



**Australian Government**

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**The Treasury**

**HOUSE OF REPRESENTATIVES**  
**STANDING COMMITTEE ON EMPLOYMENT AND**  
**WORKPLACE RELATIONS**  
**INQUIRY INTO EMPLOYMENT: INCREASING**  
**PARTICIPATION IN PAID WORK**

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## House of Representatives

### Standing Committee on Employment and Workplace Relations

#### Inquiry into employment: Increasing participation in paid work

##### **Executive Summary**

The nature and extent of labour force participation is largely a matter of individual choice, and the wellbeing of society as a whole is likely to be enhanced if people have maximum scope to make choices, taking into account their own circumstances and preferences. However, such choices sometimes impose costs on society and can be distorted by disincentives or obstacles to participation.

The *Intergenerational Report* (IGR) identified that Australia is faced with an ageing population. The combined effect of recent participation trends and an ageing population is projected in the IGR to reduce the overall participation rate markedly over time, from around 64 per cent in 2003–04 to slightly over 55 per cent in 2041–42. The IGR also projects a fiscal gap, which gradually increases to around 5 per cent of GDP by 2041–42..

Improving participation rates would assist in reducing the fiscal gap, and will also have other benefits, making society both richer and fairer in terms of access to employment than would otherwise have been the case.

Policies aimed at improving participation could focus on:

- Improving education and skill levels across the population;
- Improving labour market flexibility;
- Reforming income support arrangements to encourage participation;
- Improving health, particularly for those of workforce age; and
- Ensuring that retirement incomes policy does not encourage early withdrawal from the labour market.

##### **Introduction**

The House of Representatives Committee on Employment and Workplace Relations is inquiring into and reporting on increasing participation in paid work. The Terms of Reference outline that the inquiry will be focussing on:

- measures that can be implemented to increase the level of participation in paid work in Australia; and
- how a balance of assistance, incentives and obligations can increase participation, for income support recipients.

Treasury has a strong interest in participation issues, and this submission draws heavily on two recent publications directly related to labour force participation.<sup>1</sup> Consistent with its mission statement, Treasury is focussed on removing the impediments that may prevent people from participating, and thereby improving the wellbeing of those wanting to work.

The ageing of the population over the next 40 years presents a challenge to policy makers. These issues are discussed in the first section of this submission. The second section considers key drivers of GDP growth, and how increasing participation might address some of these challenges. Section 3 looks at possible policy directions for addressing barriers to participation.

### **Ageing of the Australian Population**

The IGR highlighted that Australia is faced with an ageing population that is due to both a decline in fertility starting 40 years ago and improved life expectancy. It will have a number of effects over time.

First, the number of young (aged 0 to 14) dependent people is projected to fall by around 5 per cent over the next 40 years. This contrasts with the 17 per cent growth in the number of people aged 0 to 14 over the last 40 years. This means that the services provided for young people will not need to expand as quickly as they have in the past 40 years, and may even provide room for reductions in some areas.

Second, the growth in the number of people of working age (aged 15 to 64) is projected to slow gradually to almost zero by 2042. In 2002 over 67 per cent of the population (13.2 million people) was comprised of people of working age and this proportion is projected to fall to around 61 per cent of the population (15.4 million people) by 2042. Overall, the labour force participation rate is also projected to fall, with labour force growth projected to slow to around zero in 40 years.

Third, the number of people aged over 65 is projected to increase significantly from around 2.5 million in 2002 (over 12 per cent of the population) to around 6.4 million (nearly 25 per cent of the population) in 2042. This will bring into further focus issues associated with retirement incomes, health and aged care. Furthermore, the number of people aged over 85 is projected to almost quadruple (from around 0.27 million in 2002 to 1.13 million in 2042) with these people being the most intensive users of the health and aged care systems.

An increasing aged population implies higher government expenditures. Over half of Commonwealth government spending is directed to health and aged care, social safety net payments to individuals, and to education. Over the next forty years, Commonwealth expenditure on aged care and pensions is projected to rise by around 2.7 per cent of GDP, slightly offset by a fall in education expenditure of around 0.2 per cent of GDP. But increasing health costs will represent the major component of the projected increase in expenditures, rising from 4 per cent of GDP in 2001-02 to over 8 per cent of GDP in 2041-42. This reflects the impact of an ageing society as well as the effects of improved technology on demand in the health sector.

