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Proof Committee Hansard

SENATE

SENATE SELECT COMMITTEE ON COVID-19

Australian Government's response to the COVID-19 pandemic

(Public)

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SENATE

SENATE SELECT COMMITTEE ON COVID-19

Thursday, 2 July 2020

Members in attendance: Senators Davey, Gallagher, Keneally, Lambie, Paterson, Patrick, Siewert, Whish-Wilson.

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KOUKOULAS, Mr Stephen, Managing Director, Market Economics

Evidence from Mr Eslake was taken via teleconference—

Committee met at 13:00

CHAIR (Senator Gallagher): I declare open this hearing of the COVID-19 select committee. Today's public hearing will focus on the economic and public policy impacts of COVID-19 in Australia, but may cover other matters under the terms of reference. Information on the procedural rules governing public hearings have been provided to witnesses. To my colleagues on the committee: we have circulated opening statements from Mr Eslake and Mr Koukoulas. Can we agree to receive those and allow them to be published? Thank you. We've also got a confidential document provided to us by Mr Eslake. Can we accept that to be received as confidential for the committee? Thank you. I'll hand over now for opening statements. Mr Koukoulas, would you like to go first and then I'll go to Mr Eslake.

Mr Koukoulas: Sure. Thank you very much. Firstly, thank you for the opportunity to appear before this hearing. Economics and the success of economic policy is judged on outcomes. That is, or at least it should be, obvious. Economic growth, the labour market, inflation and wages can be heavily influenced by government policy. Government decisions on who to tax, how much to tax, where to spend, the rules and regulations on the labour market and the environment, for example, will all impact on the economy.

When I look at the government's response to COVID-19, I see a timid approach. I think the government has been stingy, with a red-tape nightmare for many of those wanting to access offers of government funds. To be sure, the dollar value of the support in the stimulus measures appears large, but when I see today 1.7 million people underemployed, a further 928,000 people unemployed and a further 620,000 people having dropped out of the labour market in just the last few months, I can see that these measures have not been enough.

As I look forward there are clear problems with private sector demand, business investment will be weak and I ask rhetorically: who now would be starting to plan to build a new hotel, an office tower or a housing development or to invest in new planes or universities and the like? At the same time, households will face record low growth in incomes, which will limit this vital part of the economy from contributing to growth and employment. This means that not only must the government look to fill the gaps left by the depression-like conditions in the private sector but it needs to generate growth over and above that.

With quarterly nominal GDP around $500 billion, additional government injections of, say, $25 billion per quarter would contribute around five per cent to GDP. The government also needs to stop obsessing with the budget deficit and provide meaningful policy stimulus to get the economy back on track and to deal with the disasters in the labour market. I look forward to expanding on these and other issues. Thank you.

CHAIR: Thank you very much, Mr Koukoulas. Mr Eslake, would you like to make an opening statement?

Mr Eslake: Thank you, Madam Chair and senators. I'm an independent economist operating through a business called Corinna Economic Advisory and I'm also a vice-chancellor's fellow at the University of Tasmania, though I'm not speaking on behalf of the university today.

Australia's done very well in containing the spread of COVID-19 by comparison with what was initially feared and by comparison with the outcomes to date in other so-called advanced economies. Moreover, what we've attained on the epidemiological front has been achieved at an economic cost, which, although very substantial, as Stephen Koukoulas has just outlined, is also likely to prove less than initially feared and less than that incurred by most advanced economies. Nonetheless our path out of the economic downturn we've experienced is in my opinion likely to be much less steep than the path into it was. In particular, I'm sceptical of suggestions that Australia, or indeed any country, will have a V-shaped recovery from the current recession.

By way of illustration, the scenarios used by the Parliamentary Budget Office in their 5 June report on medium-term fiscal projections show that the level of real GDP won't return to its pre-pandemic 2018-19 level until the 2021-22 fiscal year, and even then the level of real GDP will still be 10 per cent below where it was projected to have been in that year in the MYEFO published in December last year. I think that underscores the point the Governor of the Reserve Bank made when he appeared before your committee on 28 May that we've got to keep the fiscal stimulus going until recovery is assured.

There's a significant risk of a setback to the recovery which seems to have started during May, if all of the fiscal support measures that have been put in place since the onset of the pandemic are allowed to expire as presently scheduled at the end of September. We shouldn't want to repeat the mistake made by other countries such as the UK, the US and Germany, in tightening fiscal policy too soon after the darkest hour of the financial crisis had passed, as the Governor of the Reserve Bank also pointed out in his appearance to you in May.

Bastions of economic orthodoxy such as the OECD and the IMF have made the same point. Most recently the IMF, in its world economic outlook published last week, said:

The exit from targeted support … should proceed gradually to avoid precipitating sudden income losses and bankruptcies just as the economy is beginning to regain its footing.

… … …

Where fiscal space permits—

which parenthetically I would say is a description that applies to Australia—

targeted fiscal support … can be replaced with public investment to accelerate the recovery and expanded social safety net spending to protect the most vulnerable.

I very much agree with the Deputy Governor of the Reserve Bank who told an Economic Society webinar on Tuesday this week that:

… there are no concerns at all about fiscal sustainability from increased debt issuance.

So long as interest rates on government debt are less than the growth rate of nominal GDP, growth in the economy will work to lower debt as a share of GDP.

I think we also need to avoid in the pursuit of greater self-sufficiency in the sourcing of so-called strategic products or any other reason policies which inhibit the movement of factors of production—that is, labour and capital—from low-productivity uses to higher-productivity uses.

Madam Chair, I'd like to conclude with an appeal to you to make a specific recommendation in your report to the Senate. As you know, the measured unemployment rate published by the ABS every month has become a particularly misleading guide to the true condition of the labour market during the current downturn. That's because of the large number of people who are counted as employed even though they work zero hours and the large number of people who, having been stood down or retrenched, are not actively looking for work and hence are recorded as being not in the labour force, rather than unemployed. In current circumstances, a better guide to the true level of unemployment is the number of people receiving the jobseeker payment, as it's now called, or the youth allowance other payments. In May the number of people receiving those two payments represented 12 per cent of the workforce—well above the official unemployment rate of 7.1 per cent.

