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**Read the (edited) extracts from the RBA Governor’s response to questions at the SENATE SELECT COMMITTEE ON COVID-19 ‘Australian Government’s response to the COVID-19 pandemic’ (28 May 2020) and answer the questions.**

**The full Hansard transcript can be accessed at the following link:**

[https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:%22committees/commsen/a3af0917-dc51-4d01-a86f-69153eb93040/0000%22](https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p%3Bquery%3DId%3A%22committees/commsen/a3af0917-dc51-4d01-a86f-69153eb93040/0000%22)

# On the labour market impact….

**CHAIR:** …I start, Governor Lowe, with your view on the latest labour force data. I am sure you have been through it pretty closely. Was what you saw in that data what you expected? What are the issues that would concern you the most, from the information you could glean from it?

**Dr Lowe:** Well, they were a shocking set of numbers: 600,000 people losing their jobs and another 750,000 people keeping their jobs but working zero hours; the unemployment rate up to 6¼ per cent; and underemployment up to nearly 14 per cent. They weren't quite as bad as we thought they were going to be. The data that we've seen since the labour force survey was undertaken in early April suggests we're seeing a bottoming out in the labour market. So the numbers are not quite as bad as I feared, but it is still a pretty bad situation.

**Questions**

1. **Explain why the underemployment rate increased by much more than the increase in the unemployment rate.**
2. **Determine the labour force underutilization rate from the figures quotes in the first paragraph.**
3. **Explain why the unemployment rate only increased by one percentage point in April (from 5.2% to 6.2%) when 600,000 people ‘lost their jobs’. [Hint the number of people classified as ‘unemployed’ only increased by 100,000]**

# On the use of policies and their relative effectiveness

**CHAIR: …** You said, I think in your remarks earlier this week when you gave a speech, that there's a limit to what can be achieved with monetary policy. We've heard from the Secretary of the Department of the Treasury about the importance of fiscal policy taking the front step. What do you think the Reserve Bank's role is in an ongoing sense—you mentioned a couple of things at the beginning—as we move into the recovery side, acknowledging that monetary policy is where it is at the moment?

**Dr Lowe:** We're going to be very much focused on keeping funding costs low right across the country and making credit available. That's the contribution a central bank can make. We've got the cash rate at 25 basis points, the lowest on record, and I think effectively the lowest we can go. We've got a target for the yield on government security to three years at 25 basis points, so that's keeping the cost of government borrowing down, and, because the government borrowing rate is a benchmark for the private sector as well, it is keeping funding costs low right across the country. We have a facility for the banks where they can borrow from us for three years at just a quarter of one per cent. That is keeping their funding low, which keeps interest rates low for their borrowers and gives the banks assurance that they will have the capacity to fund new loans. That's the contribution the Reserve Bank can make. It's a very significant contribution. The head of the Federal Reserve keeps saying, 'Central banks work through lending, not through spending', so it's kind of an indirect channel and there's a limit to what we can do. I agree with Steven Kennedy that, going forward, fiscal policy will have to play a more significant role in managing the economic cycle than it has in the past. For the last 20 years monetary policy has been the mainstream instrument; we've moved interest rates up and down to manage the business cycle and keep inflation under control. In the next little while there's not going to be very much scope at all to use monetary policy in that way. So I think fiscal policy will have to be used, and that's going to require a change in mindset

**Questions**

1. **Explain how the RBA is keeping ‘funding costs low across the economy’. In your answer outline how the RBA manaes to keep the three year bond rate to 25 basis points.**
2. **In the context of monetary policy’s effectiveness, explain what is meant by the expression *'Central banks work through lending, not through spending'*.**
3. **Explain how monetary policy has been used to manage the business cycle over the past 20 years.**
4. **Explain why, in the current climate, fiscal policy needs to play a more significant role in managing the economic cycle.**

# On interest rates over the short to medium term

**Senator PATERSON:** …My first questions follow up on some questions the chair was just asking then about monetary policy support. I think you said words to the effect that the Reserve Bank will be keeping monetary support in place for a long period of time. Does that formally constitute forward guidance about interest rates for the next few years?

**Dr Lowe**: I think so. We've been very clear that we're not going to be raising interest rates until full employment is achieved and we're sustainably within the two per cent to three per cent target range. So that's the guidance we're giving. I think it's also reasonable to expect that that will not be for some years. With the way of the world at the moment, I have trouble seeing inflation sustainably within two to three per cent for quite some time and I think it's going to be a long drawn-out process to get back to full employment, which means that we're going to keep interest rates where they are perhaps for years.