Putting together all of the expenditure factors – health, aged care, pensions and education, the IGR projects a fiscal gap of around 5 per cent of GDP by 2041-42, assuming no debt costs from previous deficits and a constant revenue to GDP ratio. To put this into perspective, the 2003-04 Budget forecast is for a surplus of \$2.2 billion. A budget deficit of 5 per cent of GDP for 2003-04 would be a shortfall of \$40 billion.

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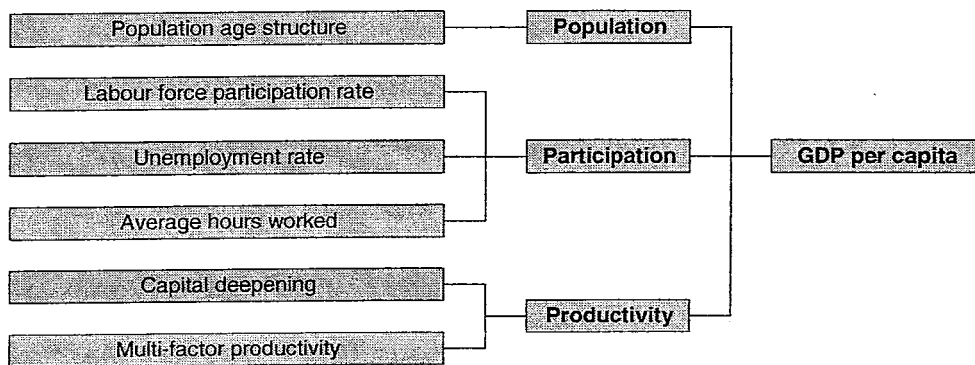
<sup>1</sup> See Department of the Treasury (2003a) and Department of the Treasury and Department of Finance and Administration (2003).

Increasing the size of the economy, while maintaining taxes as a proportion of GDP, and with the level of government expenditure remaining stable will allow the fiscal gap to be reduced or eliminated. Increasing participation will play a key role in growing the economy faster.

### The Drivers of GDP Growth

The productive capacity of the economy can be decomposed into trends in population, labour force participation and productivity (Chart 1). In Australia's case, trends in population, participation and productivity have all pulled together to produce strong growth in GDP per person over the past decade or so.

**Chart 1: The Components of GDP per capita growth**



*Population* trends over recent years have featured a rising proportion of the population in traditional working age groups (15 to 64 years). This has been the first part of a transition that started with the substantial decline in birth rates experienced in the 1960s and 1970s. The decline in the birth rate meant that the youth dependency ratio, that is the ratio of people below working age to those of working age, declined. The second part of the transition will see a rise in coming decades in the age dependency ratio, as the number of those above 65 rises relative to those aged 15 to 64. Among those of working age, there will be a rising proportion in the 55 to 64 years age group.

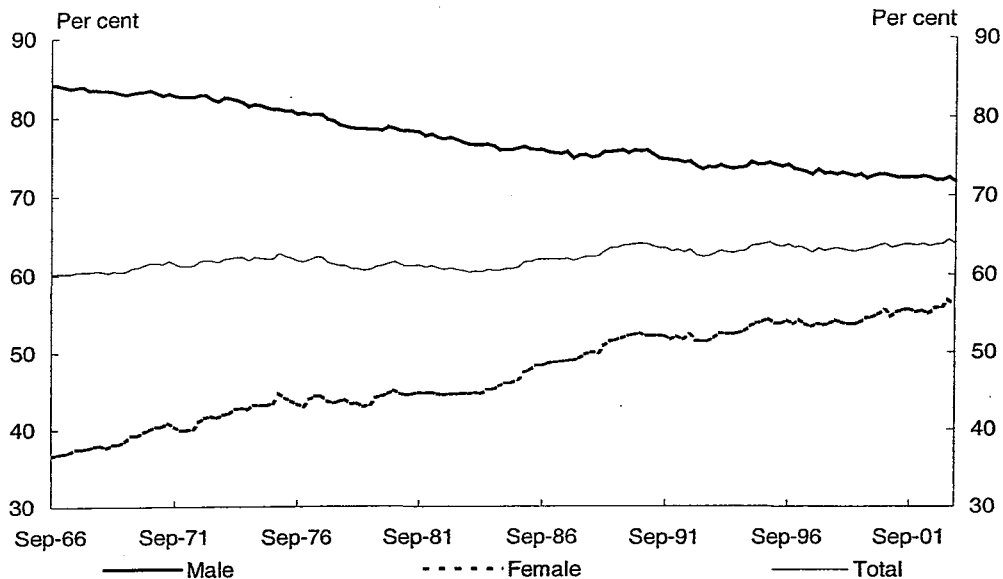
The various components of *Participation* (Chart 1) determine the extent to which the population is willing and able to work. Over recent years, these components had a net positive effect on economic growth. The overall labour force participation rate (the proportion of the working age population that chooses to enter the labour force and seek work) has risen gradually as more women have entered the labour force, more than offsetting a declining participation rate among men. The unemployment rate has fallen since the early 1990s, while the average number of hours worked per employee has fallen only slightly. As a result, participation (the hours worked per head of the working age population) has risen.

