Statement 4: The labour market through COVID-19

The labour market recovery in Australia has exceeded all expectations. Compared with major advanced economies, Australia is the first economy to have recovered hours worked and employment to pre-pandemic levels.

The Government's policy response has played a significant role in supporting the labour market through the COVID-19 recession and setting it up for a strong recovery. This includes policies aimed at boosting household incomes, ensuring business continuity and preserving economic and financial linkages.

As a result, Australia is set to avoid the worst of the economic scarring effects seen following past recessions. The size of the COVID-19 shock, coupled with the speed of labour market deterioration, made economic scarring a real possibility as the crisis unfolded. In the 1990s recession, the unemployment rate took a decade to recover to its pre-crisis level. In contrast, the unemployment rate is now on track to recover in just two years.

The next priority must be to lock in the substantial benefits that have been achieved. While Australia is emerging from the COVID-19 shock with a strong recovery in activity and employment, the outlook for the global economy remains highly uncertain. With 800,000 COVID-19 cases diagnosed daily across the world, new strains of the virus emerging and international travel restrictions yet to be lifted, the effects of COVID-19 may not dissipate for some time yet.

In this context, it is crucial that the Government continues to support a strong labour market that is both flexible and resilient. The fiscal support contained in this Budget will provide broad-based support to the economy, stimulating economic activity and driving down the unemployment rate. This is consistent with the Government's Economic and Fiscal Strategy to drive the unemployment rate down to pre-pandemic levels or below. This Budget will also support cohorts who face greater risks and challenges in the labour market.

With sound policy and an improving global outlook, the Australian economy is on course to do better than merely recover to its pre-pandemic levels, with the unemployment rate forecast to reach 4¾ per cent in the June quarter 2023. The unemployment rate in Australia has only been sustained below 5 per cent once since the early 1970s and this Budget sets us on a course to achieve this again. The Australian economy may be able to sustain lower unemployment rates — and this will mean more Australians finding work, and setting the foundations for a strong, resilient and productive economy in the longer term.

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The impact of COVID-19

The COVID-19 pandemic led to Australia's first recession in almost 30 years. Not only had Australia not faced an economic shock of such magnitude for decades, the nature of the shock was quite different to previous downturns. As such, there was the need for a different framework to guide the development of a policy response that tackled the health crisis and the potential for long-term economic damage.

Past experiences with infectious diseases, such as the Avian Flu and the Severe Acute Respiratory Syndrome (SARS) had provided the basis for analysing the economic effects of a pandemic. The economic effects of pandemics tend to spread quickly as the disease itself spreads quickly across international borders. The effect is magnified as the shock to one country is transmitted to other countries through trade and financial linkages.[5] These spillovers have been evident during the COVID-19 pandemic, with substantial disruptions to global value chains and a sharp contraction in global growth over 2020.

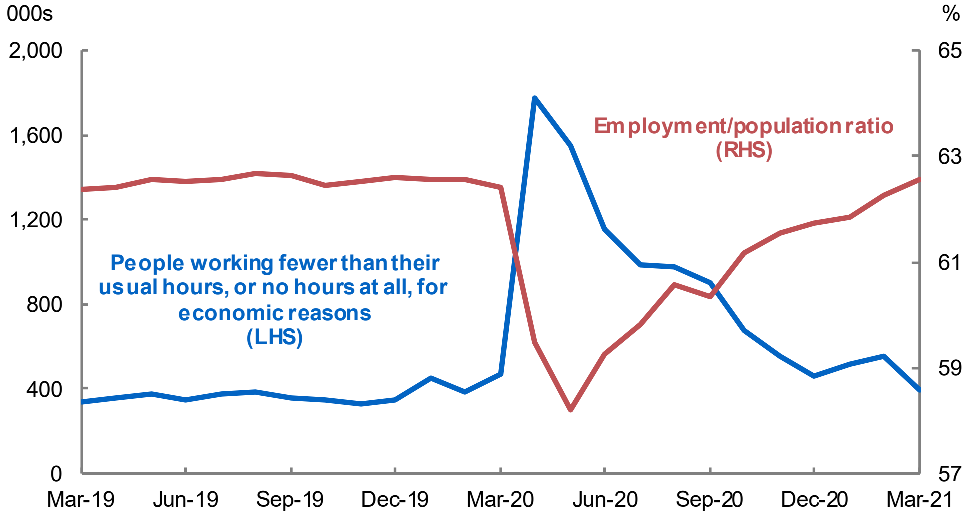
On the domestic front, earlier analysis — including work published by Treasury in 2006 — identified three key channels through which pandemics impact the economy.[6] First, pandemics lower consumer confidence and therefore consumption, even with a small number of deaths. Second, business investment contracts due to weaker demand, lower confidence, and increased domestic and global uncertainty. Both of these channels were evident in Australia during COVID-19.

Third, a pandemic has significant effects on the labour market, decreasing both the supply of, and demand for, labour through absenteeism and activity restrictions. This third channel makes pandemic-related shocks such as COVID-19 different to previous downturns in the early 1980s, the early 1990s and the Global Financial Crisis (GFC). During COVID-19 this last channel was significant. The need to protect the community and its most vulnerable members saw the rapid imposition of activity and travel restrictions. These restrictions led to a deep and sharp downturn in employment — the largest on record — as well as a sharp increase in the number of workers on reduced hours (Chart 4.1).