The Department of Social Services publishes monthly data on the number of people receiving these payments on data.gov.au, but it's with a considerable lag. In fact the DSS compiles this data weekly, as you're aware, because the secretary of the department provided that data in evidence to you on 30 April. Otherwise, this information isn't available to the general public. I can't think of any reason why it should be a state secret. By way of contrast, the US Department of Labor has been publishing the American equivalent of these numbers at 8.30 am Washington time every Thursday morning since 1968. It would greatly assist with more timely and accurate assessments of the state of the labour market if the DSS were to do the same here.

The ABS is to be commended for the efforts it's made to provide a wider range of data in a more timely fashion to help both policymakers and analysts, and the general public, track how households, businesses and the Australian economy more broadly are responding to the challenges posed by COVID-19 and the measures necessary to deal with it. Other government agencies, including the DSS, should do the same, and I'd encourage you to include that in the recommendations you make to the parliament. Like Stephen, I welcome the opportunity to answer your questions.

CHAIR: Thank you very much, Mr Eslake. You will get furious agreement from members of this committee on that recommendation you just put to us; in fact, Senator Siewert and myself have attempted to extract that information on a weekly, if not fortnightly, basis. We have a regular question on notice now seeking that information fortnightly. We'll see where we can go with that because we agree that access to timely data is essential, particularly as we work through the recovery phase.

Thank you both for attending today and providing us with your expertise and input. Two questions for both of you: looking forward—and I know it is difficult, so with appropriate caveats—how do you see the economic outlook evolving over the next six to 12 months, and what do you think the major challenges facing the Australian economy will be as we emerge from this crisis?

Mr Koukoulas: I can kick off. I think in the next six months we will see a statistical bounce back in the September quarter GDP, as many businesses have reopened and we are going about our business to some extent—certainly to a greater extent than we were in the June quarter. When we get the June quarter data for GDP in early September, it will be a substantial negative. At the moment it's a guess as to what that might be, but I think it's fair to say it will be a big negative. So there'll be some sort of bounce back coming then.

The question, as I alluded to in my opening statement, is that the growth momentum just does not appear to be there in the private sector. We do know that, with immigration levels very low, support for the housing market will be very limited. We also know that consumer spending will be held back by the elevated weakness in the labour market—the various definitions of underemployment and unemployment. We know that there have been widespread wage freezes and wage cuts in many parts of the economy, so household income will be severely constrained. With household consumption spending over 50 per cent of GDP, that component will not be driving the economy to any significant extent—other than the statistical rebound we're likely to see.

Huge questions occur to me for the December quarter—the current scheduled end of the JobKeeper and jobseeker stimulus measures, if we can call them that. Mine are focused more on the mortgage holiday that the banks have generously granted a lot of people who have had trouble making monthly repayments on their mortgages, and, at a state and territory government level, the ending of the no-evictions policy that has been in place. I'm fearful that when we get to October, with many people not having paid their rent and many people not having paid their mortgages but still accumulating debt and debt on their rent, we will see a dislocation in banking and in the housing sector. Unfortunately, we will probably see high-profile cases of people being evicted from their houses, because they're allowed to be evicted, and a very heightened risk of some genuine mortgage stress and foreselling of the property market at a time when we already know that the housing market has well and truly come off the boil. So it's a scenario where pinpointing hard numbers on GDP forecasts and inflation of majors probably isn't all that helpful, but it's a scenario where you see the momentum in the key parts of the economy being very problematic.

Overlaying all that is the fact that the global economy is very weak. The Australian dollar is overvalued because the RBA has clearly given up on targeting inflation; it's claimed it can do no more on monetary policy. So we've got a very strong Australian dollar at the moment. It says to me that the export side of the economy is also potentially a constraint—other than the fact that the Chinese still want to buy our iron ore, for example. So it will be a scenario that will see evident pain in society and the economy unless there is a substantial ramping-up of fiscal policy stimulus measures, because the private sector is certainly going to be weak. The only question that's worth debating about that is how weak the private sector demand will be.

CHAIR: Thank you. Mr Eslake, do you have anything to add to that or in answer to my question?

Mr Eslake: Not a lot. I by and large agree with the scenario that Stephen has painted for you. I just draw to your attention a couple of things in the chart pack that I've provided to you. On page 83 I set out six reasons why I think a V-shaped recovery is unlikely. That includes some of the specific factors that Stephen mentioned, but I'd also emphasise the likelihood that Australians will continue to observe a degree of social distancing voluntarily and will be reluctant to exercise in full all of the freedoms that governments are now starting to allow them to have, even if we avoid further lockdowns of the sort that are now happening in Victoria. Most of that is a short-term thing, but I'd also, as Stephen did, emphasise the risks that might eventuate if all of the fiscal and regulatory supports that have been put in place since the onset of the pandemic were to be withdrawn at the end of September. I just take a degree of comfort from the signals the government is giving that it's aware of those risks. I assume that between now and 30 September—and particularly in the Treasurer's scheduled speech on 23 July, I think it is—the government will be announcing some measures designed significantly to reduce that risk.

From a slightly longer term perspective, I draw to your attention page 86 of the chart pack that was circulated to you, where I emphasise that Australia's 30-year, almost, run of continuous economic growth owed a lot to four factors. One was our above average rate of population growth, of 1½ per cent per annum. The second was our unusual, for an advanced economy, economic relationship with China. The third was the housing boom and the associated substantial increase in household borrowing. And the fourth was mostly good macro-economic policy settings over that 20- or 30-year period. My point here is that the first of those three is likely to be missing in action, especially for the next 12 and possibly 24 months and may not return in the same full force even after then. Clearly we're not having any immigration, at least until the middle of next year and maybe longer. Our economic relationship with China is starting to turn sour and, while I don't think there's much risk to our iron ore exports—as Stephen mentioned, because the Chinese don't really have any alternative to that, especially while Brazil has the problems which it currently has—almost all of our other exports of goods and services to China are potentially at risk from vengeful actions by the Chinese government. And I would hope that the housing boom that we had over the previous 25 years doesn't resume, and I don't think it will. Indeed, there are probably some downside risks to the housing market in the next 12 months, especially after it reopens at the end of September. So a lot hangs on the fourth of those factors, good macro-economic policy, and of course that's one of the principal things that you're reviewing as part of your inquiry. But I think Stephen and I have both made our views pretty clear about the broad nature of what fiscal policy should be seeking to do.