*Productivity* growth has been by far the major source of growth in GDP per capita. Australia's productivity growth in the 1990s was stronger than in most other OECD countries, particularly in the second half of the 1990s. Policy can also have a major influence on the productivity growth rate. Productivity is discussed in further detail in *Sustaining Growth in Living Standards*, Budget Statement 4, 2003-04.

Turning to the individual components of participation, the labour force participation rate has risen modestly, from around 60 per cent in the mid 1960s to around 64 per cent at present (Chart 2). This gradual upward trend masks quite different trends among men and women. Female participation rose dramatically from below 40 per cent in 1966 to over 55 per cent in 2003. At the same time, male participation fell markedly from 84 per cent in 1966 to around 72 per cent in 2003.

Given that the nature and extent of labour force participation is largely a matter of individual choice, the wellbeing of society as a whole is likely to be enhanced if people have maximum scope to make choices, taking into account their own circumstances and preferences. However, it needs to be recognised that such choices may impose costs on society and can be distorted by disincentives or obstacles to participation that may exist. Policy choices can affect these distortions and obstacles. These issues are discussed in greater detail later in this submission.

**Chart 2: Participation rates by gender, Australia**



Source: Australian Bureau of Statistics, *Labour Force, Australia, Preliminary* (Cat. No. 6202.0, June 2003)

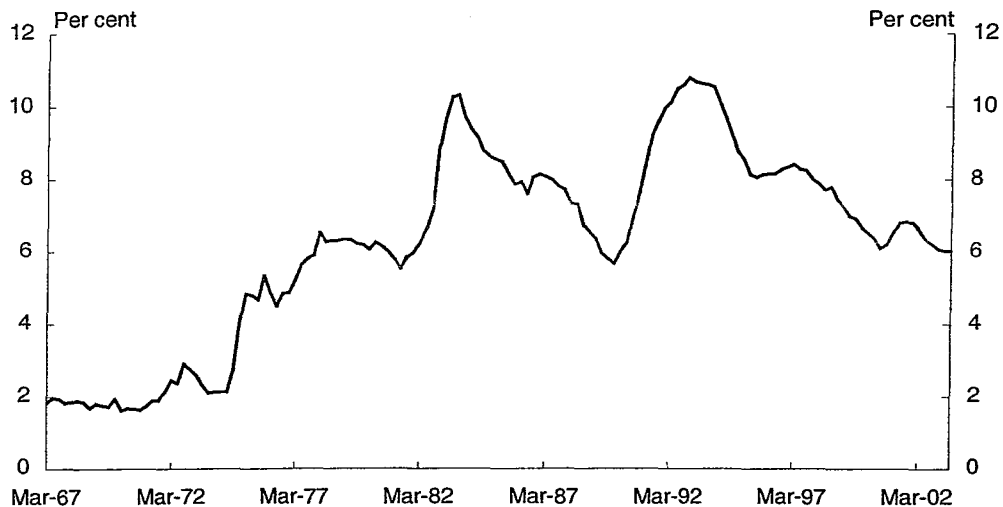
Broadly similar trends in overall participation rates by gender are apparent across the OECD. The breadth and strength of these trends suggests that they are mainly driven by economic opportunities and social factors. However, policy settings also can have an influence.