5 See for example: Lee J and McKibbin W (2004), 'Estimating the Global Cost of SARS', in Learning from SARS: Preparing for the Next Disease Outbreak: Workshop Summary, 2004 and McKibbin W and Fernando R (2020), 'The global macroeconomic impacts of COVID-19: Seven scenarios' CAMA Working Papers Vol 19/2020.

6 Kennedy S, Thomson J and Vujanovic P (2006), 'A Primer on the Macroeconomic Effects of an Influenza Pandemic', Treasury Working Paper 2006-01, February 2006.

Chart 4.1 Labour market indicators



Note: People working fewer than their usual hours, or no hours at all, for economic reasons, includes those receiving JobKeeper payments.
Source: ABS Labour Force, Australia, Detailed.

The risks of economic 'scarring'

The imposition of restrictions met the overriding policy priority of protecting the health of the Australian people. However, past experiences have shown that economic downturns can have long-term adverse effects on the economy, known as 'scarring', and unemployment can remain elevated for a sustained period following a downturn.[7]

Downturns increase job separations and churn, and can destroy what had been viable businesses. In turn, this can sever productive employee-employer relationships, end business-to-business linkages, and destroy firm-specific human and intangible capital. The risk of this was acute in the context of COVID-19, given the widespread nature of the restrictions meant that many highly productive and otherwise viable firms may have closed.

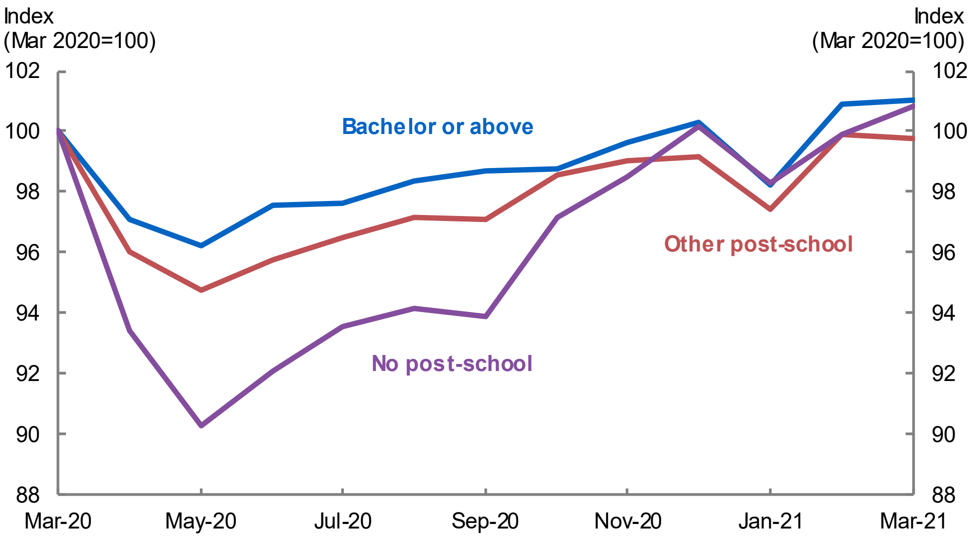
For individuals, downturns often lead to sharp increases in the number of long-term unemployed. If people are unemployed for an extended period it can cause a deterioration in their skills that may require them to retrain or relocate for new employment opportunities. A slump in the demand for labour can also mean that new entrants to the labour market, such as recent graduates, are unable to secure a solid foothold, limiting their future job opportunities for many years.

7 See for example Day I and Jenner K (2020), 'Labour Market Persistence from Recessions', RBA Bulletin, 17 September 2020.

Typically the most affected workers in a downturn are those in the hardest hit industries. This proved to be the case during the COVID-19 downturn. In addition, employment status also had a large bearing on labour market outcomes, with part-time and casual workers experiencing the largest declines.

In past recessions, the most affected cohorts tended to be men in full-time jobs in sectors such as manufacturing. In contrast, the industries most affected by the pandemic were accommodation and food services and arts and recreation services, and casual workers were far more likely to lose employment than permanent employees.[8] As a consequence, women and young people were more likely to lose work. Job losses were also more notable for individuals with lower levels of educational attainment (see Chart 4.2), English proficiency, and in lower income quintiles.

Chart 4.2 Employment to population ratio by educational attainment



Source: Treasury analysis using ABS Longitudinal Labour Force Survey.

The differing cohorts affected by this crisis may have meant that there were additional or different dimensions and risks around labour market scarring. For some of these groups, the scarring may have exacerbated existing economic insecurities, such as for lower-skilled workers and women. For younger workers, it may have disrupted the formative years in their careers.

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8 For example, based on analysis of newly available Labour Force Survey microdata, an individual working in accommodation and food services was over 20 percentage points more likely to lose work (either through job loss or a reduction in hours) between February and April 2020, after accounting for other differences. Working in arts and recreation services increased the probability of losing work by almost 30 percentage points. Casual workers were around 20 percentage points more likely to lose work than permanent employees.

Analysis of historical firm-level data shows that firm closures lead to persistent wage scarring for workers of all age cohorts. For older workers this entirely reflects a lower likelihood of finding a new job, while younger workers still face persistent wage scarring even when they are able to find new employment.