1. **Outline the conditions that would need to exist for the RBA Board to consider a tightening of monetary policy. In your answer refer the RBA’s charter.**

# On deficits and debt in a low interest rate environment and the role of infrastructure

**Senator WHISH-WILSON:** … Former Reserve Bank director, Warwick McKibbin, was on record again this morning saying that now is an historically important opportunity for a fiscal policy at record low interest rates in terms of government investing in the community and delivering returns. Do you have a view on whether there will be more debt required for the recovery phase verses this shutdown phase we've been through? Do you have any position on the magnitude of debt that the country's in at the moment, or what might be optimal for the future?

**Dr Lowe:** Again, the world's so uncertain that I don't really want to give a particular number. My main point here is: we've got to keep the fiscal stimulus going until recovery is assured. I've seen, particularly over the past decade, the fiscal stimulus withdrawn too quickly, and the economy suffered. The level of public debt in Australia, while it's rising, is still low. The government can borrow for three years at one quarter of one per cent and it can borrow for 10 years at 0.9 of one per cent. The AOFM held a bond auction two weeks ago and it was able to borrow $19 billion at one per cent for 10 years. So there's strong demand for debt. The Australian government has the capability to borrow more, and I think it would be a mistake to withdraw the fiscal stimulus too quickly. What that means to future—and I've been making this point even before the crisis, particularly on infrastructure—is that, at the interest rate of one or 1½ per cent, there were surely plenty of good projects that would yield a risk-adjusted rate of return, both in financial terms and for society of greater than 1½ per cent. And at low level of interest rates and with excess supply capacity in the economy, we should be doing that, and that remains my view. That's why—

**Senator WHISH-WILSON:** I'm aware of your long track record there, Dr Lowe, in relation to making points about the need for infrastructure spending. I don't know if you read it, but Oxford university, along with Nicholas Stern and Joseph Stiglitz, just released a report looking at the GFC stimulus program. They came to the conclusion that green projects—climate focused infrastructure investment—create more jobs, have higher short-term returns and reduced longer-term costs in terms of infrastructure spending. They surveyed 231 global authorities to put that report together. …Are you aware of the literature, and do you have any views on where is the best place to spend fiscal policy in terms of stimulus on infrastructure?

**Dr Lowe:** Not particularly. My main point of view is that we need to do a thorough cost-benefit analysis on these projects. And, if what you say is correct, that the projects with the highest social rates of return are in green, well, so be it. We need good governance around infrastructure because it's incredibly important to the country's future we do this. But we do know we can waste a lot of money on ill-chosen infrastructure projects, and when that happens, [inaudible] becomes distrustful of the political class and the process and doesn't support borrowing and infrastructure projects. So my main observation here has always been, if governance is incredibly important, make sure the cost-benefit analysis is done properly and choose the best projects for the society. And you can do that when interest rates are at the lowest level in hundreds of years.

1. **Outline the relationship between a budget deficit and government debt.**
2. **Explain the argument for the government delivering larger budget deficits given the current low interest rate environment. In your answer, describe how much the government is currently paying to borrow in the market.**
3. **Explain why low level of interest rates and excess capacity in the economy provide an opportunity to undertake more infrastructure investment. Describe one way that Australian living standards could improve by the government investing in greater infrastructure.**
4. **Summarise the conclusions made by the Oxford University report in relation to ‘climate focused infrastructure investment’ and outline the possible implications for infrastructure investment in Australia.**
5. **Discuss the role of a cost-benefit analysis when spending government funds on projects.**

# On where the RBA’s money comes from and separation of monetary and budgetary policy

**Senator PATRICK:** In terms of the government making money available for things like the JobKeeper program, that's a separate activity to what the Reserve Bank is doing. You're trying to provide liquidity to the financial system. The source of your money to do that is what?

**Dr Lowe:** The source of the Reserve Bank's money—this is the beauty of central banking: central banks are unique entities in that they can create money. When we want to buy a government bond from a pension fund, the way we pay for that is credit—if you buy it from a bank—at the bank's account at the Reserve Bank. We are the one entity in the country that can create money just out of nothing. That's why it's incredibly important that the governance around that process is very strong, and that, as I said in response to Senator Whish-Wilson's question, the separation of monetary and fiscal policy is kept. We have seen, where that has not been maintained, that it can be abused—creating money out of thin air and financing government expenditure without checks and balances.

**Senator PATRICK:** It sounds like a great job, if you don't mind me saying!

**Dr Lowe:** The governance of it is incredibly important. It's mainly about interest rates, but the central banks are the only entities that can create money out of thin air. We take that responsibility incredibly seriously, and it's not to be abused.