Senator KENEALLY: Senator Gallagher has kindly let me follow up on that. I was quite drawn to this slide because it reminded me of a statement from the Reserve Bank governor a few weeks ago, where he said that, when the virus is over, all of the factors that made Australia a successful economy will still be there. I'm not sure, taking your answer, that that is necessarily the case. If we are looking at a possible shift of significant proportions that outlives the virus, or outlives the time in which there's a vaccine for the virus, what are the things that we as a committee, or we as a Senate, should be recommending to government that they be doing now? I'm throwing things out there for you to comment on, whether it be productivity enhancing measures and reforms, whether it be investment in skills and education and training, whether it be a change to migration settings. If we look forward, what should we thinking about in terms of recommendations to government for changes in policy?

Mr Eslake: I draw your attention the slide on page 88 of the chart pack that I circulated, which goes to the heart of a couple of the issues I'd raise in response to your question. One of the things that contributed to Australia's good economic performance over the last three decades that I mentioned was our unusually rapid population growth rate of 1½ per cent per annum. That's like a head start that Australia's economy has enjoyed, all else being equal, over countries with much lower—or, in some cases like Japan and Italy, even negative—rates of population growth. At least for the next 12 months, or until our international borders open, the contribution that population growth will make to economic growth, all else being equal, will be close to zero. It may be that when our borders reopen more people will want to migrate to Australia because of the success we've had in combatting the virus, but then the question is whether the government will want to accommodate that or will continue with the path they started to go down before the pandemic of reducing the migration intake a bit. So you can see from that chart—

Senator KENEALLY: Excuse me, Mr Eslake. Can I clarify: you mean reducing the permanent intake, not the temporary?

Mr Eslake: Yes, the permanent intake. Although that may be a policy that the government wants to consider in the light of continuing high levels of unemployment. I don't have a strong view either way on that, but that's something that I'm sure the government will take into account in deciding how much temporary immigration it allows. What the chart on page 88 also highlights is that over the last five years barely more than a quarter of our economic growth has come from labour productivity growth, compared with over 54 per cent of our economic growth coming from productivity growth between the early 1990s and the onset of the global financial crisis. So, in the absence of a strong contribution from population growth, the only way Australia can generate the sort of economic growth that I think we'll need to make steady inroads into the pool of unemployment that we're going to have at the end of the pandemic is by lifting our rate of productivity growth. Lots of suggestions have been put forward by lots of different people as to how to do that. It's with that in mind that I emphasise that we need to be careful that, in the pursuit of objectives like greater self-sufficiency in the range of so-called strategic products, that doesn't become a cover for protectionist instincts, which are still very strong in this country, as in others. If those instincts were allowed to flourish, it would inhibit the movement of resources—of labour and capital—from low-productivity industries to high-productivity industries. That's also a risk in an environment of very low interest rates. Firms which may otherwise have gone out of business—allowing the factors of production they've been using to be picked up and used more productively—will otherwise stay in business. It could also be the result of misdirected policies designed to save all firms, irrespective of whether, even in the absence of the pandemic, they would have had a commercially viable future.

CHAIR: Thank you Mr Eslake. Mr Koukoulas, in your opening statement you paint a pretty bleak picture of the labour market at the moment, with the 1.7 million underemployed, 928,000 unemployed and a further 620,000 who've dropped out of the labour market in the last few months. What needs to happen to flatten that curve, basically—to reduce that and get as many people back to work in as short a time as possible? What's the size and scale of that problem?

Mr Koukoulas: Strong economic growth fixes the labour market. It's been well established for many, many decades that that is the solution to creating jobs—one of the solutions to getting towards full employment anyway. We really need to see the snap-back, if we can call it that, in economic growth to be powerful. After, let's assume, a five per cent fall in GDP in the June quarter and after the small fall in the March quarter, we need to see that lost output clawed back and then move onto the trajectory where potential GDP in Australia is 2¾ or three per cent or thereabouts. We need the economy to be very strong to make inroads into those really troubling labour market numbers.

In a sense—this might be a very generic comment—it's getting money into the economy. If the private sector is not willing to borrow and not willing to invest much at the moment, then the onus is on the government sector. That's things like—some of these will be well-worn ideas—fast-tracking infrastructure. I know people have said that for three or four or five months, but I've seen scant evidence of it. I've heard the rhetoric around it, but I've not seen much in the way of fast-tracking those sorts of issues. It's perhaps getting money to people's pockets through a permanent increase in jobseeker payments. I mentioned in my earlier comments rental stress and mortgage stress. Perhaps have the government consider some sort of strategy so that people who are impacted and at risk of being evicted or being forced to sell their house can get some form of cash injection.

The other thing that is very important and has been evident in the labour market numbers is a very strong gender bias away from women in the weakness in the labour force. So if I can just put on my economic security for women hat—I've been doing a lot of work on these things in recent times—gender equality as a means of promoting economic growth is a well-established structural issue. It's not necessarily a response to COVID-19 as such, but it's an opportunity like what we're hearing on some of the tax reform discussion at the moment. If we were to have a policy regime that made childcare affordable and accessible, we'd get a rebound in female participation in paid work, which is a vital, important part to repair the numbers you mentioned. Things like above-average wage increases can be determined through government representations to the Fair Work Commission for sectors that have a heavy skewing to female employment. The ones we seemingly celebrate for their wonderful efforts over the last six months or so—nurses, teachers, carers—are the sorts of sectors that are poorly paid relative to male dominated sectors. If we were to argue, or if the government were to argue, for pay increases over and above the average in those sectors, you'd do a couple of things. First of all, you would address the gender inequality issues which are still very well entrenched in the Australian society and economy, and you would boost economic growth. To me, they are a couple of things that perhaps don't have a lot of attention in how we get that economic growth back to absorb a lot of the three-odd million people on the wayside in terms of the labour market at the moment.

CHAIR: Do you have an idea, quickly, on what size of fiscal package, whatever it may be, is needed in order to tackle some of the numbers we know right now exist?

Mr Koukoulas: This is a back-of-the-envelope calculation; I don't have access to the Treasury modelling machines.