Similarly, Australians graduating into a local labour market where the youth unemployment rate was 5 percentage points higher can expect to earn roughly 8 per cent less in their first year of work, and 3½ per cent less after five years. It takes around a decade for this effect to fully disappear. Female graduates experience even more labour market scarring than men.[9]

It was with this potential for scarring in mind that the large and rapid fiscal response was developed. The response was designed to maintain productive employee-employer relationships, support productive and viable businesses, and provide income support to those most affected by the downturn. The further support in the 2021-22 Budget, outlined below in 'Supporting the Recovery', is targeted at getting vulnerable cohorts into work and driving the unemployment rate down to further mitigate scarring from extended periods of unemployment.

The policy response

As the COVID-19 health crisis unfolded during March 2020, three Economic Response Packages were rapidly introduced. The support was underpinned by clear principles: that it be temporary, targeted, scalable, proportionate and use existing mechanisms. The support packages assisted the economy through three key channels: helping households, directly supporting businesses, and preserving the link between employees and employers.

Individuals and households were supported through the payment of a Coronavirus Supplement to certain income support payment recipients, four Economic Support Payments, and temporary early release of superannuation. These policies helped to support those who had lost employment and who were not supported directly by the other policies aimed at businesses and employees.

Businesses were supported through a number of investment incentives, cash flow boost payments, a wage subsidy to retain apprentices and trainees, and targeted support for the most severely affected sectors and regions. Businesses were also supported with loan guarantees, increased availability of credit, and insolvency reforms.

9 See Andrews D, Deutscher N, Hambur J and Hansell D (2020), 'The Career Effects of Labour Market Conditions at Entry', Treasury Working Paper 2020-01, June 2020.

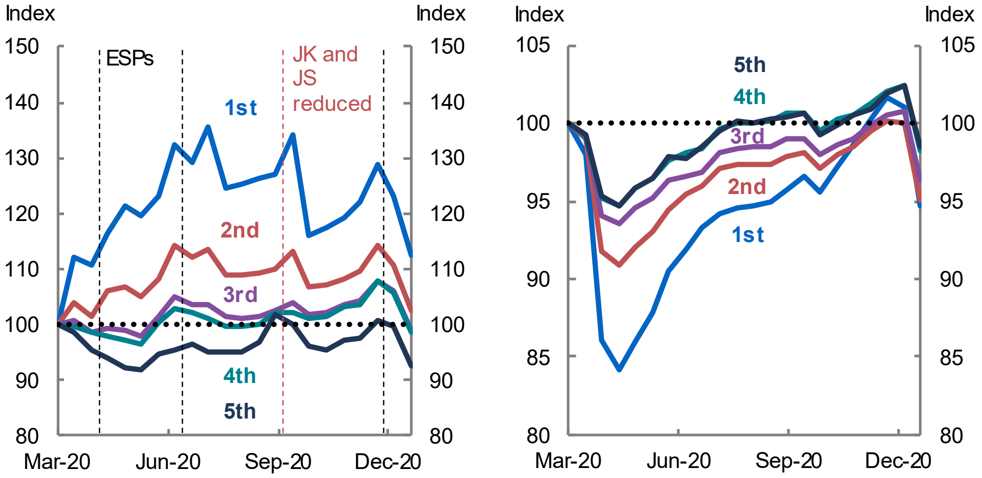
Businesses and their employees were further supported in the third economic support package with the announcement of the JobKeeper Payment. It was the largest one-off fiscal measure in Australia's history, supporting more than 3.8 million individuals and over one million organisations from March to September 2020. The JobKeeper Payment had a number of objectives including: preserving employee and employer relationships, providing additional income for households, and decreasing uncertainty. It was expressly designed to work in conjunction with the JobSeeker Payment (enhanced by the Coronavirus Supplement). For example, some employees who had more tenuous relationships with their employers were supported by JobSeeker instead of JobKeeper.[10]

The JobKeeper Payment was complemented with temporary changes to the *Fair Work Act 2009* which gave businesses the ability to adapt workplace arrangements to the challenging economic conditions. These policies were designed and implemented in an environment where a large number of businesses faced strict public health restrictions, resulting in significant job losses and reduced incomes. From September 2020, the JobKeeper Payment was tapered and extended by six months, conditional on businesses re-establishing their eligibility for support.

The Government response was targeted towards vulnerable cohorts who had been hit hardest by the shocks, allowing them to continue spending and, in some cases, save. Average incomes in the lowest two income quintiles increased in the June 2020 quarter, despite larger declines in employment for these groups, reflecting the Coronavirus Supplement and JobKeeper (see Chart 4.3). Average incomes in these quintiles remained above pre-pandemic levels through 2020, even as the JobKeeper Payment and the Coronavirus Supplement were tapered as labour income recovered in line with the improvement in employment. In comparison, the third and fourth income quintiles saw broadly no change in income from March to December 2020, while the top quintile experienced a sustained lower level of income throughout the year.

10 JobSeeker arrangements were modified in a number of ways to support employees retaining an attachment to their employers. Separation certifications were no longer required to access the JobSeeker Payment, and partner income tests were eased, as were waiting periods.

Chart 4.3 Individual fortnightly wages and welfare payments by income quintile (left), and employment index by income quintile (right)



Note: Quintiles based on 2019 financial year salary income, ranked from lowest income (first quintile) to highest income (fifth quintile). ESPs refers to Economic Support Payments. JK refers to the JobKeeper Payment and JS refers to the JobSeeker Payment. For the first chart, the spike in September reflects processing changes when the Coronavirus Supplement was reduced, which resulted in some October payments being brought forward. For both charts, the decrease in December reflects seasonality over the Christmas period.

Source: Treasury analysis of tax and welfare payment microdata; ABS Australian National Accounts: National Income, Expenditure and Product.