Consistent with the general trend, Australian participation rates for men aged between 55 and 59 fell over the last 20 years. But Australia's rates fell more than in other key economies. While Australian participation rates for women aged between 55 and 59 increased significantly, these increases were consistent with the trend across most of the OECD countries. So, while the Australian female participation rate almost doubled for this age group, Australia's OECD ranking remained stable for the group.

OECD research shows that it is more difficult to reverse retirement decisions, once taken, than it is to encourage people still in employment to delay retirement (OECD 2003). Those most weakly 'attached' to the labour force tend to be more likely to initiate early retirement before age 65. OECD evidence shows that workers who did not complete secondary education, sole parents and the moderately disabled are other groups similarly at risk of withdrawing from participation.

European studies also indicate that, across all age groups, withdrawal from participation is seldom reversed and leads to a high risk of persistent low standards of living (OECD 2003). So there are social as well as economic reasons for concern about falling participation rates among those of working age. It is also unlikely that withdrawees have made sufficient financial provision for permanent withdrawal from the labour force. In equity terms, the falling participation problem is similar to that of long-term unemployment.

The second aspect of participation is the unemployment rate – the proportion of people participating but unable to find work. After exceeding 10 per cent during the early 1990s, the unemployment rate has fallen to around 6 per cent in 2003 (Chart 3).

**Chart 3: Unemployment rate, Australia**

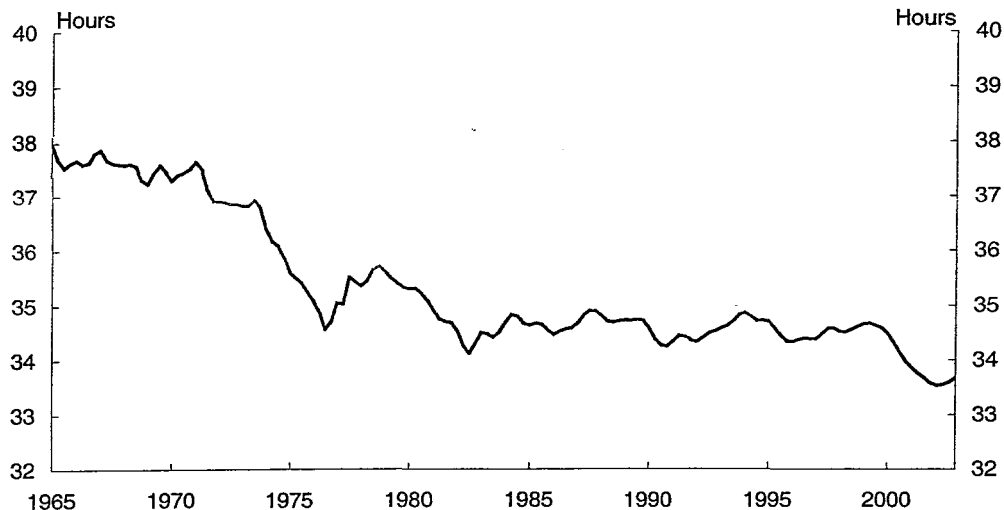
Source: Australian Bureau of Statistics, *Labour Force, Australia, Preliminary* (Cat. No. 6202.0, June 2003)

While the unemployment experience in Australia has, in general, been better than in many other developed countries, there have been other countries that have experienced lower levels of unemployment over a consistent period of time, most notably the United States.

Policy actions can influence unemployment outcomes. For example, if minimum wages are high compared to the median wage, businesses will be less willing to employ some lower skilled workers.<sup>2</sup> Employment protection legislation which makes it harder to dismiss employees also makes it riskier and more expensive for employers to hire new employees, and contributes to unemployment. Tax and welfare policies also can interact to increase unemployment if benefit payments are not work-tested or time-limited, or are generous compared to after-tax incomes from employment (OECD 1999). While these issues are seen as contentious by some in Australia, they are part of an increasing consensus about the causes of persistent unemployment.