CHAIR: Neither do we, unfortunately.

Mr Koukoulas: My educated guess is something in the order of $100 billion per annum—which, on the old GDP numbers, was about five per cent of GDP—for, say, two years. Obviously that's a moving feast. If we miraculously get a vaccination or a cure quickly and the global economy rebounds quickly—an optimistic assumption—it would be less than that. But if what is happening in Victoria and the global economy creates a lockdown and a jolt to what should be some form of economic recovery in the second half of 2020, then of course the number will be greater. But, in a sense, the number doesn't worry me terribly much; it's making sure that money is going into the economy, particularly at the middle- to low-income part, because the propensity to spend and propensity to consume for people on low and middle incomes is significantly higher than the well off.

CHAIR: If we have time we might come back to that.

Senator PATERSON: Mr Koukoulas, I might start with you. I think it'd be fair to say there'd be issues of economics and public policy we'd disagree on. But one area I suspect we're in heated agreement on is so-called modern monetary theory, so this might be a bit of a Dorothy Dixer for you! Is COVID-19 a good reason for Australia to contemplate MMT?

Mr Koukoulas: I don't think anything's a good reason for us to consider it—COVID or anything else. I know that different people have different opinions on modern monetary theory, but to have a scenario where policy settings are paid for by printing money—even if you're a sovereign like Australia, and you've got your own central bank and your own currency—seems to me to be badly flawed. I've seen some of the other comments on that, and to me they seem to be well-meaning. I would love it to be possible to have a central government printing money to fund everything: to fund the budget deficit; to fund the economic fallout from COVID-19; to fund a myriad of issues. Job guarantees are a worthy objective. But, in reality, I don't think they work terribly well, because there is pressure on the budget. When I look around the world economy to see the number of countries that have embraced a lot of this really fascinating reading—I must confess I'm really enjoying it—and to see the discussion on modern monetary theory, unfortunately, though a number of countries have embraced it in the sense that it's been widely published by the very vocal proponents of it, I'm yet to see anybody fully embrace it. So I agree with you completely.

Senator PATERSON: There's no government in the world that has embraced MMT, is there?

Mr Koukoulas: No, no. There have been vague snippets of it from the Bank of England. They've sort of monetised a little bit of the government borrowing there, but it's tiny.

Senator PATERSON: What are the risks to the economy of going down that path?

Mr Koukoulas: The risks to the economy? Of course, inflation is the obvious one. Unbridled spending leads to high inflation. So that's the biggest concern. While the proponents would say that there'll be a discipline from the government in terms of how much to spend, at the end of the day, I'm not as confident as those proponents that governments are always responsible when it comes to fiscal settings.

Senator PATERSON: What would you say to them, though, when they say: 'Well, inflation's pretty low, historically, at the moment. It might even be a good thing if we get inflation up to more standard levels. Wouldn't this be one way of starting down that road?'

Mr Koukoulas: We can achieve that through normal policy settings. We can achieve a reflation of the economy through some of the things that I mentioned earlier. Through significant fiscal stimulus, for example, through a significant monetary policy stimulus, as another example, or through a range of other micro reforms—while they tend to improve productivity, which of course is against higher inflation—you can reflate the economy. I would love to see the Reserve Bank meet their two to three per cent inflation target. I would love to see nominal wages growing at 3½ or four per cent, like they did prior to the GFC—so I am going back a long way there. So real wages growth of perhaps three-quarters or one percentage point a year would be great to see. It's not easy, necessarily, to achieve it, but it is achievable through conventional policies of stimulatory monetary and fiscal policy.

Senator PATERSON: Just finally on this: although you are an advocate of stimulus spending, you also believe that that stimulus spending must be paid for in a conventional budgetary way?

Mr Koukoulas: Yes, indeed.

Senator PATERSON: Mr Eslake, moving to you, on a similar topic: I've seen you quoted in the media worrying about the implications of Reserve Bank independence and potentially going down an MMT path. Would you like to expand on that at all?

Mr Eslake: Yes, Senator. I guess I'd first of all say that MMT is actually not particularly modern. In a sense, I'd disagree with my colleague Stephen Koukoulas in saying that there's never been a government that has embraced it. There have actually been plenty of governments historically that have printed money to finance spending—usually under wartime conditions, or occasionally in circumstances of egregious economic mismanagement. The two most recent examples that you'll be familiar with are Zimbabwe and Venezuela. And that's what happens when you print money to finance government spending in circumstances where the supply side, the productive capacity of an economy, has been severely damaged. But, if you strip MMT of the ideological baggage that its leading proponents usually carry, there is a kernel of truth in the assertion that monetary financing of budget deficits isn't inflationary when there is a lot of unused spare capacity—that is, idle labour or capital—in an economy. You can see contemporary evidence for that in the sense that, although no central bank is directly purchasing government debt anywhere in the world, central banks are indirectly financing an awful lot of budget deficits. For example, the Bank of Japan owns more than half the outstanding stock of Japanese government debt, and the Bank of England owns about a third of the outstanding stock of British government debt.

Although the proportion of Australian government debt which the Reserve Bank owns is quite low by comparison—and I should say in passing that it's actually not easy to find out up-to-date information on how many Australian government bonds the Reserve Bank owns, because, unlike other central banks, it doesn't publish that in its weekly balance sheets; the best way of finding it out is from the Reserve Bank's finance and wealth accounts—the most recent edition of the finance and wealth accounts, which came out last Friday for the March quarter, shows that the Reserve Bank indirectly absorbed all of the debt issuance by the federal and state governments during the March quarter, as well as picking up a lot of the Australian government bonds that foreign investors were keen to sell during those panicky two weeks in the latter part of March.

