Submission to the Senate Economics References Committee into Economic Stimulus Initiatives
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The Australia Institute

The Australian economy may have avoided recession but it has not avoided rising unemployment. Indeed, unemployment is likely to rise further before it begins to fall again. There are 180,000 more people officially defined as unemployed today than there was 12 months ago. The 'crisis' is not over for these people. In fact, it is only just beginning for many of them. Unemployment benefits in Australia are too low to sustain families who lose full-time jobs for long. While the stimulus has helped reduce the number of unemployed, it is ironic that the $900 stimulus payments were made to most adults except the unemployed. The unemployment benefit continues to fall behind the age pension and other benefits. The best way to help the economy is to help the unemployed, via the provision of financial assistance, job creation and the provision of training.

Was the stimulus needed? The fact that the economy has so far avoided recession shows that the stimulus has most likely worked, not – as the Coalition appears to suggest - that it wasn't needed. There is no evidence of excess demand in the Australian economy; on the contrary, indicators other than unemployment remain weak – e.g. jobs are stagnant and average hours worked are falling markedly. Price pressures remain subdued – the RBA's underlying measure of inflation continues to fall.

At $42 billion the second stimulus package was large, but not atypically so given spending by governments around the world. It amounted to 2 percent of GDP in each of 2009 and 2010, and brings the total deficit to a forecast 2.8 percent of GDP in 2009-2010. The average for advanced economies is 7 percent in 2009.

The Australian deficit may well turn out to be even smaller given that the increase in unemployment has so far been less than forecast. Reducing unemployment by 100,000 saves about $1.2 billion per annum in direct spending on benefits and induces a further $1 billion in tax receipts. (It was forecast in the Economic Recovery Plan 2009 that an extra 300,000 people would join the dole queues by 2010, bringing the total to 750,000).

It may be that Australia could have relied more on monetary policy and less on fiscal policy. The official cash rate has not dropped below 3 percent, compared with zero rates in many countries. However the mix of monetary and fiscal stimulus that did eventuate allowed for continued flexibility on both fronts. Once the official interest rate falls to zero there is much less flexibility[1]. It is only with hindsight that the possibility of a different mix emerges, and there was a strong case at the time for acting aggressively on the fiscal front. This is particularly the case given the long lags which are normally associated with monetary policy.

[1] There is the option of so-called 'quantitative easing', basically printing money.

Could it have been more effective? There are question marks over the 'bang for the buck' of the stimulus package. For example, construction spending has quite a high cost for each job, due to necessary overheads such as materials and equipment. Treasury estimates suggested that each job saved or created cost around $230,000 per year. Alternatives were possible (and were suggested by The Australia Institute in our previous submission) involving direct job creation in the community and care sectors. Such investment in labour intensive community services would have created more jobs at a much lower cost per job than the stimulus package.

Specifically, we proposed that community groups, local governments, environmental and other non-profit groups be invited to apply for funding to employ people presently unemployed. The government would provide salary assistance of $50,000 per annum per job, with organisations required to meet non-salary costs. This could have created a large number of jobs at much less cost than the government's stimulus, and helped meet unmet needs in the community such as caring for the sick and elderly, and participation in Landcare and Coastcare programs.

We also proposed the use of wage subsidies to particularly assist the long-term unemployed.

Was the package fairly distributed?

Most Australians benefitted from the cash handouts in the first and second stimulus packages, some more than once. On the other hand there were many who missed out completely. Notable among this last group were the unemployed. They missed out in December 2008, when pensioners received a bonus, and again in 2009 when taxpayers and schoolchildren received a bonus. It would have been fairer to simply distribute a cash hand-out to every Australian permanent resident.

The unemployed have also missed out on recent rises in the base rates of age and disability pension. This is creating a severe discrepancy between the deserving and the 'undeserving' poor in the Australian social security system. This difference in treatment is all the more surprising when we remember the Newstart Allowance (NSA) is one of the best forms of automatic fiscal stabiliser as spending expands in times of economic downturn and reduces as the economy improves. It also flows most strongly to the most disadvantaged regions.

A worker on an average wage, on losing a job, goes from an income of $1196 a week[2] to a NSA of $228. If he/she is in a couple they get $412, but only if his or her spouse doesn't work. Such huge drops in disposable income for an event normally outside the worker's control – and especially so at a time of economic contraction – are not the mark of a civilised society.

The OECD has found that unemployment is a key driver of poverty in Australia. The OECD Employment Outlook 2009 shows that 55% of jobless households in Australia were poor, compared with 37% on average across the OECD. The OECD concludes that Australia's tax and transfer system is "less successful in tackling poverty in

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[2] Full-time adult ordinary time earnings at June 2009

jobless households”, and there can be no doubt that the low rate of NSA is a key driver leading to this outcome.

The difference between the NSA and the disability support pension is creating a strong incentive for those with any medical problems to apply for the latter payment. Once they are on it, there is very little probability of them ever coming off, except to go onto the age pension. There is also a huge drop in income for sole parents whose youngest child turns eight, and a big discrepancy in the situation of sole parents protected by the saving provisions in the legislation, and those not.

At the time we published ‘Increasing the Newstart Allowance – a necessary part of equitable fiscal stimulus’ (Research paper No 60 February 2009), raising the NSA to pension parity would have required an increase of $56 per week for singles and $64 for couples, at a cost of $1.7 billion in 2010. However from 20 September 2009 the full single pension has increased by $32.50 a week to $336. The pension for couples has increased by $10.15 a week combined to $507. This increases the gap to $108 a week for singles and $95 a week for couples. Even if we exclude the pension supplement the gaps are $80 (single) and $74 (couple).

Such wide divergences in rates will put further pressure on an already inequitable system. We note that, in contrast to the Australian system, most other advanced economies provide unemployment benefits which are related to the recipients’ earnings in their last job. However such benefits are normally of limited duration, unlike the NSA.

Assistance for the automobile industry

Most countries around the world have provided assistance for the automobile industry during the global financial crisis, as this is the epitome of a cyclical industry and is typically also of great importance to the whole economy. In addition to the USA bailouts in 2008, assistance has been provided to the European and US auto industries in the form of scrappage schemes for older cars, with a cash bonus paid when the old car is traded in for a new one. In the USA this scheme was called ‘cash for clunkers’. Such schemes have great environmental benefits as well as economic benefits, as older cars tend to pollute more and be much less fuel efficient than newer models. New cars are also much safer.

By contrast in Australia we assist the automotive industry through direct schemes of industry assistance, by concessional taxation of employment fringe benefits (of which the car is the most expensive item) and currently by additional depreciation allowance for business investments (of which company cars have been a significant item). These concessions have tended to be environmentally unfriendly. The fringe benefits tax, in particular, encourages excessive driving as the greater the kilometres driven, the less tax is paid.

Consideration should be given to scrapping these various schemes of car industry assistance in favour of more environmentally-friendly alternatives such as ‘cash for clunkers’.