The third element of participation is average hours worked. Average hours worked per employee in Australia has fallen only slightly over the past two decades, after falling sharply between the mid 1960s and early 1980s (Chart 4). Since mid 2001 average working hours have fallen further, apparently due to full-time employees working fewer average hours. In recent months, the average number of hours worked has begun to climb again.

<sup>2</sup> Australia has the second highest minimum wage in the OECD, at 57.9 per cent of the median wage. Only France, at 60.8 per cent of the median wage, has a higher minimum wage. In contrast, the minimum wage in New Zealand is 46.3 per cent of the median wage, 41.7 per cent in the United Kingdom and 36.4 per cent in the United States. See Keese and Puymonen (2001).

**Chart 4: Average hours worked per employee, trend, Australia**

Source: Australian Bureau of Statistics, *Modeller's Database* (Cat. No. 1364.0.15.003, December 2002), unpublished data, and *Labour Force Statistics, Australia* (Cat. No. 6203.0, June 2003).

While Australia's average hours of work fell by around 10 per cent over the last four decades, most other OECD countries have recorded larger falls. Average hours fell by over 30 per cent in Germany and Norway and by around 20 per cent in the United Kingdom and Japan. An important exception is the United States, which has around the same average hours of work today as four decades ago.

The fall in average hours worked in Australia almost entirely reflects the increase in the number of people in part-time employment, as average hours worked by part-time and full-time employees both increased over the past two decades. In the mid 1960s, around one in ten employees worked part-time. By the start of 2003, over one in four worked part-time.

The rise in part-time employment in Australia parallels rapidly increasing labour force participation by women. Availability of part-time work is likely to have facilitated higher participation by women, and by formerly non-working parents in both single-parent families and dual-income families.

It is impossible to prescribe what tomorrow's participation performance ought be. Participation outcomes (that is, hours worked per head by the working-aged population) are a product of individual and family choices in the context of labour market options and policy influences.

However, European experience suggests falling participation rates, like long-term unemployment, bear mostly on the least affluent, are difficult to reverse, and can lead to persistent poverty and social disengagement.

Demographic projections show more of the labour force will be concentrated in the older age brackets within which participation in Australia has become relatively low by international standards. It could be that employers, in response to changing demographic structures, might change their employment practices and make it more attractive for this group to actively participate. However, it would appear that these low participation rates are at least in part driven by insufficiently flexible and competitive markets, rather than changing worker preferences.



## **The Demographics Taskforce**

Demographic change has been identified by the Government as one of the nine key strategic leadership policy directions for Australia. An interdepartmental Taskforce, reporting to the Treasurer, has been established to focus on:

- labour force participation, particularly for older Australians who wish to work;
- superannuation and retirement incomes policy; and
- managing expected increased government spending in areas affected by demographic change, particularly health and aged care.

