

Box B

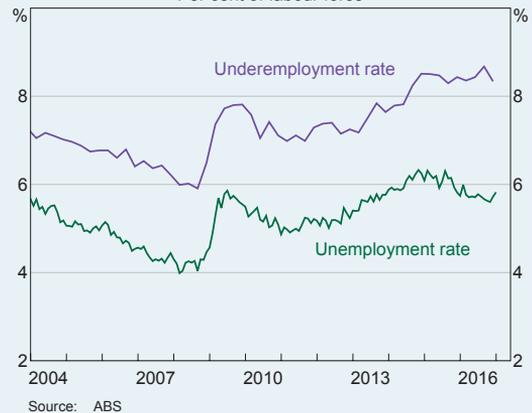
Underemployment and Labour Market Spare Capacity

The unemployment rate is the most commonly used measure of spare capacity in the labour market. A complementary measure is the underemployment rate, which measures the number of employed people who would like and are available to work additional hours, expressed as a share of the labour force. Since the mid 2000s the two rates have generally moved similarly (Graph B1). However, over the past two years they have diverged somewhat, with the unemployment rate moving lower and the underemployment rate remaining elevated.

There are two categories of underemployed workers, as defined by the Australian Bureau of Statistics (ABS). The first is part-time workers preferring and available to work additional hours; by this definition, around one-quarter of all part-time workers are underemployed, accounting for around 8 per cent of the total labour force.¹ The second category is people who usually work full time but are currently on part-time hours for economic reasons; these workers account for less than 1 per cent of the labour force.

The upward trend in the underemployment rate since the early 1980s is consistent with the rise in the share of part-time employment. Underemployment rates are higher among groups that have a higher share of part-time employment, such as females, younger workers

Graph B1
Labour Market
Per cent of labour force



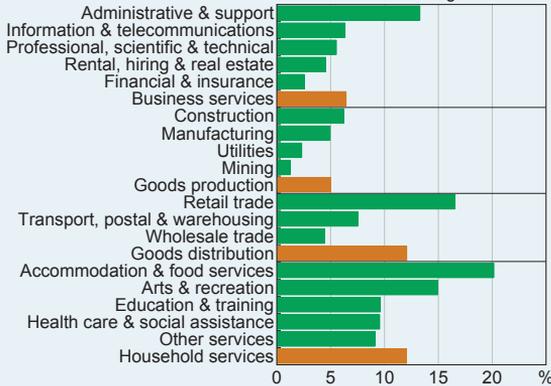
and older workers.² For example, the share of female workers who are employed part-time is a little more than twice as large as the share of male workers who are employed part-time, and female workers have a higher incidence of underemployment than male workers. Underemployment is also more prevalent in industries with a higher share of part-time workers. The accommodation & food service industry has a part-time employment share of 60 per cent and the highest rate of underemployment, while almost all mining jobs are full time and underemployment is minimal (Graph B2).

Over the past two years the increase in employment was associated with a decline in the unemployment rate. However, growth in part-time employment was relatively strong over

¹ Workers are defined as part-time if they usually work less than 35 hours per week. People currently working full-time hours who desire additional hours are not counted as underemployed.

² Over the past two years the underemployment rate and part-time employment share have increased across most age and gender groups.

Graph B2
Underemployment Ratio*
2016 average



* Underemployment as a share of industry employment
Sources: ABS; RBA

Graph B3
Desired Additional Hours
of Underemployed Workers
Per week



Source: ABS

this period, and some of these workers desired additional hours. This helps to explain why the unemployment rate has declined while the underemployment rate has remained elevated. Accordingly, the underutilisation rate – the sum of the unemployment and underemployment rates – has declined only a little.

The number of additional hours of work desired by underemployed workers has been stable at around two days per week since the mid 2000s (Graph B3). Around half of part-time underemployed workers desire enough additional hours to become full time; this is around 15 per cent of part-time employment. The share of people who usually work full-time but who are working part-time hours for economic reasons has been little changed over the past couple of years, at a low level.

There are various ways to combine information about unemployed and underemployed workers to measure overall labour market spare capacity. The underutilisation rate is simple but has two limitations. First, it does not take into account that, on average, each unemployed person represents more potential (additional) hours of work than each underemployed worker.

On average, unemployed people seek 33 hours of work per week compared with 14 additional hours per week for underemployed people. Around one-third of unemployed people have a preference for part-time work, and the number of hours of work desired by the unemployed has been stable over time. An implication is that the recent strength in part-time employment growth cannot be attributed to a stronger preference for part-time work among recently employed people.

Second, people are only counted as unemployed if they take active steps to find a job, such as responding to a job advertisement; in contrast, there is no requirement to be searching for additional hours of work to be classified as underemployed. Only around half of all underemployed workers reported that they were actively searching for additional hours in 2016, and a similar share reported that they would prefer not to change their employer to find additional hours.³ This might help to explain

3 The most common active steps taken when searching for additional hours include: 'Wrote, phoned or applied in person to an employer for work' (80%), 'Answered an advertisement for a job in a newspaper/Internet/noticeboard' (70%) and 'Contacted friends or relatives' (55%).

why the average duration of underemployment (currently 94 weeks) is around double that of unemployment (currently 46 weeks).

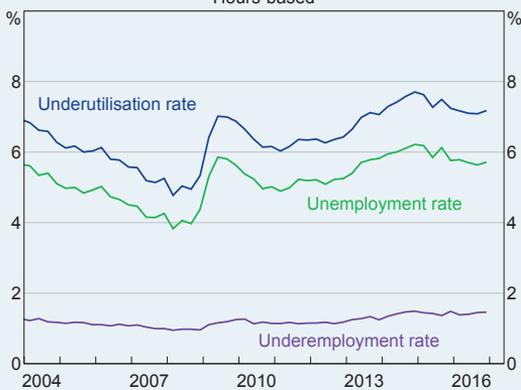
Given these two limitations, it is possible to construct a measure of labour market spare capacity that takes into account how many (additional) hours each unemployed and underemployed person would like to work, as well as excluding those underemployed people not actively searching for additional work. That is, an hours-based measure of underutilisation can be constructed as the sum of hours of work sought by unemployed people and additional hours of work *actively* sought by underemployed workers, as a share of total hours worked and actively sought.

The unemployment rate has driven most of the movements in the hours-based underutilisation rate (Graph B4). This is largely because underemployed workers contribute less to the hours-based measure than the heads-based

measure of underutilisation. As a result, even though the heads-based underemployment rate has diverged from the unemployment rate over the past couple of years, the unemployment rate remains a broadly reliable guide to changes in labour market spare capacity.

Nonetheless, changes in underemployment could become a relatively more important driver of changes in labour underutilisation over time or in specific episodes. This could have implications for labour market dynamics. For example, if the downward pressure on wage growth exerted by unemployed and underemployed workers differs, the effect of rising labour demand on wage pressures could depend on how much of it is met by increasing hours for existing employees rather than increasing employment. This suggests that it is prudent to monitor all dimensions of underutilisation when assessing spare capacity in the labour market. ↗

Graph B4
Labour Underutilisation
Hours-based



Sources: ABS; RBA