The policies kept viable businesses afloat. Over the course of 2020 the number of business insolvencies was subdued, with around 40 per cent fewer companies entering external administration than in 2019.

By keeping businesses afloat, the suite of support policies also kept jobs intact. The JobKeeper Payment was an important component of this. It maintained employee-employer relationships through the worst of the crisis, reducing and then stabilising the rate of decline in employment.[11] The RBA estimated that the JobKeeper Payment increased the likelihood of a JobKeeper-nominated employee remaining employed over the April to July 2020 period by around 20 per cent. This implied the JobKeeper Payment saved at least 700,000 jobs at the height of the crisis.[12]

These policies provided a great deal of support to the economy, and helped to drive the economic recovery. Moreover, they will continue to contribute to the economic recovery even as they are tapered because much of the financial support provided remains on households' and businesses' balance sheets, and will contribute to spending in the coming quarters.

11 Treasury (2020), 'The JobKeeper Payment: Three-month review', 21 July 2020.

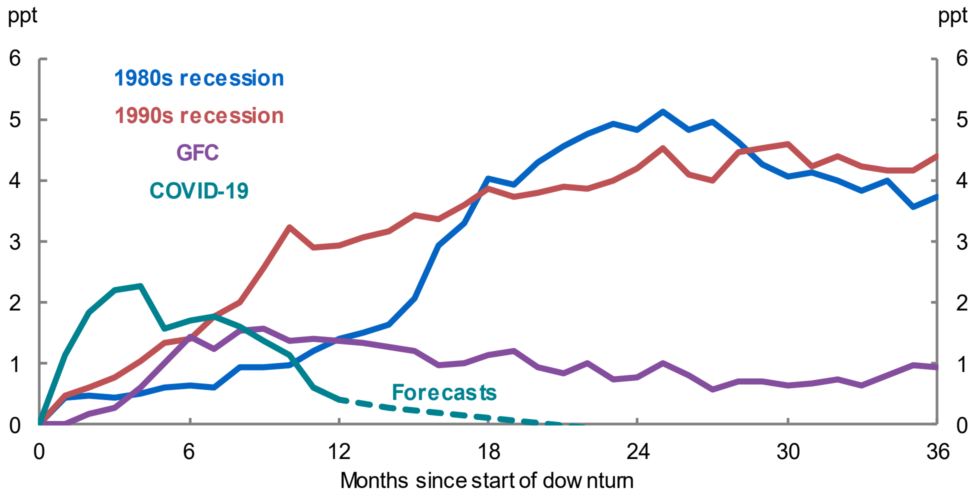
12 Bishop J and Day I (2020), 'How Many Jobs Did JobKeeper Keep?', RBA Research Discussion Paper 2020-07, November 2020.

The labour market recovery and JobKeeper transitions

The recovery in the labour market since mid-2020 has been unprecedented. Employment reached a record high of 13.1 million in March 2021 (0.6 per cent higher than a year earlier), and the unemployment rate is down to 5.6 per cent. Total monthly hours worked is now 1.2 per cent higher, and the number of people working zero hours for economic reasons has fallen below pre-pandemic levels.

The recovery has significantly outpaced the protracted recoveries experienced in past downturns (see Chart 4.4), and those of other advanced economies during COVID-19 (see Box 4.1). Workers who lost their jobs were far more likely to be re-employed quickly compared to past downturns, improving outcomes for individuals and ameliorating some concerns around scarring. For example, based on Labour Force Survey microdata, workers who lost their job in 2020 were 17 per cent more likely to be re-employed after six months compared with workers who lost their jobs during the early 1990s recession.

Chart 4.4 Change in unemployment rate during downturns

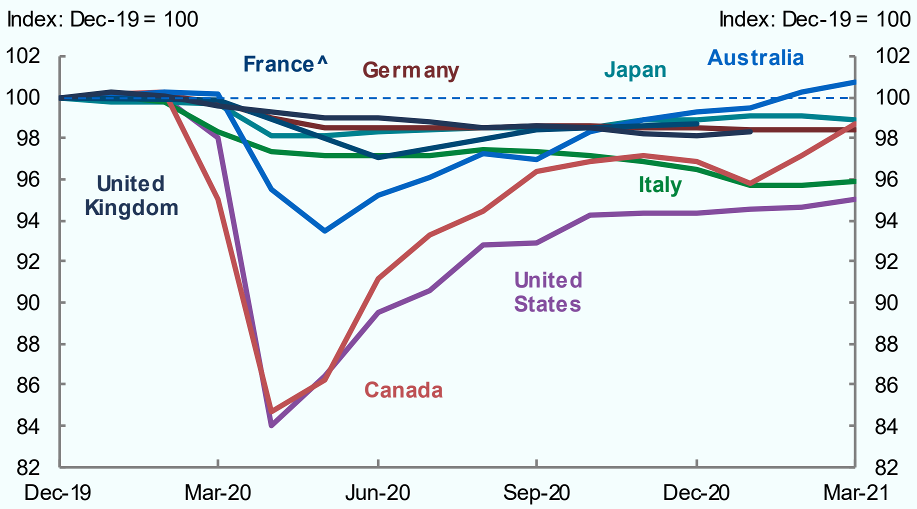


Source: ABS Labour Force, Australia; Treasury.