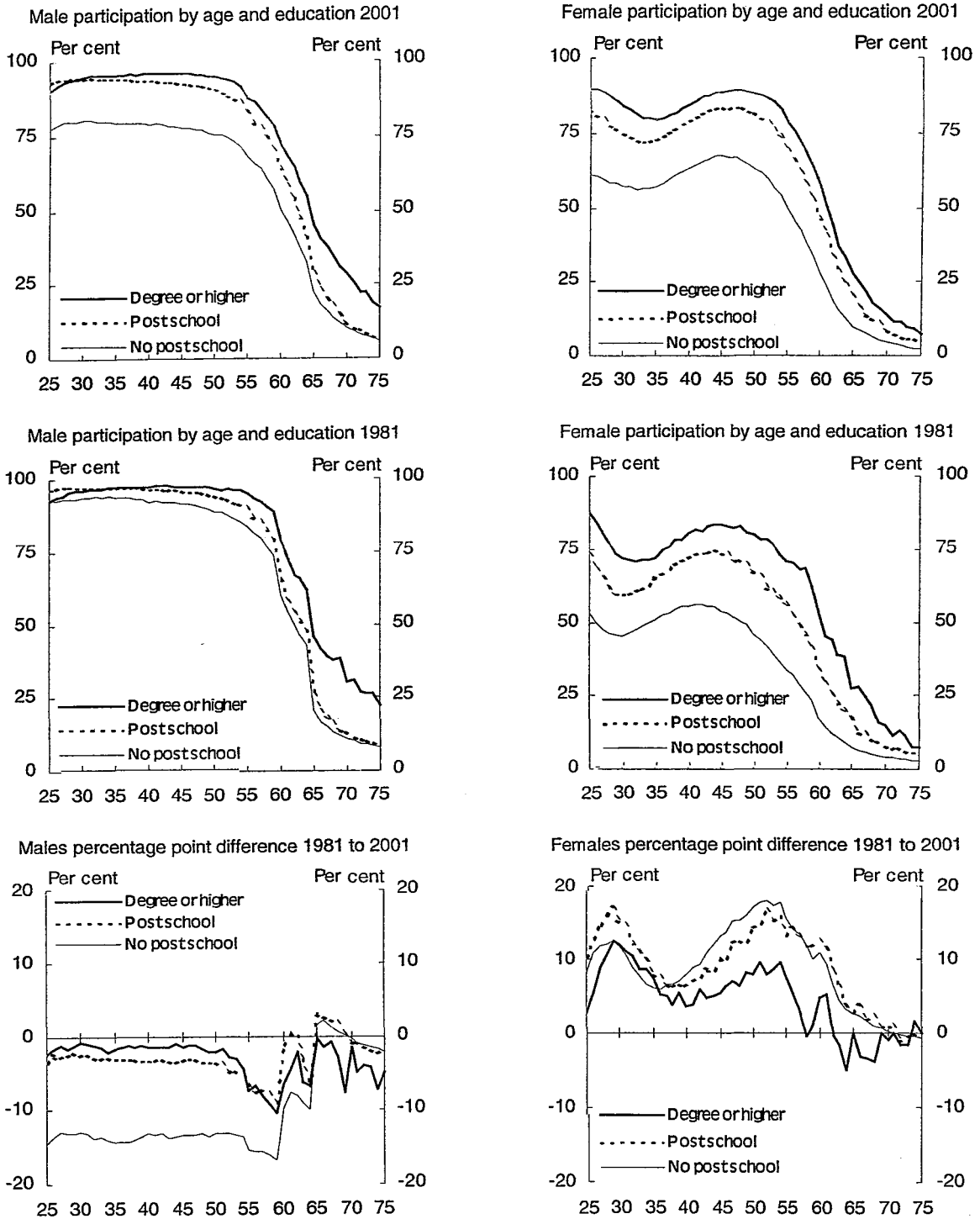
Treasury chairs the Demographics Taskforce, and while consideration of many issues remains in early stages, a number of policy areas have the potential to increase labour force participation over time. In particular, the Taskforce has identified skills and education, income support recipients, workplace relations, health and retirement incomes. Each of these areas is discussed briefly below.

### **Skills and Education**

Recent research highlights improving skills and educational qualifications as an important element in improving participation outcomes. In Australia, as in other countries, there is a strong correlation between skill level and labour force participation. A fuller discussion of these issues is contained in the Winter 2003 *Economic Roundup* (Department of the Treasury 2003a). While labour force participation of all men has fallen over the past 20 years, this fall has been far greater for unskilled men whose participation is now significantly less than that for skilled men. Furthermore, this fall in participation has been uniform across all age groups, suggesting that low skills is a problem affecting the participation of young and old alike (Chart 5). There was also a significant increase in early exit from the labour force for all males aged 55 years and over for all educational attainment categories.

Consistent with the increase in aggregate female labour force participation, participation rates have increased over the past 20 years for all educational attainment categories and for all age groups (Chart 5). However, there remain large differences in participation rates between educational groups, with females with post-school qualifications having much higher participation rates than those without post-school qualifications. Since the early 1990s, the increase in female participation for all educational attainment groups has slowed substantially.

