

The Senate

Economics

References Committee

Government's economic stimulus initiatives

October 2009

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Senate Economics References Committee

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and replacing Senator Annette Hurley for the hearing on 9 October 2009)

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Chapter 1

Introduction

The referral

1.1 Disruptions to the financial system have resulted in the global economy contracting in 2009, for the first time since the Second World War.¹ The Australian economy is less vulnerable to external shocks than many other advanced economies given its stronger and better regulated financial system and its mining industry's links to the strong Chinese economy, but nonetheless was expected to suffer a serious contraction as a result of the global downturn.

1.2 When the global outlook deteriorated sharply in late 2008, most advanced economies moved to implement some form of fiscal stimulus. A record of prudent fiscal policy going back more than a decade allowed Australia to introduce a larger stimulus than most countries, which further moderated the recession in Australia.²

1.3 The economic outlook has improved over recent months.³ This has led to calls to scale back the economic stimulus initiatives announced by the Government in October 2008 that will be progressively wound down over the forward estimates to 2011-12. The Senate referred this issue to the Economics References Committee on 8 September 2009. It initially asked the Committee to report by 2 October 2009. The Committee presented an *Interim Report* on 30 September 2009, requesting an extension of the reporting date to 27 October 2009.

1.4 The Senate's reference requested the Committee to invite the Secretary of the Treasury and the Reserve Bank Governor and other pre-eminent economists to appear with the goal of a full update on the economic stimulus initiatives, which addresses:

- (i) the efficacy of the spending measures to date,
- (ii) the anticipated costs and benefits of continuing the spending measures,
- (iii) consequent change in the stimulus 'roll out' that ought to be entertained given the changed economic circumstances,
- (iv) anticipated impact of the stimulus spending on future interest rate movements and taxpayer liabilities,
- (v) an evaluation of the environmental impacts of the spending to date, and
- (vi) other related matters.

1 IMF, *World Economic Outlook*, October 2009; Angus Maddison, *The World Economy: Historical Statistics*, OECD, 2003; Secretariat estimates.

2 See Chart 5.1 in Chapter 5.

3 See Table 5.1 in Chapter 5.

1.5 In a sense, this inquiry is a sequel to that by the Senate Finance and Public Administration Committee in February 2009.⁴

Conduct of the inquiry

1.6 The 18 submissions received by the committee are listed in Appendix 1.

1.7 The Committee held public hearings in Canberra on 21 September and 9 October and in Sydney on 28 September. As instructed by the Senate, the witnesses included the Secretary of the Treasury (on 9 October) and the Governor of the Reserve Bank of Australia (on 28 September). The Committee also heard from a number of academic economists and business representatives. A list of witnesses appearing before the Committee at the hearings is provided at Appendix 2.

1.8 The Committee thanks all those who participated in this inquiry, especially those witnesses who made themselves available at short notice.

Structure of the report

1.9 The composition of the stimulus packages is outlined in Chapter 2, with further details in Appendix 3. The arguments presented to the Committee about the merits of Keynesian discretionary fiscal policy are the subject of Chapter 3. Estimates of the impact of the fiscal stimulus packages are discussed in Chapter 4. Chapter 5 evaluates the arguments for scaling back (faster or further) the fiscal stimulus in light of the stronger economic outlook. Chapter 6 presents conclusions and a recommendation.

4 *Nation Building and Jobs Plan - Inquiry into the provisions of the Appropriation (Nation Building and Jobs) Bill (No. 1) 2008-2009 and 5 related bills*, 10 February 2009. (hereafter 'Nation Building Report'.)

Chapter 2

Spending initiatives

Australian stimulus measures since the global financial crisis

2.1 The Government has undertaken various fiscal initiatives since the collapse of Lehman Brothers in September 2008 sparked the global financial crisis.

2.2 The first package to be described as a stimulus measure was the Economic Security Strategy (ESS) in October 2008. This package included combined expenditure of \$10.4 billion through various cash payments, a boost to the First Home Owners grant and further investment through the Nation Building Funds.¹

2.3 In November 2008, the Council of Australian Governments (COAG) announced a \$15.2 billion COAG funding package which included measures to address housing, hospitals and education.