Box 4.1: International comparison

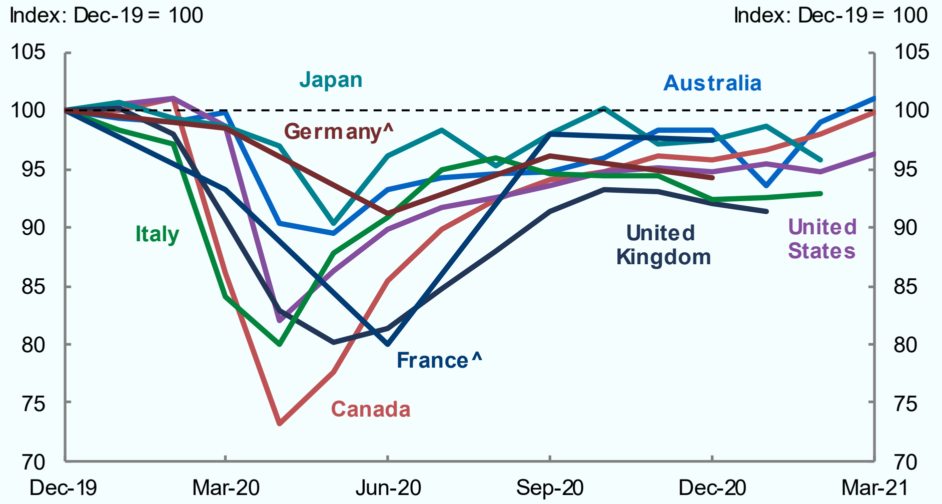
Australia's labour market continues to perform favourably compared with all major advanced economies. Compared with major advanced economies who have published data for March 2021, Australia is the first economy to have recovered hours worked and employment to pre-pandemic levels.

Chart 4.5 Employment levels, Australia and the G7 economies



Box 4.1: International comparison (continued)

Chart 4.6 Hours worked, Australia and the G7 economies



^Data are quarterly and latest data are for the December quarter.

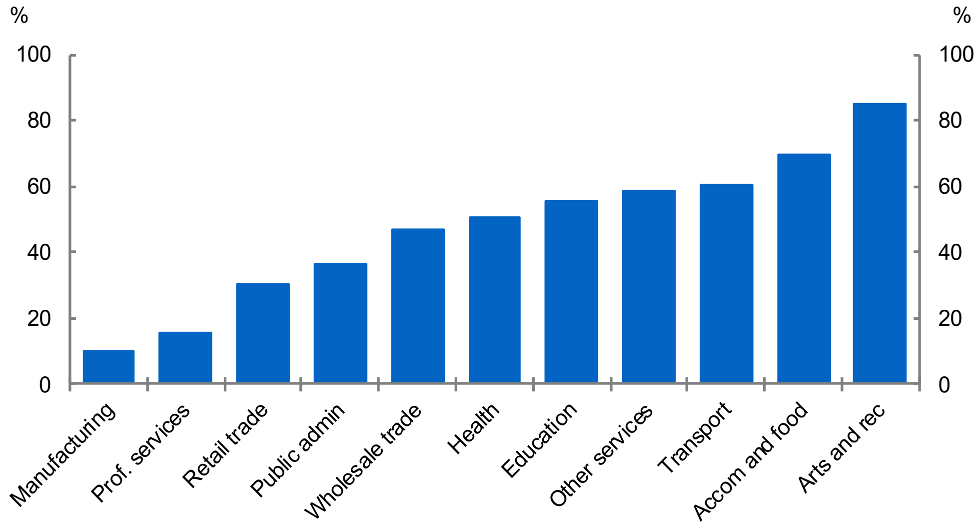
Note: Data are monthly and cover the cohort aged 15+ unless otherwise specified. UK employment and total hours worked data are a 3-month moving average from December 2020 to February 2021. France's total hours worked data are for the cohort aged 20-65 years. Due to definitional differences, care must be taken when comparing employment data across countries. Data is up to date as at 6 May 2021.

Source: Refinitiv; National statistical agencies; ABS Labour Force, Australia.

The combination of well-targeted economic support, $291 billion as at this Budget, and the lifting of restrictions on activities, means that the labour market has rebounded quickly. Many workers were able to return to their previous jobs supported by policies to keep businesses afloat, with a record number of entries into pre-existing jobs.[13] Further, the proportion of the recovery that reflected people returning to past jobs was higher in sectors that were more heavily affected by temporary COVID-19 restrictions, such as accommodation and food services, and arts and recreation services (see Chart 4.7).[14]

13 Based on Labour Force Survey microdata.
14 Based on Single Touch Payroll microdata.

Chart 4.7 Share of recovery in employment from April to June 2020 explained by workers returning to previous jobs



Note: Shows the percentage of the mid-April to mid-June recovery accounted for by the recovery in jobs that existed before 1 March 2020 — namely the change in pre-existing jobs divided by the change in total jobs over this period, expressed as a percentage.
Source: Treasury analysis of Single Touch Payroll data.

As the labour market recovers, transitioning away from job retention schemes (such as the JobKeeper Payment) towards policies that promote labour reallocation is important. Barrero, Bloom and Davis (2020) highlight the risk that policies designed for the height of the recession outstay their welcome and distort incentives to seek new employment, while policies that facilitate reallocation of labour can improve the speed of the recovery.[15] The IMF has highlighted that employment reallocation policies can help ease the adjustment process to some of the more persistent effects of the pandemic.[16]

By early 2021, there was substantial evidence that the labour market was recovering strongly, allowing a smooth transition from JobKeeper and the Coronavirus Supplement and for private sector-led growth to play a greater role in the recovery.

