial years, the re-entrant training will be especially important, and the onus will be on government funding to kick-start higher employment participation.

IPART is therefore recommending that the states and the Australian Government enter a compact to cover the proposed expansion and funding of VET. This compact would involve the Australian government also agreeing to ensure the referral of sufficient numbers of trainees to take up the extra VET places to be provided. Many of these people would be Centrelink clients, so that the savings to the Commonwealth Budget would be very direct.

Conclusion

A major challenge for Australia is to increase employment participation in the years ahead.

A very significant increase in education and training will be required. In addition, the type of training will need to change. Life-long learning will need to become the norm and not the exception. People need to be trained so that they can adapt to continuing change.

The VET system, and particularly TAFE, will also need to change if this expansion in the number of VET places is to lead to increased employment participation, where skills are not only provided but are also used. [These issues are explored in the second half of the recent IPART draft report, although they have not been developed in these notes.] Some states are further along the road than others to achieving an entrepreneurial TAFE system that is able to work closely with industry, and achieve the results projected.

As with all public policy, there are of course risks in making a very large extra investment in human capital, especially when this investment is deliberately targeted at people who are themselves at risk. These risks will be minimized if, as proposed, the two levels of government work together and the VET system develops a closer partnership with industry. Furthermore, the risks of doing nothing – and allowing the levels of VET and employment participation to continue in line with current trends and forecasts – are very much higher.

Indeed, investing in peoples' skills to increase employment participation is vital if we are to avoid the future budget problems that could otherwise result from an ageing society. It also offers the best hope of preserving Australia's egalitarian traditions.