2.4 A further \$4.7 billion in stimulus expenditure was announced in December 2008 through the Nation Building Plan, which included investment in road, rail and the higher education sector.

2.5 A much larger stimulus package, the Nation Building and Jobs Plan, was announced in February 2009, adding approximately \$42 billion worth of stimulus expenditure.

2.6 There were further measures announced in the May 2009 Budget which included \$8.5 billion for investment in road, rail and port infrastructure, an initial investment of \$4.7 billion in the National Broadband Network, \$3.6 billion for development of clean energy technologies and \$5.8 billion for various investments in the health, tertiary education and research sectors.

2.7 Summing up all these announced measures gives a total of more than \$90 billion over five years (Table 2.2). Treasury itself indicated in the 2009–10 Budget Paper No. 1 that the scale of fiscal stimulus over four years would be almost \$90 billion (Table 2.1).

1 The Hon. Kevin Rudd, Prime Minister of Australia, and the Hon. Wayne Swan, Treasurer, 'Economic Security Strategy', *Media release*, 14 October 2008, p 1.

Table 2.1 Composition of Fiscal Stimulus

Composition of Fiscal Stimulus (\$b)				
	2008-09	2009-10	2010-11	2011-12
Transfers	20.44	4.22	1.78	1.59
<i>Major fiscal stimulus packages</i>				
ESS package (consumption)	9.55	0.65	0.07	0.00
Nation Building and Jobs Plan (consumption)	10.49	1.72	0.00	0.00
<i>2009-10 Budget Measures</i>				
2009-10 Budget net pension spend*	0.39	1.86	1.71	1.59
Investment	4.52	21.93	17.27	4.91
<i>Major fiscal stimulus packages</i>				
ESS package (investment)	0.12	0.07	0.00	0.00
Dec. Nation Building package (all investment)	0.88	1.95	0.39	-0.19
Nation Building and Jobs Plan (investment)	2.04	16.19	10.03	1.67
<i>2009-10 Budget Measures</i>				
2009-10 Budget infrastructure (investment)**	1.48	3.72	6.85	3.43
COAG reforms	3.50	1.78	2.23	3.57
COAG funding package (transfers)	3.50	1.78	2.23	3.57
Total	28.46	27.93	21.27	10.07

* This is the net effect of the pension and carer reforms and structural savings.

** These amounts do not include the provisions for future equity injections for the National Broadband Network, which are subject to the outcome of the Implementation Study and subsequent commercial negotiations.

2.8 The Treasury Secretary's tally was that:

...around \$79 billion of what may broadly be characterised as fiscal stimulus measures are expected to impact on the economy over three years from 2008-09 through to 2010-11.²

2.9 However, other Treasury forward estimates³ operate through to 2011-12.

2.10 From Table 2.1, it would appear that there is at least \$31 billion of discretionary stimulatory spending out of the remaining \$45 billion over the forward estimates unspent. This discretionary stimulatory spending comes from the construction of the building and infrastructure elements of the stimulus package to ensure stimulus projects and funding will impact in the 2009-10 to 2011-12 financial years.⁴

2.11 Appendix 3 outlines the composition of the ESS, the COAG Funding Package, the December Nation Building Package and the Nation Building and Jobs Plan.

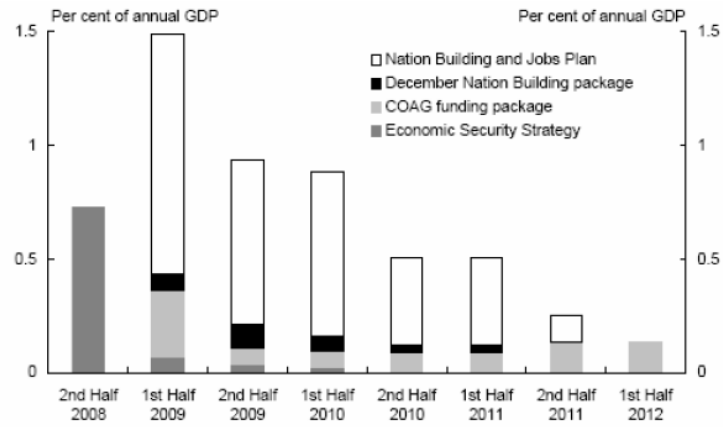
2.12 Chart 2.1 shows the projected contribution of the pre-budget packages over time, while Table 2.2 provides an itemised breakdown of the five packages.