**Chart 5: Participation rates by age, educational attainment and sex**

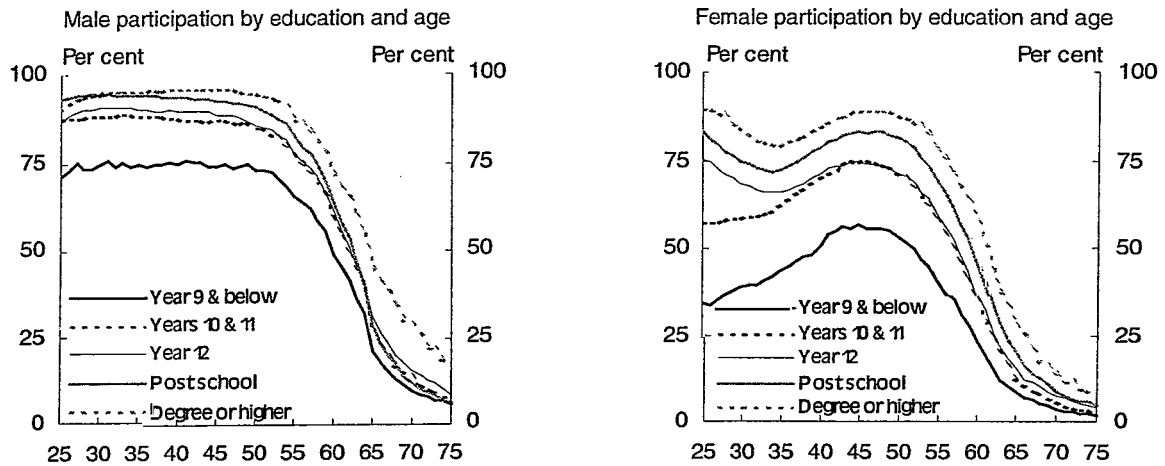


Source: Australian Bureau of Statistics, 1981 and 2001 Censuses.

The large fall in participation rates for males with no post-school qualifications, and the substantial differences in female participation rates between those with no post-school qualifications and those with higher educational levels prompts a closer examination of this group. Chart 6 disaggregates the no post-school group by the level of schooling completed. The participation rates of males who

have completed year 12 schooling are only just below those with post-school qualifications. However, as the level of schooling completed declines, participation rates fall dramatically.<sup>3</sup> Similar to the experience of males, female participation rates are lowest for those with the least schooling across all age groups. Female participation rate age profiles also varied with the level of educational attainment. Females who did not complete year 12 had much lower participation rates at younger ages than other female education groups.

**Chart 7: Participation rates by educational attainment and age in 2001**



Source: Australian Bureau of Statistics, 2001 Census.

This analysis highlights the importance of improving skills and educational outcomes – particularly for the low skilled. The increase in school retention rates already achieved over the past decades is likely to lead to higher participation in the future – but additional increases are possible if rates improve further. Measures to ensure that existing education and training systems are working effectively – thereby enabling lifelong learning to take place – and enabling individuals to flexibly move between and within education and work also assist participation. Remedial action to improve the skill levels of adults of working age who are not participating or are at risk – including the mature aged – is important to enable low skilled Australians of working age to participate effectively.

### Income Support Recipients

Participation decisions are influenced by four key elements of the income support system: the maximum rates of payments; income test structures (including their interaction with the income tax system); eligibility criteria for payments; and obligations (such as requirements to look for work) attached to payments. Ensuring that the income support system provides an adequate safety net for those in need while minimising disincentives to work is a delicate balancing act.

There are variations in participation requirements across categories of income support. For example, pension payments to those of labour force age (eg. Disability Support Pension and

<sup>3</sup> A substantial portion of the no post-school qualifications category is persons who did not state their level of schooling. This group had extremely low participation rates reflecting, in part, that many of these persons also didn't state their labour force status. Exclusion of the 'not stated' group would substantially increase (for example, by around 5 to 6 percentage points for prime age males) participation rates for the no post-school qualifications group. However, to promote consistent treatment of this group across censuses we have chosen to follow Wei's (2001) approach and include 'not stated' labour force status as not in the labour force. These issues remind us that these data need to be interpreted cautiously.

Parenting Payment, Single) are paid at a higher maximum rate and have more generous income tests than allowance type payments (eg. Newstart Allowance). In addition, pension recipients generally have less active participation requirements. Together these factors create significant incentives to seek entitlement to pension payments. These differences across payments can influence labour force participation.

High effective marginal tax rates (EMTRs) are often cited as a disincentive to work for those on income support payments. This is because a high EMTR reduces the individual's effective returns from working. While there is some merit in these arguments, the policy prescriptions are not obvious:

- Correcting high EMTRs is a balancing act, because reducing EMTRs for one group usually means increasing them for another group. That is, improving incentives to work for some individuals almost always comes at the expense of reducing work incentives for others.
- In addition, reducing EMTRs often results in higher levels of benefits for many existing and some new recipients, which can in itself act as a disincentive to work.

