

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 55

Topic: Stimulus Package – Effect on Employment

Hansard Page: E22-23

Senator Abetz asked:

Senator ABETZ—Thank you for that. In general terms, we are agreed that as the stimulus dissipates the job dissipate as well.

Dr Gruen—That is right. One small point which is worth making is that there can be a long-term benefit in terms of jobs to the extent that, if you reduce the peak in the unemployment rate, you reduce the amount of damage done to the unemployed. Being unemployed tends to lead to skill atrophy, and long-term unemployment is a very unpleasant experience. It has obvious psychological impacts on people as well as impacts on their job readiness. To the extent that the unemployment rate can be kept below what it would otherwise be, that may well have good effects on the labour market that last a long time.

Senator ABETZ—I am willing to accept those comments. But would you agree that would be more around the periphery?

Senator PRATT—I hardly think it is peripheral for the people affected.

Senator ABETZ—If I wanted to ask you, Senator Pratt, I would be asking you, but in fact I am asking Dr Gruen.

Dr Gruen—It is fair to say that a long period of recovery can eventually eat into the long-term unemployed, as we saw in the recovery in the nineties and 2000s. All I am saying is that it can have long-term benefits.

Senator ABETZ—Yes, but the vast majority of the stimulus package dissipates, and we are anticipating this particular stimulus package to be dissipating about this time.

Dr Gruen—For the ESS?

Senator ABETZ—Yes.

Dr Gruen—Some parts of it, but it may well be that the boost has more impact on GDP later rather than earlier.

Senator ABETZ—That is not what was predicted, though, was it?

Dr Gruen—I was making a statement about a particular piece of it. The aggregate GDP effect made the statement also true that the majority of it is in the first half of 2009.

Senator ABETZ—When would you expect the majority ‘benefit’ of the stimulus package to have washed through? We agree it dissipates.

Dr Gruen—Yes.

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Senator ABETZ—I accept that there will be some residual benefits that keep going for some time, but in general terms when would the majority of the benefit have washed through?

Senator Conroy—The government have engaged in a range of other measures since that stimulus package.

Senator ABETZ—I know that.

Senator Conroy—I just want to make sure you are clarifying the impact of—

Senator ABETZ—Do not delay. I am talking about this one.

Senator Conroy—holding everything else constant, pretending nothing else has happened in the world and just going through—

Senator ABETZ—I am just asking about the stimulus package—that is right.

Senator Conroy—Okay.

Dr Gruen—I cannot give you a detailed answer to that, because we did this analysis some time ago. I am happy to take it on notice if you wish. The general point you are making I agree with, which is that the package should be expected to have its maximal impact over the subsequent six months and then its effect to gradually dissipate. I cannot give you chapter and verse.

Senator ABETZ—Of course not, because a lot of this would be very difficult to model and predict. I would imagine that there is a short-term big boost and a longer legacy boost, if I can call it that, through first home owners et cetera. In relation to jobs, have you done any even back-of-the-envelope calculations? We agreed that as the benefit dissipates the jobs dissipate, so when would the majority of the jobs dissipate? I am not talking about other stimulus packages that might keep it going, just this stimulus package.

Dr Gruen—I would have to take it on notice.

Senator ABETZ—If you could I would be much obliged.

Answer:

The Senator is referred to Box 7 in Budget Statement 2 of the 2009-10 Budget, which discusses the historical relationship between GDP and employment, and the relationship between the unemployment rate and the duration of unemployment during a downturn.

Treasury modelling suggests that most of the employment impact of the Economic Security Strategy (ESS) is likely to have dissipated 12 to 18 months after the spending entered the economy.

However, the above modelling approach does not capture the longer term benefits that are likely to flow from the ESS, including benefits from limiting the incidence of long-term unemployment and its associated costs.

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The underlying assumption that fluctuations in aggregate demand have only temporary impacts must be weighed against historical evidence that economic downturns have highly persistent effects on the unemployment rate. The ESS is expected to prevent larger rises in the unemployment rate than would otherwise occur, which is likely to translate into fewer long-term unemployed in following years. In particular, history suggests that a 1 percentage point rise in the unemployment rate leads to an approximate 3¼ percentage point rise in the long-term share of unemployment one year later.