**Questions**

1. **Explain how the RBA ensures that there is a separation of monetary policy and fiscal policy.**
2. **Describe how the RBA prints money.**
3. **Discuss the implications for inflation and economic activity in the future if there was no separation of monetary and fiscal policy and the government financed its budget deficits by borrowing from the RBA (i.e. the RBA buying Bonds or CGS from the government)**

# On the life of Jobkeeper

**Senator PATERSON:** … I think you were hinting or indicating earlier that modification or extension of the JobKeeper program might be necessary. Is that what you were alluding to?

**Dr Lowe:** It may be necessary, but the key observation is that the world is very uncertain and I think it's too early to say what the economy is going to be like in four months time. If we have not come out of the current trough in economic activity, there will be, and there should be, a debate about how the JobKeeper program transitions into something else, whether it's extended for specific industries or somehow tapered. It's very important that we don't withdraw the fiscal stimulus too early.

**…Senator SIEWERT:** Governor, I have a couple of questions for you that follow up on some of the previous questions. I'm particularly interested in the jobseeker program and the fact that that's scheduled to finish at the end of September. What impact would that have on our economy given that unemployment rates are still predicted to be high at that stage?

Dr Lowe: It's very hard for me to be specific there because there's just tremendous uncertainty. Some of the very recent indicators suggest the economy is bouncing back and other parts of the economy are slowing down as the order books empty. If we're still in the situation where there hasn't been a decent bounceback in four or five months time, then ending that fiscal support prematurely could be damaging. On the other hand, if we bounce back reasonably effectively, tailoring that and tapering it might be the right thing to do. I'm not trying to avoid the question; it's just really hard to know—depending upon the state of the economy. But, if the labour market's not improving, then we will need to keep the fiscal support some way or other.

**Senator SIEWERT:** Have you looked at what levels of unemployment would be required to see that bounceback?

**Dr Lowe:** My focus has been very much on hours worked because, as we saw in the labour force survey the other day, the actual unemployment numbers are less relevant because some people are working zero hours and are included in the labour force, and some people are out of the labour force and they have a job and they can't look for jobs, so they're counted as out of the labour force. So my main focus on the state of the labour market has been on hours worked. We saw that decline by nine per cent in April. I'm expecting to see another decline in May, but not of the magnitude we saw in April, and, by the time we get into June, I'm expecting to see hours worked increasing.

**Senator SIEWERT:** I very strongly take your point in terms of hours worked. What level, then, would you see as a good indicator?

**…Dr Lowe:** I don't want to put a precise number on it now, but, by the time we get to June, I will want to see a reasonable increase in hours worked in July and August. I think the other perspective here, in terms of the JobKeeper program, is that we will need to look very carefully at the industry composition. It may be that many of our industries are getting back to something approaching normal, but the tourism industry, particularly operators catering to foreign tourists—realistically I don't think we're going to see the borders open again this year on a substantial scale, so there may be a need to have some form of JobKeeper for specific industries. Steven Kennedy [Treasury Secretary] spoke to you about this possibility. So, rather than having it right across the board, as it is at the moment, we could narrow it down. But, again, it depends so much on what's happening in four or five months time.

**Questions**

1. **Outline what is meant by Jobkeeper and indicate if it is an initiative from monetary or budgetary (fiscal) policy.**
2. **Describe why the government set an end date for the Jobkeeper program.**
3. **Explain how the Jobkeeper program is impacting on both unemployment and underemployment.**
4. **Outline the conditions under which an extension of the Jobkeeper program will be considered or announced by the government.**
5. **Explain why the RBA Governor prefers to focus on hours worked rather than unemployment when determining the strength of the labour market.**

# On full employment

**Senator SIEWERT:** You referred to 'full employment' in your earlier evidence. What do you define as full employment? What's the percentage of unemployment that's counted as full employment?

**Dr Lowe:** It's a very good question. In February, if you'd asked me that question, I would have said 4½ per cent, roughly. There's a degree of uncertainty around that. In February, remember, the unemployment rate had got down to 5.1 per cent. So, before this virus hit, we were making progress. It was slower than we liked, than we wanted, but we were making progress towards full employment, and I thought it was quite possible that Australia could get its unemployment rate over time down to 4½ per cent.