Under the current system, those on pension payments generally face lower EMTRs than those on allowances, yet participation for those on pension payments is lower than for those on allowances.

The Government has already taken steps to improve the participation outcomes of certain income support recipients through the *Australians Working Together* package. Another stage in the welfare reform process is an examination of the overall structure of the system. This is occurring through the recent community consultation process on the Government's discussion paper *Building a Simpler System to Help Jobless Families and Individuals*.

### **Workplace Relations Reform**

Ongoing workplace relations reform will be important to ensuring that increased labour force participation does not result in higher unemployment. Reforms over the past decade have contributed strongly to employment growth by allowing employers and employees to tailor wages and conditions to the specific skills and needs of particular individuals and jobs. The Government's agenda of proposed amendments to the Workplace Relations Act continue to simplify procedures, increase labour market flexibility and link wages and conditions to productivity improvements.

A number of workplace relations reforms are currently proposed: reform of unfair dismissal laws to minimise the impact on employment; simplification of procedures for agreement-making; improvements to the remedies and sanctions against unprotected action; improvements to bargaining processes; and improvements to the processes for union right of entry to the workplace. However, the full benefits of reform have not yet been realised. Workplace culture has been slow to adjust to the new options and flexibilities on offer.

Increased flexibility in the workplace relations system will allow older workers to choose whether to remain attached to the labour force for longer by, for example, working part-time as a transition to retirement.

### **Health**

Improving the health of working age Australians is an important factor in increasing labour force participation and productivity. Poor health is an important determinant of early retirement, spells out of work, and lost productivity through sickness or injury. Thirty per cent of those who retire between the ages of 50 and 65 in Australia do so because of illness or disability.

The key health conditions affecting the Australian labour force are musculo-skeletal conditions, circulatory diseases, anxiety and depression. These conditions tend to be chronic, and to worsen over time. They are largely preventable, and the World Health Organisation argues that preventive action by governments is feasible and cost effective.

These conditions are among the most costly occupational diseases, and are also highly prevalent in the community at large. They share common and modifiable risk factors, some of which are work-related and some lifestyle-related, including insufficient physical exercise, chronic stress and being overweight or obese. Physical fitness, for example, can be protective against high blood pressure and mild depression, and – alongside ergonomic job design – can contribute to the reduction of back injury. Lack of time is a significant factor to overcome if many workers are to make lifestyle changes to avoid obesity and to be fit and healthy.

### **Retirement Incomes**

The superannuation preservation rules aim to limit access to superannuation savings until the retirement phase of life by restricting the withdrawal of superannuation savings until preservation age, which is currently age 55. The extent to which retirement savings are maintained until age 65 also impact on Age Pension outlays. The preservation rules also affect participation. For example, the preservation age can influence employer and employee decisions about the appropriate age for employees to leave the workforce.

The preservation rules are important from a fiscal perspective. In the absence of preservation rules, superannuation contributions (and the associated tax expenditure) would be higher as contributions would be available on demand. However, these higher contributions would likely be significantly more than offset by higher withdrawals from superannuation funds before retirement, meaning retirement incomes would be lower and Age Pension costs higher.

It would be expected that the preservation age will have an increasingly important influence on participation as superannuation balances increase. Voluntary retirement will be influenced by the amount of superannuation benefits and other savings that a person has accumulated. The Government has already legislated to progressively increase the preservation age to 60 between 2015 and 2024.

### **Summary**

The IGR points to a fiscal gap arising on a no-policy change basis, arising through demographic influences on government spending and increases in health costs driven by improvements in technology. Allowing greater choice about participating in the labour market through removing barriers and disincentives is one way to address this gap. Higher participation will result not only in a wealthier and more equal society, but will also assist in meeting the challenges presented by demographic change.

Initial work undertaken by the Demographics Taskforce suggests that there may be scope to improve participation through improving education outcomes, removing disincentives to participate from the income support and retirement income systems, allowing greater flexibility in the workplace relations system, and improving health outcomes.

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