15 Barrero J M, Bloom N and Davis S J (2020), 'COVID-19 is Also a Reallocation Shock', May 2020.
16 International Monetary Fund (2021) 'World Economic Outlook: Managing Divergent Recoveries', Washington, DC, April 2021.

The JobKeeper transition at the end of the September 2020 quarter was relatively smooth. Around two million individuals (employees and business participants) transitioned off JobKeeper at the end of September 2020. The vast majority of the employees that transitioned off JobKeeper during this period remained in employment.

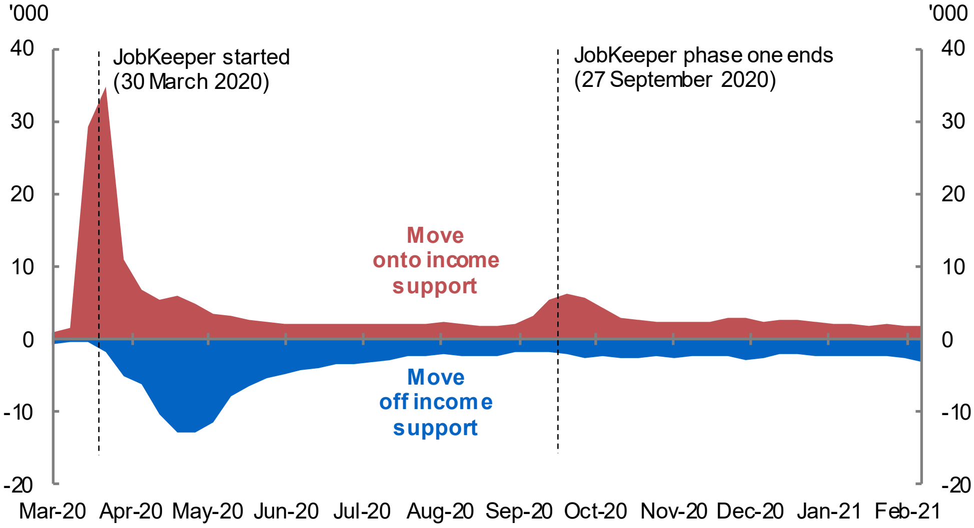
Although total employment at organisations transitioning off the JobKeeper Payment remained broadly unchanged, experiences differed across firms. Some organisations grew as operating conditions and confidence in the economic outlook improved. Others shrank, shedding workers as they rolled off the Payment. Overall, these two effects broadly offset each other.[17] This highlights the dynamism and resilience of the Australian labour market. This also alleviates some concerns that transitioning organisations might shed JobKeeper workers and hire casuals.

There was only a modest increase in the number of people moving off the JobKeeper Payment and onto other forms of income support, such as JobSeeker and Youth Allowance (Chart 4.8). Unemployment levels have fallen in each successive month since October with nearly half a million jobs created since the initial transition from JobKeeper in September.

The second transition at the end of the December 2020 quarter appears to have been similarly smooth.

17 Based on Single Touch Payroll microdata.

Chart 4.8 Weekly income support flows for individuals on the first phase of the JobKeeper Payment



Note: Income support includes Newstart Allowance, JobSeeker Payment and Youth Allowance (Other). Flows onto and off income support payments include flows from nil rate recipient status to being in receipt of a payment. Two week moving average.
Source: Treasury analysis of tax and welfare payment microdata.

In the final quarter of the JobKeeper Payment (January to March 2021), reliance on the Payment reduced further to around 1.1 million individuals and around 385,000 organisations.

Following the conclusion of the JobKeeper Payment, early data indicates the labour market has remained resilient. Job vacancies rose to reach a record high and the number of job seekers for every vacancy fell to its lowest level in over a decade, while the number of people on unemployment benefits has continued to fall.

Supporting household incomes, keeping firms afloat, and maintaining employee-employer relationships has played a crucial role in reducing potential business and labour market scarring, allowing Australia to recover swiftly. The conclusion of emergency support measures to avoid scarring and transitioning to policies that encourage private sector-led activity will allow the labour market to reallocate resources more efficiently and further drive recovery.

Supporting the recovery

The measures contained in this Budget will provide broad-based support to the economy and are expected to drive the unemployment rate down, consistent with the Government's Economic and Fiscal Strategy of pre-pandemic levels or below. This includes the Government's extension of the low and middle income tax offset, business tax relief, infrastructure investment and the significant Government investment in a range of essential services. This broad macroeconomic support will stimulate aggregate demand and economic activity, helping to drive down the unemployment rate.

The Budget is also aimed at assisting cohorts who face greater risks and challenges in the labour market. By building the skills that workers need, and removing barriers to employment faced by women and the long-term unemployed, these measures will help move people into employment and support building a flexible, resilient and productive economy.

Supporting women in the workforce

As noted above, labour market outcomes for women have largely recovered to their pre-pandemic levels. However, even before COVID-19, female participation was well below male participation. COVID-19 has also highlighted existing economic insecurity for women. Raising the female participation rate will assist with the recovery, address longer-term structural issues in the labour force and improve women's economic security (for more information see *Women's Budget Statement*).

The 2021-22 Budget provides further assistance to raise women's participation in the labour market. The Government is investing an additional $1.7 billion into the Child Care Subsidy, which assists parents with the cost of child care while they are working, training, studying or volunteering. The measure focuses on families with multiple young children in child care, where the secondary earner (often female) can face particularly high financial disincentives to take on additional work.