2 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 2.

3 Table 2.1: Composition of Fiscal Stimulus and Table 2.2

4 Coordinator-General, *Commonwealth Coordinator-Generals Progress Report 3 February 2009 – 30 June 2009*, Nation Building Economic Stimulus Plan, published August 2009, p 23.

Chart 2.1: Fiscal stimulus packages delivered by the Australian Government



(a) Impact on underlying cash balance as a per cent of annual nominal GDP.
Source: Treasury.

Table 2.2: Itemised Expenditure by Package

Economic Security Strategy – \$10.4 billion (October 2008)	
(\$billion)	Item
\$4.8	Cash payments (\$1000-\$1400) to various pension categories
\$3.9	Cash payments (\$1000) to families based on Family Tax Benefit or for dependent children
\$1.5	First Home Owners Grant Boost
\$0.2	Training – Productivity Places Program
	Fast tracking of nation building funds
COAG Funding package – \$15.2 billion (November 2008)	
\$4.8	Increased funding for the Australian Healthcare Agreement
\$3.5	Funding for the National Education Agreement and education initiatives
\$2.0	Indigenous reform (health, housing, economic development and service delivery)
\$1.8	Hospitals and health workforce reform
\$0.8	Affordable housing
\$0.7	Improvements to emergency departments
\$0.6	Business sector deregulation
\$0.5	Preventative health measures
\$0.5	Other
Nation Building Package - \$4.7billion (December 2008)	
\$1.2	New funds for Australian Rail Track Corporation
\$1.6	Investment in university and TAFE infrastructure
\$1.6	10% temporary capital investment allowance
\$0.4	Bringing forward of road spending including black spots program
Nation Building and Jobs Plan - \$41.5 billion (February 2009)	
\$14.7	Building the Education Revolution (School construction and refurbishment)
\$12.7	Cash payments to various categories
\$6.6	Construction of 20,000 Social housing and Defence homes
\$3.8	Energy Efficient Homes (Insulation and solar hot water rebate)
\$2.7	Small business and general business tax break
\$0.9	Black spots, boom gates and community infrastructure
2009–10 Budget – Nation Building Infrastructure Measures - \$22.5billion (May 2009)	
\$3.4	Road Network Investment
\$4.6	Metro Rail
\$0.4	Ports
\$4.7	National Broadband Network
\$3.6	Clean Energy Initiative (does not include \$1b of existing funding)
\$2.6	Investment in tertiary education, research and innovation
\$3.2	Hospitals and Health Infrastructure
Total of all measures listed: \$94.3 billion	

Chapter 3

Policy responses

Fiscal policy and monetary policy

3.1 There are two broad actions that can be undertaken to intervene in an economy that is facing a downturn. Monetary policy refers to action by the central bank to lower interest rates, encouraging higher rates of borrowing and investment, and improving cash flows for debtor households and firms as the size of repayments decreases.

3.2 The other approach is for the government essentially to pump money into the economy by running or increasing budget deficits. This can take many forms including tax cuts, tax rebates, or direct government spending such as government-funded construction of infrastructure, but all borrowed expenditure has to be repaid in the future. The various economic stimulus measures that are the focus of this inquiry include a mix of cash payments, some tax breaks and various forms of infrastructure expenditure.

Keynesian policies

3.3 One of the 20th century's pre-eminent economists, John Maynard Keynes famously wrote:

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribblers of a few years back.¹

3.4 But even he may have been surprised at the frequency with which his ideas were lauded and contested during this inquiry, over 60 years after his death. His name has become synonymous with the idea that in a recession, when there is a deficiency in private demand due to low business confidence, the government can usefully stimulate total spending in the economy by either increasing payments to households or cutting their taxes so that they will spend more, or directly spending money itself on infrastructure payments. This, it is said, will reduce the extent to which lower demand leads the economy to operate below capacity with increased unemployment, with both commensurate social and economic costs.