I think the key point is that the Reserve Bank—being independent of government and, in this country at least, having a strong tradition of resisting political pressure on its decision-making under three or four consecutive governments now—is well placed to make the judgement as to when the economy is starting to run out of spare capacity and hence it should cease operations like that, whereas proponents of modern monetary theory argue that that decision should be made by, as they call them, elected officials. In effect—and most of them are quite open about this—modern monetary theory has at its core the subjugation of monetary policy to fiscal policy and the subjugation or subordination of the central bank to the elected government. Our own experience in Australia of that—when, as a former Treasurer famously said, he had the Governor of the Reserve Bank in his pocket and monetary policy was just a matter of picking up the telephone and telling him what do with interest rates—wasn't really all that successful, nor was it in other countries where monetary policy was in effect a political tool and was manipulated to the advantage of incumbent governments. So—with no disrespect to any of you as elected officials—I would have far greater faith in an independent Reserve Bank to make those decisions, and of course the Reserve Bank is ultimately accountable to the parliament through the six-monthly appearances that the governor and his officials make.

Senator PATERSON: No offence taken; I happen to agree. What are the dangers, though, of having politicians directly involved in monetary policy, apart from what you were saying there about the politicisation of interest rates? If the Reserve Bank were to be buying bonds directly from the government, what would that enable governments to do that they can't do right now?

Mr Eslake: In present circumstances, it wouldn't make any difference in practice, because the Reserve Bank is in effect doing that in a roundabout way, and of course the interest which the Reserve Bank receives from the government on its holdings of government bonds ends up being paid back to the government in the form of dividend payments out of its profits every year. Where the difference would become important is when the economy was approaching full employment of labour and capital, when an independent central bank would be far more likely to come to a judgement that, if they were to continue doing what they had been doing when there was spare capacity in the economy, eventually there would be a rise in inflation. History tells us that, if you wait until there actually is a rise in inflation—not just to two per cent, which, as Stephen and others say, would probably be welcome, but going well beyond that to something that would be politically uncomfortable as well as damaging for, for example, people who depend on fixed incomes and can't protect themselves from higher inflation as wealthier people or people who own financial and real assets usually can—the only way to reverse a rise in inflation to damaging levels is to bring on another recession, which is also something that we would want to avoid to the extent that we can.

Senator PATERSON: Mr Koukoulas, is there anything you'd like to add to that discussion?

Mr Koukoulas: Not really. I think we can safely say the prospects of MMT being implemented in Australia as a broad concept would be close to zero, so that's comforting.

Senator PATERSON: Indeed.

Senator WHISH-WILSON: Normally when someone else asks your questions during these committees, you can always find another way to come at it, but I should have known when Saul was involved—and his comprehensive answers—it was going to be very difficult! I'll just ask one last question around quantitative easing. To Saul or Stephen, is there any evidence that that liquidity is making its way to where it's needed, for example to business investment, rather than to retiring debt or more real estate speculation?

Mr Eslake: There's no evidence at the moment that the quantitative easing undertaken by central banks anywhere in the world is finding its way into increased levels of business investment; although, to be fair, you also have to consider the counterfactual—that is, if central banks weren't doing what they're doing, would the downturn in business investment be even worse than it actually is? There is perhaps some evidence from the period after the global financial crisis that, had it not been for the quantitative easing that central banks undertook, for example, in the United States, the downturn in housing activity would have been much sharper than it was because one of the ways the feds' quantitative easing clearly was effective was in preventing a sharp rise in mortgage rates that would have occurred because of the loss of faith in mortgage backed securities that was an integral part of the global financial crisis in 2008-09.

Another dimension to the quantitative easing that's being undertaken at the moment, particularly by the fed and the Bank of England, is that they're directly finance lending to small and medium enterprises. They've set up special facilities to do that to prevent what otherwise may have been a credit squeeze faced by those firms who perhaps couldn't get access to credit. I think, again, you have to ask what the counterfactual is, but I suspect we would have seen more bankruptcies among small firms in the UK and the US if it hadn't been for those facilities. Now, that's a lesson that's been picked up by the Reserve Bank here in Australia, which you'll recall established in March, as part of its suite of measures, this $90 billion term lending facility which was constructed as a way to incentivise bank lending to small and medium enterprises. So far only about $12½ billion of that $90 billion has been drawn out, but that's because that banks actually have plenty of funding already and haven't needed it. But, as Guy Debelle, the deputy governor of the Reserve Bank, said on Tuesday, the Reserve Banks' expectation is that, as the bonds and other forms of financing that banks have issued mature over the next six months, they'll be drawing more heavily on that facility to support lending. In the particular Australian context where banks might be a bit nervous about lending to marginal small businesses because of the more onerous responsible lending criteria that have been imposed on them in the wake of the royal commission, that's, I think, a particularly effective policy response that the Reserve Bank has overseen to address those very real concerns that you mentioned.

Senator WHISH-WILSON: Thank you. Stephen, did you have anything quick you'd like to add to that?

Mr Koukoulas: I think Saul's covered it very, very well. I'd only add that quantitative easing is more of a support measure for the economy than a pro-growth measure. There's a slightly subtle difference. It comes in when the banking system, when private sector corporations are under huge financial stress. The central banks implement QE to stop the haemorrhaging of those businesses and the banks when the economy is under severe stress. I think, again, as Saul, brilliantly articulated, it's been generally successful in the countries that have tried it since the GFC.

Senator WHISH-WILSON: Thank you. You're both fans of more focus on fiscal policy and a bigger role for government investment or public investment—the words Saul used in his opening statement. Have you got any thoughts on what kind of benchmarks we should be looking at in terms of government debt to fund growth in the recovery? We've got some historical benchmarks—net debt to GDP—we can look at for this country. We can look at international benchmarks for Commonwealth debt and for state and Commonwealth debt. Have you got any thoughts on how high we could take that? And could I also get your views on whether you think spending $270 billion on a military industrial complex as the Prime Minister announced yesterday is going to be a good job creator? Also, do you have any views on Europe's green-led economic recovery?

CHAIR: Pretty small issues there!

Mr Koukoulas: The first one, on debt levels: I don't have any preconceived idea about what the optimal level of debt is. My only thoughts on the level of debt and budget deficits are that they're a product of the state of the economy. In a sense, is a budget surplus or a deficit good or bad? The answer to that is always going to be: it depends. It depends what's happening elsewhere in the economy. Of course you run deficits when the economy is weak; big deficits when the economy's really weak. If we get to the position, one day hopefully, where the economy is very, very strong, we can run budget surpluses. That would be okay. In a sense right now, I wouldn't worry about debt. It's a bit like saying, 'Are we using too much water to put out the bushfires that are raging around Australia?' Well, no, we've got to put them out first.