Changes to the Child Care Subsidy and the removal of the annual cap are estimated to add up to 300,000 hours of work per week, which would be the equivalent of around 40,000 individuals working an extra day per week.

As many women take time out of the workforce during their careers, the 2021-22 Budget includes measures to support women to return to work after a career break. This includes improving access to the Mid-Career Checkpoint program, which provides free career counselling to help people re-enter the workforce or advance their careers after returning to work. It also includes an expansion of the Career Revive program, which supports medium to large businesses to attract and retain women who are returning to work.

The 2021-22 Budget also delivers a range of programs to encourage women into leadership positions and into diverse industries and occupations. An expansion of the Women's Leadership and Development Program will include further funding for successful Women@Work projects such as the Academy for Enterprising Girls, and an expansion of the National Careers Institute's Partnership Grant Program will have a specific focus on career opportunities and pathways for women. The Government will also establish the Boosting the Next Generation of Women in STEM Program with an investment of $42.4 million over seven years.

Helping younger workers

Employment among young people has almost recovered to pre-pandemic levels, mitigating some of the concerns about long-term scarring, but some risk still remains. The number of young workers (15-24) looking for full-time employment who have been unemployed for more than 12 months has increased by 54 per cent between March 2020 and 2021. Many of these young workers looking for 'careers' are likely to find jobs as the labour market continues to improve. But given the importance of early labour market outcomes for career trajectories, this Budget also contains policies aimed at getting young people upskilled and into work.

The 2021-22 Budget will help provide young people with relevant skills and experience to ensure they can access good job opportunities in the recovery period ahead. The Government's commitment to extend the JobTrainer Fund, subject to matched funding by state and territory governments, will provide a further 163,000 free or low-fee training places in areas of skills need, helping people access valuable upskilling and reskilling opportunities. The extension and expansion of the Boosting Apprenticeship Commencements wage subsidy will also provide more opportunities for young people to upskill and reskill.

In addition, new avenues for young people to move into digital careers will be created through the Digital Skills Cadetship Trial. Recognising the need for specialist skills in emerging fields such as artificial intelligence, robotics and quantum computing, the Government will provide assistance through funding for more than 460 new scholarships.

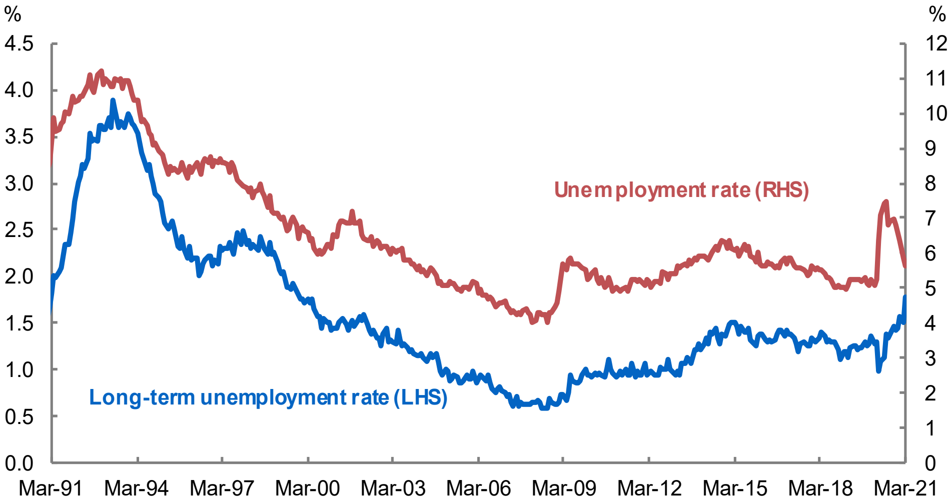
The 2021-22 Budget also provides tailored assistance to young people to help them move into employment. Transition to Work, an intensive employment program for young people, is expected to support an average caseload of around 41,000 disadvantaged people each year to transition into work or education (including apprenticeships or traineeships). The National Careers Institute service, which provides independent and impartial careers information and advice, is being extended to support young people to make well-informed decisions about their education and career paths through career coaching sessions.

Getting the long-term unemployed back into work

Success in re-entering employment becomes significantly harder the longer an individual is unemployed. This reflects a range of factors, including the atrophy of critical employability skills which are highly valued by employers. Despite the strong recovery, the long-term unemployment rate (those unemployed for one year and over) has increased (Chart 4.9). While many of these workers are likely to find work as the economy recovers, policies to assist in the process are still valuable.

Because of this, the 2021-22 Budget is focusing on transitioning the long-term unemployed back into work, which will also help to achieve and sustain a lower unemployment rate.

Chart 4.9 Long-term unemployment rate and unemployment rate



Source: ABS Labour Force, Australia and ABS Labour Force, Australia, Detailed.

The Government is assisting those who are already long-term unemployed by expanding the support available to them in employment services. All wage subsidies under the existing jobactive program are being increased to $10,000 until 30 June 2022, after which wage subsidies of up to $10,000 will be available under the enhanced services stream of the new employment services program. The introduction of the new employment services program in July 2022 will also deliver more tailored support to job seekers, including the long-term unemployed, which will help them overcome barriers to employment.

In addition, the 2021-22 Budget is ensuring the long-term unemployed have the opportunities to gain the skills employers seek. The Skills for Education and Employment program will be uncapped and expanded, ensuring that more job seekers in employment services can receive the training they need in foundation skills such as literacy and numeracy, as well as digital skills.

