20 July 2009

Unemployment: the coming crisis

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Employment and output in the crisis

Employment and unemployment move in line with cyclical fluctuations in economic activity. However, there is a generally a time lag between movements in economic activity and changes in employment and unemployment. The current global recession is no exception. Increases in unemployment did not emerge until the global crisis was well underway. The typical lag from the onset of recession to the beginning of an increase in unemployment is between two and four quarters. Global unemployment is still rising rapidly, even though many commentators expect a recovery in economic activity in the second half of 2009.

Recent recessions have exhibited a troubling pattern, referred to as jobless recovery. The lag between employment and output is much longer in the recovery phase of the cycle than in the downturn. In the 1989-91 recession, unemployment kept rising for several years after output had begun to recovery.

The Australian government's response to the crisis has so far focused mainly on measures designed to stimulate output, such as cash handouts targeted at sustaining retail sales and infrastructure projects aimed at maintaining activity in the construction sector. Although such measures have some beneficial effects on employment, they are not, in general, as effective in this respect as more directly targeted measures.

The budget response to unemployment

The limited response to unemployment was evident in the May Federal budget. The budget projects that, despite the effects of the stimulus package, unemployment in Australia will reach 8.5 per cent next year. It's striking then, how little the budget contains in terms of measures specifically directed at improving the lot of the unemployed.

Most obviously, unemployment benefits have not been increased, further widening the gap between these benefits and other pensions. In an environment

where suggestions that unemployment is partially or wholly voluntary can no longer be sustained (if they ever could), it is hard to avoid a feeling of injustice here.

The direct response to unemployment in the budget amounts to $1.5 billion for the Jobs and Training Compact, much of which has already been announced or foreshadowed. The main focus is on training, which is good long term policy, but may not be all that helpful in a recession. In addition to existing infrastructure projects the government is offering a $650 million Jobs Fund, designed to 'support local jobs in areas hardest hit by the downturn'.

The need for a new stimulus package

While welcome, the measures announced by the government so far represent a small fraction of the expenditure allocated to the Keating government's Working Nation program. As with other responses to the 1989-91 recession, Working Nation was not introduced until high unemployment was firmly entrenched. The Rudd government's limited steps in this respect contrast unfavorably with its rapid, indeed pre-emptive, adoption of fiscal stimulus policies.

As output begins to recover, employment will almost certainly lag. The economy needs a new stimulus package focused directly on jobs. This implies a shift in focus from capital-intensive infrastructure project to employment-intensive services, including health, community services and education. All of these are areas of substantial unmet need.

Active labour market policies

In addition to employment-intensive stimulus, recovery from the recession will require substantial expenditure on active labour market policies directly targeted at the unemployment. There are three main forms of active labour market policy: training, wage subsidies and direct job creation. Each has a role to play.

Most of the timing, training is the best way of making people more employable. A lengthy recession strengthens the case for participation in school, university or TAFE diploma courses. If the labour market is weak, the option of staying in school, or of going back to university or TAFE to enhance your qualifications is more attractive. Demand for tertiary education places is going to be higher in the future. Even with the expansion of places announced in the budget, it is likely that the number of qualified students unable to find a university place will increase in coming years.

On the other hand, short-term training programs directed at those who are already unemployed are of little use in recessions. When few employers are hiring, those who do so can pick and choose from a pool of experienced and qualified candidates. A training course of a few months is unlikely to move an unemployed person to the front of the queue.

Wage subsidies are another popular policy. But they are least effective during the initial contraction phase of a recession, when employers are cutting back or freezing their staff numbers. Wage subsidies are most effective during the early expansion phase. They can be used to encourage employers to hire the long-term unemployed

Job creation gets a bad name from silly projects exemplified by the (apparently apocryphal) case of 'painting rocks white', so they tend to be a last resort. In a sustained recession, there is a strong case for direct job creation, targeted at the unemployed.

Concluding comments

The Rudd government moved early and effectively to offset the impact of the global recession on economic activity in Australia. We need similarly rapid and effective action to prevent a re-emergence of sustained mass unemployment. Time is running out.