At the moment my discussion on the level of government debt is that we shouldn't worry about it. We'll worry about the mopping up when the economy's back on its feet again when we're running along strongly. But for now, as I alluded to, I think we need to ensure that the money within the economy is generating a decent degree of economic growth, that it's generating the sort of growth that's going to see some of the people currently unemployed, using the broadest definition that Saul touched on, actually able to regain employment. Obviously, if we can direct some of that to the cliched productivity-enhancing infrastructure spending that would be ideal. Of course there's a list as long as your arm for some of those measures.

Senator WHISH-WILSON: Any thoughts quickly on spending money on defence expenditure versus other things in the economy?

Mr Koukoulas: I'd prefer to be spending it on areas that are going to be driving the domestic economy. I don't know what bogeyman we're looking at in terms of defence spending. I'm not privy to the defence information, so maybe there's legitimate—

Senator WHISH-WILSON: I don't think any of us are, Stephen, by the way.

Mr Koukoulas: I don't know whether there's a legitimate threat to us and people are going to invade us. I don't know that, but for now I think that there might be bigger priorities domestically.

Senator WHISH-WILSON: Thank you. Saul?

Mr Eslake: Just very quickly, first on the nature of fiscal stimulus: while I certainly favoured public investment as the vehicle for fiscal stimulus in my opening statement, I'd also acknowledge that fiscal stimulus can be delivered through tax cuts, so it doesn't necessarily mean a bigger size of government. That's a choice, which is a legitimate one, but it's not the only possible outcome. In my view, in present circumstances, part of the reason for preferring public investment over tax cuts is that public investment does put dollars directly into the economy; whereas with tax cuts, and particularly personal income tax cuts, given that most income tax is paid by people in the upper half of the income distribution, there's a significant likelihood that the dollars that fund tax cuts would be saved and hence wouldn't boost economic growth to the same extent as public investment would. But there's also a risk with public investment that it can be wasted on projects that are chosen for reasons other than the contribution they'd make to improving social or economic productivity.

Just very quickly in relation to the other questions you put: in my view the level of debt to GDP shouldn't be a target in itself but rather an outcome of a well-chosen suite of policies which you look at in order to ask yourself whether there are any risks associated with financing those measures through increased debt.

Australia's probably going to end up on an unchanged policy basis, taking into account the states and territories as well, with public debt to GDP of somewhere between 40 to 50 per cent, and I think that's sustainable. At the current level of interest rates, there are plenty of countries that have public debt to GDP ratios of double that, that aren't suffering any obvious penalty in their credit ratings or in the price they have to pay to raise new borrowing. What you just have to be conscious of is the higher the level of public debt you have if and when interest rates eventually revert to more normal levels. For example, instead of paying 0.9 per cent for a 10-year bond, you will end up paying 2½ or three per cent and then a bigger percentage of your budget will necessarily be pre-empted by interest payments and not available for what you may consider more worthwhile purposes. So the level of debt to GDP in some sense is not something you should target. You would say, 'Let's get our public debt to GDP up to 60 per cent, and what does that mean we can spend?' The chain of thinking, in my view, should be the other way around.

On the question of military spending, I interpreted the government's announcement yesterday as a way of fleshing out the commitment which Australia has had since the Abbott government was elected to lift defence spending to two per cent of GDP, something which hadn't really been fleshed out all that much beforehand. Like Stephen, I don't have access to the advice on which the decision was based but I certainly don't have any trouble accepting the Prime Minister's assertion that the security environment, particularly in our region, looks more troubling and dangerous given the belligerence of China in particular in our region. That is a view that is shared by people in governments in a lot of other countries in our region, including Vietnam, which is—officially at least—on the same side of the political ledger as China.

But what is also important from an Australian perspective is the increasing doubt we have to have that the US will play the role in defending us that we had assumed they always would in the past, especially if—not that it looks likely, according to opinion polls—Donald Trump were to be re-elected. All countries who care about their own security would feel a need to be more self-reliant in that regard than they have been able to be in the past.

Lastly, on your question about green jobs, again, I note that both the IMF and the OECD put that tinge on some of the recommendations they make. While I don't think every fiscal measure should be framed through that lens, I certainly have no problem with the idea that some of the public investment that could form part of a fiscal stimulus response could be directed towards facilitating, accelerating or easing the transition that Australia eventually has to make to a lower carbon economy.

CHAIR: Mr Koukoulas, you wanted to add something?

Mr Koukoulas: Just very briefly, on the question of the size of government, I think the last four or five months have shown very clearly that the government has an absolutely vital role to play in the economy. Even in good times but also in these very troubled times, the role of government, the size of government, has increased dramatically with JobKeeper, jobseeker, free child care, which have all been to the benefit of the economy. Had they done nothing, had there have been no increase in the size of government, the economy would be much worse than it is today. The sort of adherence that small government is always better than big government has completely been put in the rubbish bin, if you like. The role of government is something we can still debate and the size of government is still something we can debate, but just to say small government is better than large government seems to me to be wrong, and the last few months are just confirming that, not just here in Australia but around the world.

CHAIR: Thank you, Mr Koukoulas. Senator Whish-Wilson, I just make this comment: I noticed you have been drinking out of a coffee mug which reflects on another member of this place. I understand it hasn't been broadcast but it is certainly visible within this room. I just ask if you reflect on that and perhaps choose another mug to drink out of. I am trying to run these proceedings in a really respectful way. I think holding that mug up consistently through your line of questioning is not helpful and not conducive to the way I'm trying to run this committee. I'm not trying to be unfair to you; I'm just making that call now because I saw it happen a number of times. I will now hand the call to Senator Lambie.

Senator LAMBIE: I have a question for both Mr Eslake and Mr Koukoulas. Most of the country is starting to pull out of shutdown now. What do you think the top three priorities should be for the federal government in the next stage of managing us out of the crisis?

Mr Koukoulas: One of the three priorities will be to make sure the economy maintains momentum. Even if we have spot shutdowns like we're seeing in Melbourne, Victoria at the moment, they have to ensure that the rest of the economy continues to grow. It would be not withdrawing the JobKeeper and jobseeker stimulus measures too early or, if they are modified, I'd be making sure that there's something else to back them up to make sure people have money in their pocket so that they're not evicted from their houses or don't have to have the forced sale of their house, so that consumers still spend in the economy and so that businesses still retain some employment. That would be the first thing: making sure that there's money in the economy in the very near term—and the 'near term' being between now and the end of the calendar year.