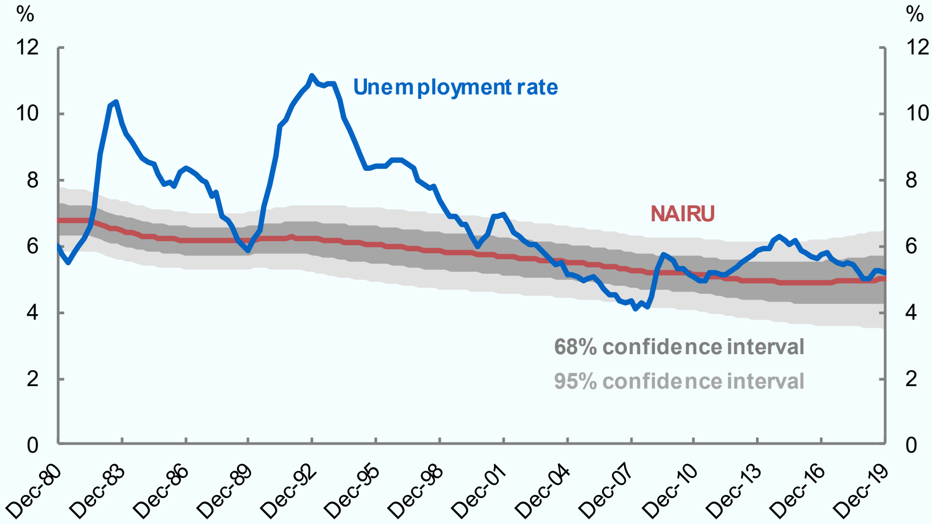
Supporting the broader labour market

The labour market recovery to date has been remarkable and ameliorates many concerns about labour market scarring. However, there is still more work to do. Both Treasury and the RBA have estimated that the Non-Accelerating Inflation Rate of Unemployment (NAIRU) in the economy is lower than previously thought (see Box 4.2). This implies that the Australian economy can do more than recover to its pre-pandemic unemployment rate — that it can realise and sustain unemployment rates below 5 per cent. Economic policy can play an important role achieving this.

Box 4.2: The Non-Accelerating Inflation Rate of Unemployment (NAIRU)

The NAIRU is the rate of unemployment associated with stable wage and price growth. The difference between the observed unemployment rate and the NAIRU is often considered to be a key measure of labour market slack. An unemployment rate below the NAIRU indicates a tight labour market, which will cause wages and prices to be bid up.

Chart 4.10 Decline in NAIRU over time



Source: ABS Labour Force, Australia; Treasury.

In Australia, NAIRU estimates have trended downwards over recent decades (see Chart 4.10). This is due to structural trends such as increased competition in goods markets, increases in services being provided internationally, advances in technology, and changes in the supply of labour.

Estimating the NAIRU presents difficulties as it is not directly observable, and its estimates are thus inherently uncertain. Nonetheless declining inflationary and wage pressures over recent years despite low and declining rates of unemployment have provided evidence that the NAIRU has been lower than previously thought. This is consistent with the experience of other advanced economies, where wage growth began picking up prior to the pandemic, but at lower levels of unemployment than previously expected.

Box 4.2: The Non-Accelerating Inflation Rate of Unemployment (NAIRU) (continued)

Both the Treasury and RBA have estimated that the NAIRU was lower than previously thought prior to the COVID-19 crisis. Australia's NAIRU was previously thought to be around 5 per cent, but based on updated modelling, Treasury believes it was within a range of 4.5 to 5 per cent preceding COVID-19.[18]

Large adverse shocks to the economy can lead to labour market scarring, with workers' skills depreciating, and thereby push up the NAIRU. Although there is still a risk that certain cohorts will find it difficult to gain employment, the strong labour market recovery to date is cause for optimism that such scarring is likely to be far less pronounced following the COVID-19 shock.

Moving the economy towards full capacity and maintaining price stability is normally a role for monetary policy. However, with monetary policy currently constrained, there is a role for fiscal policy to assist in a sustainable manner. That is, there is a greater role for fiscal policy to drive unemployment down further to generate increases in wage growth and inflation, without generating excessive inflation. This is consistent with the Government's Economic and Fiscal Strategy to drive the unemployment rate down to pre-pandemic levels or below.

Doing so, and locking in the recovery seen to date, is particularly important in light of the ongoing uncertainties on the health and economic fronts. Around the world, more than 800,000 new cases of COVID-19 are being diagnosed every day, with new strains of the virus emerging. Our international borders are still largely closed, and while the vaccine rollout is progressing both here and abroad, it remains at a very early stage.

In this context, while the outlook is strong, it is important to continue to support the economy and ensure that the recovery is locked in. The fiscal support contained in this Budget will provide broad-based support to the economy, stimulating economic activity, creating jobs and driving down unemployment. The measures in this Budget will also assist cohorts that may otherwise face great risks and challenges in the recovery. In doing so, the Government is prioritising job creation as Australia's pathway to a stronger economy, and a stronger budget position. And with their focus on skills and participation, and emphasis on the digital economy and innovation, the policies in this Budget are designed to boost the economy's productive capacity, raise living standards, and set Australia up for the future.

18 Ruberl H, Ball M, Lucas L and Williamson T (2021), 'Estimating the NAIRU in Australia', Treasury Working Paper 2021-01, 29 April 2021.