1 John Maynard Keynes, *The General Theory of Employment, Interest and Money*, 1936, Chapter 24.

3.5 Keynes expounded the case for an 'activist' fiscal policy, most notably in his influential book, the *General Theory*.² It became the economic orthodoxy of the post-war years up until the 1980s, when classical monetarist theory began to prove itself. The basic approach to managing the business cycle was adopted by most governments. Even Richard Nixon said "we are all Keynesians now".³

3.6 The Keynesian approach was widely adopted worldwide to stave off the effects of the global financial crisis and was enthusiastically applied by the Government in Australia.

3.7 But not all witnesses accepted the basis of the Keynesian approach:

The standard theory of recession is wrong. That is my conclusion from a number of years of research on these issues. The use of Keynesian demand side theories to restore growth to economies in recession is misconceived... Keynesian stimulus, as we have had here in Australia and in America and elsewhere, is actually an obstacle to returning to economic growth and full employment rather than being any kind of assistance.⁴

...we have actually gone back into a world where, rather than letting the economic institutions—the market and those government instrumentalities such as the Reserve Bank and what have you—actually operate and let the automatic stabilisers operate, an activist fiscal policy has been adopted. I think that is very much a backward step.⁵

3.8 One aspect of this is to assert that business cycles are inevitable and nothing should or can be done, at least through fiscal policy, to moderate their size:

...economies are subject to periods of rapid growth and periods of recession and therefore the overreaction to the downturn at the beginning of this year has been wrong. We have not had the need for this kind of stimulus to be taken because the business cycle would actually have covered most of the change that we need to have anyway.⁶

3.9 Other witnesses espoused an alternate view that accepts the idea that fiscal policy can be effective and should be employed:

...there is a logic, when the private sector suddenly does not want to borrow and wants to contract and de-leverage, for someone who has a strong balance sheet to come in and temporarily go in the other direction, not

2 The full title is *The General Theory of Employment, Interest and Money* (1936).

3 President Nixon made the statement when taking the United States off the gold standard in 1971. In some accounts the quotation is "I am now a Keynesian". A similar quotation has been attributed to Keynes' rival as the 20th century's greatest economist, the free-market monetarist Milton Friedman.

4 Dr Steven Kates, *Proof Committee Hansard*, 21 September 2009, p 2.

5 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 51.

6 Dr Steven Kates, *Proof Committee Hansard*, 21 September 2009, p 3.

permanently but just for a temporary period. That is a stabilising thing to do...⁷

...it is important, where government can, to try to smooth the economic cycle and not simply to see this additional two percentage points of unemployment as being a statistic but as being many young people whose livelihoods will be better if they do not spend a scarring period of unemployment early in their careers.⁸

Some people seem to be suggesting that the stimulus has had no impact on the economy. To take up that point, I would just ask: where did the money go? If you pump billions of dollars into the economy and we have not observed any inflation, it has gone somewhere. It has obviously created jobs, employment and income for the people who received that money.⁹

The prescription from economic analysis is clear, that major fiscal expansion is warranted in response to deficient demand. The concerted expansion in many countries is easing recession.¹⁰

Fiscal multipliers

3.10 Treasury argued that the debate on the efficacy of fiscal policy is a debate about the size of the 'fiscal multiplier'. This is the ratio of the consequent increase in GDP to the size of the fiscal stimulus.

3.11 Treasury provided fiscal multiplier estimates from the OECD and IMF, reproduced in Table 3.1.

Table 3.1: OECD and IMF estimates of fiscal multipliers

	OECD				IMF G-20
	Australia		United States		
	Year 1	Year 2	Year 1	Year 2	
Infrastructure	0.9	1.1-1.3	0.9	1.1-1.3	0.5-1.8
Government consumption	0.6	0.7-1.0	0.7	0.8-1.1	
Transfers to households	0.4	0.7-0.8	0.5	0.8-0.9	

Source: *Treasury briefing paper*, p 4.

7 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, pp 27-8.

8 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 28.

