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This is a recession – we're just not calling it one

Following the release of the better-than-expected GDP figures last Wednesday, which showed that Australia's economy expanded by 0.7% in the June quarter, it now seems likely that Australia may avoid a 'technical recession' if the New South Wales and Victorian Governments are able to allow their economies to re-open in sufficient time to allow economic activity to rebound in the December quarter, after the inevitable contraction which will be recorded in the current quarter.

As I've argued previously, the stipulation that a 'recession' is necessarily delineated by consecutive quarterly contractions in real GDP is lazy, silly and misleading. Does anyone remember the 'recession' of 1977? No, I don't either – even though real GDP contracted by 0.4% and 0.3% in the September and December quarters of that year. But I do remember the recession of 1974 – even though real GDP only contracted in one quarter, the June quarter, of that year (albeit it by 2.0%, which until last year was the largest single-quarter contraction in Australia's real GDP ever reported).

Had the bushfires which ravaged south-eastern Australia in the final weeks of 2019 and the first couple of weeks of 2020 not occurred, real GDP might have increased marginally in the March quarter of last year, rather than declining by 0.3%, as it actually did. Would it have been at all sensible for anyone to have suggested that, because we would then have had only one quarter of negative growth (in the June quarter of last year) that we had again escaped 'recession' – even though the 7.0% contraction in real GDP in that quarter was larger than that which occurred during the two previous recessions (of 1982-83 and 1990-91) combined?

A much more sensible definition of a recession is when the unemployment rate rises by 1½ percentage points or more in 12 months or less. That 'rule of thumb' correctly identifies every episode that common sense would regard as a 'recession' in the past sixty years – without giving any false signals (as the 'consecutive quarters of negative real GDP growth' criterion does).

And by that definition, Australia's economy is in recession now.

The Reserve Bank Governor said, after Tuesday's Board meeting, that "the unemployment rate will move higher over coming months", alongside what he characterized as a "material' decline in real GDP in the current quarter (a decline which is likely to be at least as large as the single-quarter contraction of 2.0% in the June quarter of 1974).

Indeed, the effective unemployment rate – which adds to the 'official' unemployment rate (as published by the ABS) people who are officially classified as 'employed' despite working zero hours (for reasons other than being on some form of leave) and people who have 'dropped out' or chosen not to enter the work force because of restrictions on their ability to 'actively look for work' (or because they see little prospect of finding it) and are hence classified as 'not in the labour force' has already risen from 5.7% in May to 8.0% in July – an increase of 2.3 percentage points in two months. It will almost certainly have risen further in August.

In my view, this is a recession which – unlike last year's – we didn't have to have. It is, unequivocally, the result of poor choices by both the Federal Government (in particular, with regard to vaccines) and the New South Wales State Government.

However, the fiscal policy responses to both the previous recession and the one we are experiencing now have, for the most part, been appropriate and, in some instances, exemplary.

When confronted with a shock of the magnitude represented by the onset of Covid-19 (or, for that matter, the global financial crisis of 13 years ago), the probability that any government (or central bank) will be able to calibrate exactly the right amount of fiscal (or monetary) policy response is about the same as the probability that I will see a thylacine on my front lawn in the early hours of the morning.

It's inevitable, in such circumstances, that a government or central bank will – at least initially – do either too much, or too little, in response to such a shock.

The 'right' mistake to make, in such circumstances – the answer to the question which former RBA Governor Glenn Stevens used to ask himself, "which mistake, of those I could possibly make, would I be likely to regret least?" – is to do what might, with the benefit of hindsight, turn out to have been 'too much'.

If you do what turns out later to look like 'too much', you can always stop doing it, or unwind it. But if you do what turns out to have been 'too little', not only will what you have done not achieve the desired result – but the credibility of your subsequent attempts to do 'the right amount' will be undermined by the failure of your first attempt.

The Rudd and Gillard Governments made the first mistake during the global financial crisis – and it was the 'right' mistake to have made – in contrast to the Obama Administration (hobbled by the Republican majority in Congress after 2010) and most European governments, which did too little.

The Rudd and Gillard Governments' error was in not winding the stimulus back once it had become obvious that they'd done 'too much' – as it should have been once the RBA began raising interest rates, from October 2009 onwards.

While the Morrison Government has made some bad mistakes with regard to its handling of the public health dimensions of the pandemic, if it has made any mistakes in its economic policy responses to the pandemic, they have generally been the 'right' ones to have made.

That applies in particular to 'JobKeeper'. That was, without question, a 'huge' program

– although it's worth noting that it ended up costing $40 billion (31%) less than envisaged when it was first proposed. It was conceived at a time when Treasury was forecasting that the unemployment rate would peak at 9¼% in the December quarter of last year and that the economy would contract by 2½% in 2020-21.

It was intended to prevent something far worse from happening – as would almost certainly have happened in its absence (and as indeed did happen in the United States, which uniquely among 'advanced' economies didn't have any kind of 'furlough' or wage subsidy scheme, and where the 'official' unemployment rate peaked at 14.8%).

And in order to prevent something far worse from happening, it needed to be implemented quickly, and simply – which it was.

As things turned out, the (official) unemployment rate peaked at 7.3% in the June quarter, and (as we learned last Wednesday) the economy actually grew by 1.4% in 2020-21.

So it should hardly come as a surprise that some businesses received payments under 'JobKeeper' who, with the benefit of 20-20 hindsight, shouldn't have – businesses whose turnover didn't fall by as much as they had assumed when applying for payments under the scheme, in accordance with the eligibility criteria which had been specified at the time.

Many of those businesses would have been as surprised at how differently things turned out for them as the Government – indeed, all of us – have been surprised at how much better the Australian economy has performed compared with what was forecast during the darkest moments of last year.

It seems that the Government has drawn at least some lessons from the 'JobKeeper' experience. It is now making payments directly to workers displaced from employment by public health restrictions, rather than to their employers. And the payments appear to be more tightly targeted than was the case with 'JobKeeper'.

There's a very compelling moral case for those businesses who received payments under 'JobKeeper' which, with the benefit of hindsight, they didn't need – and which have instead gone to boosting their profits, and the rewards paid out of those profits to their shareholders and senior executives – to return them to the taxpayers of Australia. Some businesses have indeed done that – and others should follow their example.

Perhaps – again, with the benefit of hindsight - applicants for 'JobKeeper' payments should have been told that their names would be made public, or that, in the event that their circumstances turned out differently from what they'd stated in their original applications, they would be required to repay any public funds which they received.

But they weren't – and retrospectively re-writing the 'rules of the game' would, in my view, set a very dangerous and undesirable precedent.

That's especially so given that 'JobKeeper' was administered by the Australian Taxation Office – whose ability to command the trust of taxpayers necessary to allow it to fulfil its functions depends heavily on the faith taxpayers have in its willingness and ability to abide by the confidentiality obligations imposed on it by law.

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