Another really important issue to me would be to start looking at reform. I know that's a well-trodden path and it has been for 20 or 30 years. We should really be thinking about how the structure of the economy can be improved. The government can use this crisis, as I touched on just a moment ago, to see what it can do to enhance the wellbeing of Australian citizens. How can we ensure that we have fairness and equity across income and wealth levels, across gender issues and between the states and territories? When we look at the cold, hard numbers on many of those measures, we see huge divergence between states and territories, between city and rural areas, between men and women, and between people on high incomes and those on low incomes. We can use this as an opportunity to enhance economic growth through a lens of fairness and equity. That is something I'd be looking at—making sure that policy measures that come into place to grow the economy have a view to those sorts of issues as well.

I'd also want to make sure that the workers who are currently unemployed, underemployed or not working any hours are at least maintaining, if not enhancing, their skill set—whether that means they reskill themselves at a TAFE, a training institution or a university. Whether they're young people who are finishing year 12 and going on to uni or a middle-aged worker who has lost their job, we need to ensure they have access to facilities that keep their skills up to date.

The other thing to remember is that, even though the COVID-19 crisis has been very disruptive, technological change, innovative change, automation and artificial intelligence are still continuing. They're still continuing underneath the whole economy. We're getting automation in retail, for example. We need people to have the skill set to be able to work not at the check-out or stacking shelves but in other parts of the economy that require a higher level skill set. I'd be looking to make sure that people who are currently out of the labour market have the opportunity to reskill and retrain so that when the economy does recover they can get a job relatively easily in an area that has decent paying jobs.

Mr Eslake: I'm conscious of the time, so I will answer Senator Lambie's question as quickly as I can. The first priority I think as we emerge from the shutdown is to do whatever can reasonably be done to minimise second waves and having to go back into lockdown, such as we're currently seeing in Melbourne. I think it would be particularly damaging to business and household confidence if we were to have to go back to statewide lockdowns, because that would undermine confidence that, once we are through this, we'll be through it for all time rather than having an endless 'lock down, let out, lock down' cycle. If people started to think that that was what the world was going to be like, it would be very hard to engineer a recovery. I think the best way to prevent that is, while acknowledging that there are going to be occasional outbreaks, to do everything you can to minimise the possibility and to minimise the spread if they do occur.

The second thing would be to get people back to work as quickly as possible. If that does mean extending JobKeeper in selected areas, then by all means do that. The third thing where I'm aligning with Stephen here is that I think governments need to be thinking about what sorts of reforms ought to be pursued, not just in tax but in other areas as well, in order to ensure that the sustainable rate of growth over the long term is consistent with what's needed to get us back to full employment as quickly as possible. That means not just thinking about reforms but openly advocating them so that the public can see what the arguments for change are rather than just being presented with a fait accompli at the last minute and being expected to go along with it.

Senator LAMBIE: Compared to other states, the Tasmanian government has been pretty generous with its support measures for households and businesses. What do you think other states and the federal government can learn from Tasmania's response?

Mr Eslake: You're right that, on the calculations I've seen, Tasmania's support for households and businesses, as well as its spending on health, has been the equivalent of three per cent of Tasmania's gross product, whereas no other state has done more than 1½, and most have done less than one. The irony is that the state which did the least, as a proportion of gross product, to support households and businesses—namely, Western Australia—nonetheless has enjoyed the highest level of public support, according to opinion polls, for what it has done. So it may well be that spending more money isn't the be-all and end-all of being seen to have done a good job by the people who elect you.

Be that as it may, one of the areas where Tasmania has been more generous than any other state or the federal government has been in the support it has provided to people who've fallen through the cracks of some of the job support proposals. The Tasmanian government has made income support payments to recently arrived migrants and some casual workers who've not been eligible for JobKeeper. That's something that the federal government could revisit as part of its review of the JobKeeper program or other states could contemplate doing as well.

Tasmania, unlike any other jurisdiction, federal or state, has provided meaningful updated revisions to its budget and economic forecasts. I've been a little sceptical about why it was necessary for the federal government and other state governments to defer their budgets until October. New Zealand was perfectly capable of bringing down a budget at the normal time, and it might have assisted with reducing uncertainty if the federal government had shared its forecasts with everybody else. I, perhaps more than most people, would have understood the uncertainties associated with doing that, but I don't think it's a reason for not doing it, and, as I say, Tasmania has been more informative in that regard than any other jurisdiction in the country has been, so that's something else that could perhaps be emulated by governments in other parts of Australia.

Senator LAMBIE: If I could make the Premier of Tasmania the Prime Minister, I'm sure we'd all have a shot at that! I have one last question for both of you. How would you reform JobKeeper to keep money in the pockets of the people and keep the economy running? Should we be looking at keeping it going for certain sectors or continue giving it to everyone by dropping the amount people get? Have you got a plan? It's supposed to end in September. Have you got a plan or some sort of vision you'd like to see? We could either reduce the rate or keep it going.

Mr Eslake: One thing that could be done, albeit at the cost of administrative complexity, is fixing up the anomaly whereby people actually end up getting more money for being on JobKeeper than they were receiving when they were working. That particularly applies to young people and people who were working part-time. That's clearly a disincentive for people in that position to go back to work, and that could be fixed by requiring employers to report to the tax office what they had been paying those people, and then the tax office ensuring that they weren't paid any more than that. But, as I say, there would be an additional administrative burden both for the tax office and the employer in doing that.

I certainly think that there's a good case for extending the availability of JobKeeper to employers in sectors which are subject to continuing social distancing restrictions. The most obvious one of those is the tourist industry. In a sense, there's almost a moral case here as well as an economic one where, in this downturn, unusually—unlike in previous recessions that have been caused by high interest rates or a financial crash somewhere—the losses of business income and wages are the direct result of government policy decisions. They were undertaken for a proper purpose, to protect people's lifes and health, but, because this is the direct result of government decisions, I think there's almost a moral obligation on government to do what they can to make good those losses. If tourist operators are expected to go for much longer with a loss of income in order to protect Australians from being infected by people coming from oversees, I think there's a moral obligation on the government to do something to alleviate at least a proportion of those losses suffered by the businesses and the people who work for them.