We know from previous sharp economic downturns that there is scarring in the labour market. People fall out of jobs and then have trouble getting back in, and then we have more long-term unemployment. So I think it's quite possible that the estimate of full employment starts rising again, back towards five per cent—there's a lot of uncertainty, again, around that. And, because that entails a very significant social cost of higher unemployment growth, this is one of the reasons I was so supportive of what the government had done with the job program to keep those connections between businesses and firms so that we don't see the scarring in the labour market. If we don't get a decent recovery fairly soon we will see more scarring, which will mean the estimate of full employment starts to rise, which is a terrible social loss. We want to reduce the amount of scarring so that the estimates of full employment and the unemployment rate don't start rising.

**Questions**

1. **Define full employment.**
2. **Describe the relationship between long-term unemployment and full employment.**
3. **Describe one possible social cost associated with higher unemployment growth.**

# On the policy reform agenda

**Senator PATERSON:** I want to move now to the policy reform agenda. In your speech on 21 May you flagged a couple of priority areas for reform for Australia to help get us out of this crisis. You … indicated that making sure that Australia is a great place for businesses to expand, invest, innovate and hire people is the best way of extending the recovery. I want to just drill down a little bit into the detail of each of those proposals. What would be necessary to make Australia a better place for businesses to invest, expand and hire people?

**Dr Lowe:** … most of the analysis that has been done on our tax system, through the various reports, comes to the conclusion that it's not optimally designed for growth. The way we tax consumption, income and land is not optimal from a growth perspective. Another area is our approach to regulation and the incentives for entrepreneurship and innovation that we establish through both our culture and the tax system. The Prime Minister talked about the industrial relations system and the skills, education and human capital systems. I would add to that list the way we select infrastructure projects, the amount of infrastructure we do and the pricing of that infrastructure. In each of those areas there have been numerous reports over the past decade, so I think the best advice I can give is for people to read those reports and take the best ideas.

**Senator PATERSON:** That's fair enough. I won't ask you to talk specifically about the reforms that are required. You identified, for example, regulation as a potential barrier to entrepreneurship. Could you explain why you think that our current approach to regulation is problematic or an obstacle to entrepreneurship?

**Dr Lowe:** This is a very high level of comment, but I think whenever a problem has emerged in society over the past 20 years we've generally responded to that with additional regulation, because the sense is that we don't want mistakes so we regulate to stop mistakes happening, which is perfectly sensible. But that process is also limiting the ability to seize the upside. We stop the downside through regulation, but the culture that's coming together with that regulation is limiting the upside and the dynamism in the economy. I think this is one thing we've seen progressively over time, that the economy is becoming less dynamic in both culture and regulation. I fear that one result of the virus, one of the shadows cast by the virus, is that we're going to become even less dynamic. There's going to be more conservativism, more caution and a lot of structural change. I can see real benefits in reinvigorating the sense of dynamism in the economy, and regulation is one way to do that. It's broader than that. It's kind of the culture and our approach: when we see things going wrong, do we regulate them or do we have a different approach? I fear that over time we've erred too far in the direction of regulation. It's perfectly sensible to stop bad problems from happening, but that also limits the other side, the upside, as well. As I said, it's a very, very high level, but it's something we should think about. Somehow reinvigorating the dynamism in our economy is going to be a critical issue over the next few years because I think we are less dynamic.

**Senator PATERSON:** I know this might seem self-evident to you, but why is dynamism important in an economy? What's attractive about that for an economy?

**Dr Lowe:** We want firms who are prepared to grow, to invest and to hire people—that's what I'm really talking about—and to develop new products and new ways of doing things and to grow the economy, because ultimately the economic growth delivers jobs and incomes to people, which is what is important. If we want to have rising incomes and our children to have better standards of living than we do, then we need to grow the economy and we need to become better at doing things, finding new ways of being more productive. It's really about, in the end, delivering a better standard of living for our kids, and we need to grow to do that. We're in a fast-paced world. If we do that we'll be okay, but our kids will not have materially better standards of living than I enjoy, and that's my fundamental concern. We have the capability as a nation to do this.

**Questions**

1. **Explain how we could change the tax system in a way that is more ‘optimal from a growth perspective’. In your response, refer to entrepreneurship and innovation.**
2. **Describe the role of infrastructure in supporting stronger and more sustainable rates of economic growth.**
3. **Describe a hypothetical change that could be made to one of the following ‘systems’ in order to generate stronger and more sustainable rates of economic growth.**
4. **Describe why ‘regulations’ are implemented by governments and examine the relationship between regulations and dynamic efficiency in the economy.**
5. **Outline how a change to regulations can potentially foster an environment more conducive to Investment and entrepreneurship.**
6. **Describe the relationship between ‘dynamism’ ( or dynamic efficiency) and living standards.**