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Riding Your Luck and Adopting the Right Policies: Why the Australian Economy is Rebounding Strongly

by Bob Kyloh

The global economic crisis that commenced in 2008 has had devastating effects across rich and poor nations. But the impact on growth, employment and incomes has not been uniform across countries. Economic performance has depended critically on the policy response adopted by governments. Other authors writing for this Column have made a convincing case for an income led growth strategy in response to the recession. At least one country has clearly demonstrated the benefits of this approach.

Australia is often referred to as the "lucky country". The recent economic performance of this resource rich nation has helped reinforce this notion. Indeed recent economic achievements down-under may be partly due to the good fortune of rebounding commodity prices and expanding Asian markets. But the terms of trade actually moved against Australia in the last eighteen months and net exports detracted significantly from economic growth in 2009. Economic recovery is actually the result of public policies that boosted the disposable incomes of low and middle income families when aggregate demand was plummeting.

The Australian economy has performed better than any other advanced economy since the onset of the global financial crisis. Real GDP increased by 1.1 % in 2008-09 in year-average terms. The economy remained resilient and recorded moderate growth when most other advanced economies were experiencing a deep recession. Looking ahead (in early November 2009) the Australian Treasury was forecasting economic growth of 1.5% in 2009-10, 2.75% in 2010-11 and projected growth of 4% over the period 2011-12 to 2014-15 before returning to trend growth of 3% in 2015-16.

The Australian labour market is rebounding strongly. Employment increased in the latter months of last year, creating 95,000 additional jobs between September and December 2009. There are now grounds for optimism that the unemployment rate, may have peaked. As of December 2009 the national unemployment rate stood at 5.5%, having declined 0.3 percentage points since October. If unemployment has peaked at this relatively moderate level this will be a remarkable achievement. Back in May 2009, when the National Budget for 2009-10 was announced, the Government had projected that unemployment could peak at around 10% without any stimulus measures. But because of the actions taken by the Government the unemployment rate was expected to reach a high point of 8.5% in 2010. This forecast was cut to 6.75% in early November 2009. Since this last projection was released conditions have again improved across the economy and in the labour market in particular with the recovery gaining significant traction. All indicators now suggest that the jobs market has stabilised – 136,000 jobs have been created since the labour market upturn began in August 2009. A significant proportion of these new jobs (60/40) are full-time and average working hours have recovered from a recent trough. This is important because much of the contraction in labour demand in 2008-09 had taken the form of declines in average working hours rather than increases in open unemployment. These trends and other partial indicators have prompted several independent economic observers to suggest that the labour market has passed a turning point and consequently incomes, consumption expenditure and aggregate demand may strengthen more than anticipated in the official Government forecasts of November 2009.

The Australian Government introduced fiscal stimulus measures in three stages: in October 2008, February 2009 and May 2009. The total package contained a variety of measures which can be summarised under three headings: first, increased transfer payments to low and middle income groups which were rapidly disbursed and had an almost immediate impact on consumption expenditure, retail sales and economic growth; second, relatively rapid investments in social infrastructure including schools, health and housing; and third major new investments in economic infrastructure which are more medium term in nature. The stimulus measures adopted were broadly consistent with proposals made by the Australian Council of Trade Unions.

A striking feature of the Australian response to the crisis, compared to most other countries, has been the emphasis placed on increasing the disposable incomes of low and middle income groups with a high marginal propensity to consume. This approach is in complete conformity with the key aspects of the ILO Global Jobs Pact with its emphasis on income led growth and improvements in the social floor.

The initial substantive fiscal response to the global financial crisis was a 10.4 billion Australian dollar package of measures announced on the 14 October 2008. This package was tightly targeted at sectors of the economy showing particular weakness in the early stages of the downturn - household consumption and dwelling investment. In the second quarter of 2008 household consumption expenditure had recorded its

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first decline in 15 years. This package included one-off additional payments to pensioners of $A1400 for singles and $A2100 for couples. (Australia has a universal pension scheme with flat rate benefits funded by general taxation. This is supplemented by private contributory pensions or what is called "superannuation"). The package also included additional payments of A$1000 to eligible persons providing care to the aged or disabled and for each child in families receiving the Family Tax Benefit (which is a means tested transfer payment received by low and middle income families).

This package of measures generated significant multiplier effects as the payments were timed to be received by credit constrained families in the lead-up to the year-end holiday period, thus limiting the leakages expected through increased savings. In Australia, like other advanced economies, consumption expenditure comprises around 60 % of GDP and has important implications for other areas of expenditure, including private investment. At the time of its announcement the Government projected that the above Strategy would boost real GDP growth by between 0.5% and 1% over a period of several quarters.

In early February 2009 the Government announced a second 42 billion Australian dollar fiscal stimulus package. This included over 12 billion Australian dollars to fund a range of additional one-off transfer payments targeted at a variety low and middle income groups. Well over half the population of Australia received payments of just under a thousand dollars as part of this initiative. These one-off increases in transfer payments were supplemented by major revisions to the aged pension system and other social security benefits in May 2009. These reforms have resulted in substantial permanent increases in welfare payments. The net impact of these revisions will be to increase expenditure on pensions and related social security payments by A$14.4 billion over the next 4 years.

The above mentioned increases in transfer payments, along with reduced interest rates resulting from monetary easing, helped retail sales remain buoyant in Australia when economic and employment growth were at their weakest. In November 2009, retail turnover was 7.3% higher than in the pre-stimulus levels of November 2008, having remained largely flat throughout 2008. The contrast in retail spending trends between Australia and other advanced economies is depicted below.

The stimulus measures, and in particular the direct payments to low and middle income households, have also had a significant impact on business and consumer confidence. Consumer confidence is now around 40% higher than the pre- stimulus levels of October 2008, while business confidence is at its strongest level in over seven years.

The effects of the first stage of the stimulus packages, involving increased transfers, are now abating. But the second and third phases of the stimulus - involving significant investments in what was colloquially referred to as "shovel ready" social infrastructure projects and longer term national building projects like roads, rail networks and energy conservation, are now underway. One critical aspect of the social infrastructure projects involved a A$14.7 billion investment in school infrastructure and maintenance. This was part of the February 2009 stimulus package and included resources to: build or upgraded libraries and halls in every primary school and special school in the country; to significantly expand the number of schools with science laboratories and language learning centres; and to ensure every Australian school has resources to maintain and renew its buildings. Further substantial investments in universities and tertiary education were provided in the May 2009 measures, thus furthering the education revolution in Australia.

Deep economic contractions can permanently reduce an economy's growth prospects through the erosion of skills and capital. The public investments in education plus other social and physical infrastructure were designed to mitigate these effects and position Australia for economic recovery by raising productivity and expanding the supply side potential. Fortunately, with the downturn now expected to be shallower and the labour market recovering rapidly the long term output loss should be mild and the economy should return to capacity sooner than expected.

Australia is in the vanguard of the economic recovery among advanced economies because it took swift and concerted action to boost the disposable incomes of working families and welfare recipients, who spent rather the saved these payments and thus sparked recovery. Australia has demonstrated the potential of an income led growth strategy as advocated by the ILO. It pays to be lucky and also adopt the right strategies.

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