Mr Koukoulas: If I could add briefly: keep JobKeeper focused on the industries that are doing it tough at the moment. That's the clear objective, or should be the objective, when it comes to it's natural end in a couple of months. Saul mentioned the tourism industry in very general terms. The university sector is another one that is under severe stress at the moment, without foreign students coming in easily to study here. Again, obviously we'll have to wait and see what data comes out, but it's clear where the pain is. In a lot of the hospitalities and the arts people just don't have any work at the moment. They're getting no opportunity to work, because we're not allowed to go back in the same numbers to sporting events, to the theatre or to restaurants and cafes, and we're not allowed to jump on a plane and have a holiday around the economy. You'd have it as a moving feast, depending on when things improve in particular sectors. I don't know whether it'd be a monthly or a quarterly review of the JobKeeper payments, if we extend them beyond September, but, clearly: direct it to the sectors that are in trouble.

Senator PATRICK: In response to the evidence given to Senator Paterson about us politicians, I used to group meteorologists and economists together, but meteorologists get their predictions right nowadays! I just say that as we go into this. You talked about infrastructure as a mechanism for assisting the economy or stimulating the economy. What about things like value-add? We know that we export a lot of rocks—lithium, for example, and even iron ore—without doing the value-add. Of course, we often see products coming back much later in time at much greater value. I presume there's benefit in stimulating the economy through value-add? Would you both like to comment?

Mr Koukoulas: I don't think there is a role for government necessarily in that space. If it were cost effective and profitable for a firm to be doing it, they'd be doing it now. How do you get the government to fund, as you said, turning rocks into steel, or whatever the process might happen to be? We add value here in Australia rather than exporting the rocks over to China inevitably. If it were profitable for a private sector firm to do it, they'd be doing it. You'd just have to check with the big iron ore producers. I'm sure they're not unaware of the opportunities that might be there, if they were available. Getting the public sector—

Senator PATRICK: Thank you for that. But, for example, if you are exporting those rocks to China and they value-add and make profit, and some of that profit has to be counted by public money in the defence space or the soft power space, surely when you look at it from a totality perspective, there is a place for government to do something.

Mr Koukoulas: Well, I don't think I will change my answer to that because the wonderful productivity within the Chinese steel mill mills, for example—they are using a lot of the steel domestically. We don't have a huge demand for steel. We use a mere fraction of the steel the Chinese manufacturers use. They use it domestically and, of course, they re-export it. In a sense, if we have public sector money, how much would you be willing to risk, if you like, to fund the value-add before you realise it was just too expensive to do? Sure, it would stimulate the economy to some extent, but to me it sounds like a very high-risk, high-cost, value-added approach. The risk is that you don't necessarily achieve what you want to do with the government doing that.

Mr Eslake: I'm instinctively suspicious of arguments for government intervention that are couched in terms of, 'What would happen if there were a war?' There are some people around who think we should have a car industry simply so that we can make tanks if someone decides to invade us at some point in the future. While it might be plausible that someone may want to invade us in the future, I don't think it's a legitimate reason for forcing Australians to play inflated prices for badly made cars, as the Australian government did for about 80 years. The same would apply to other protectionist arguments.

Where I think there might be a legitimate case for the sort of intervention you propose is in circumstances where value-adding isn't taking place in Australia because a multinational or foreign owner of a company undertaking resource extraction, for example, thinks it fits better with its corporate strategy to do further processing in other locations, even though it could be shown to be commercially viable in Australia. If a foreign company were to decide to do that, I think it could well be legitimate for the Australian government to seek to intervene. But if an Australian owned company thinks there is no way it or some other firm can be commercially viable by doing further downstream processing in Australia, I think it is in the national interest for that company to be allowed to export the raw materials for the highest price that it can possibly get. That company has every incentive, I would think, to get the highest price it can possibly get rather than give them away at a below-market price. But where you have an extensive chain of foreign control there are risks of transfer pricing at below-market prices that would be legitimate grounds for governments to intervene. But any such intervention would need to be based on solid evidence rather than on speculation about what might happen in hypothetical circumstances at an unknown point in the future.

CHAIR: Thank you Senator Patrick. Sorry, we are pushing up to 2.15, which is when we're due to finish. Mr Koukoulas, can I ask you one last question. It's around unemployment and underemployment. The underutilisation rate in the labour market is deeply worrying to me and to most other people in Australia. On current settings, how long would it take to get back to where we were pre COVID?

Mr Koukoulas: I've got my own forecasts, and I think they're broadly similar to the ones that have been published by the RBA. As Saul noted, we haven't seen any official forecasts from the Treasury on what their projections are for the unemployment rate, so we're relying on the RBA and private sector forecasts. To get back to five per cent unemployment, which is where we were at the start of the year, and a workforce participation rate roughly 2½ per cent to three percentage points higher than it is today is not on my forecast horizon. I think it requires a series of heroic—that is, strong—forecasts, for GDP growth in 2021, 2022 and 2023—so three years, approximately, from now. If we have a statistical rebound of perhaps five per cent in the near term and then sustained economic growth of 3½ per cent for the following two years, we might get back to that five per cent unemployment rate with a higher workforce participation rate. As I mentioned, they're heroic forecasts. I would love to see them come into play.

CHAIR: In three years or so?

Mr Koukoulas: I would say that, at the end of 2023, there's a reasonable chance, with everything going right on the economy, that we'll get the unemployment rate, the participation rate and the underemployment rate back to where they were at the end of 2019 and the start of 2020.

CHAIR: Thank you very much to both of you, Mr Koukoulas and Mr Eslake. Thank you so much for your time today. You've been very generous with the committee. We appreciate it, and it will assist us. We look forward to engaging with you in an ongoing way as we continue this inquiry, which is not due to finish until June 2022, although we will be providing interim reports. Mr Eslake, we'll make sure that that one about DSS data is in there in one of the first.

Mr Eslake: Thank you.

CHAIR: If we can't convince them ourselves, we'll do it through the Senate. Thank you very much.