9 Dr Richard Denniss, Australia Institute, *Proof Committee Hansard*, 21 September 2009, p 62.

10 Professor Ross Garnaut, *The Great Crash of 2008*, Melbourne University Press, October 2009, p 211.

3.12 A recent study by Ilzetzi, Mendoza and Vegh was discussed during the Committee's final hearing.¹¹ It concludes:

Relatively closed economies have long-run multipliers of around 1.6, but relatively open economies have very small or zero multipliers.¹²

3.13 Treasury argued that the Australian economy is in the former category, and so likely to have a higher multiplier:

They break their sample into those countries that have a high trade share and those countries that have a low trade share, and the criteria they use is that your exports plus your imports have to be greater than 60 per cent. We are very clearly in the category of countries with a low trade share. Our trade share—exports plus imports—is about 40 per cent.¹³

3.14 The multiplier effects may well be higher when Australia acts at the same time as a number of other countries:

...if there is a global downturn and everyone responds with fiscal policy then the exchange rate effect is much less important because everyone is stimulating their economies. If you like, you can think of the whole globe as a closed economy and in that world the relevant multipliers are the ones for a fixed exchange rate because the whole world is providing fiscal stimulus.¹⁴

3.15 The size of the multiplier will vary across the cycle:

If you are in a fully employed economy, our presumption would be that the multiplier would be close to zero—to the extent that, if you are in a fully employed economy and the government engages in expansionary fiscal policy then a range of offsetting things will happen which will completely crowd that out. Whether it is the private sector responses that you are talking about or the anticipation that the Reserve Bank will tighten monetary policy in order to offset it, leading to the exchange rate rising, there are a range of ways in which that will be offset. In a fully employed economy, I would agree with you that the best estimate would be a fiscal multiplier of zero. In a situation such as that Dr Henry talked about earlier, in which private sector demand is retreating and public sector demand is acting to take its place, the strong balance of evidence is that such spending

11 *Proof Committee Hansard*, 9 October 2009, pp 4-5.

12 Ethan Ilzetzi, Enrique Mendoza and Carlos Vegh, 'How big are fiscal multipliers?' *CEPR Policy Insight*, no 39, October 2009, p 1. Similarly the OECD conclude there are 'lower multipliers for more open economies'; *Economic Outlook Interim Report 2009*.

13 Dr David Gruen, Executive Director, Macroeconomic Group, Treasury, *Proof Committee Hansard*, 9 October 2009, p 5. While Australia is not a 'closed' economy in the sense of having heavy tariff restrictions, its physical insularity means that it is likely to always engage in less international trade than do European countries with adjoining partners.

14 Dr David Gruen, Executive Director, Macroeconomic Group, Treasury, *Proof Committee Hansard*, 9 October 2009, p 5.

has a positive multiplier, and I think that is accepted by the IMF, the OECD and by most interested observers...¹⁵

Ricardian equivalence

3.16 One academic argument against the efficacy of fiscal policy is based on 'Ricardian equivalence'. This idea, popularised by Robert Barro, draws on a conjecture dating back to the pioneering British economist David Ricardo two centuries ago.¹⁶ Dr David Gruen of Treasury described the argument to the Committee as follows:

The idea is that consumers who are in a position to smooth their consumption through time will realise that the extra government spending now implies extra government debt which will need to be paid back at some time in the future and they respond by reducing their consumption now...It certainly works in theory; the question is how relevant it is to the real world...my reading of the evidence is that it is more convincing for economists than it is for the real world.¹⁷

3.17 Interestingly, even David Ricardo himself did not believe in Ricardian equivalence.¹⁸ It remains the view of most economists that only a small proportion of the population's spending decisions would be based on Ricardian equivalence:

...there is not much empirical support for this motivation for savings.¹⁹

3.18 Dr Gruen referred the Committee to his own research on this topic:

Many years ago I went out and asked people how much they knew about the level of Australian government debt. I then asked academic economists how much they thought people would know, and it turned out that the academic economists massively overestimated the amount of knowledge of the people I had asked.²⁰

15 Dr David Gruen, Executive Director, Macroeconomic Group, Treasury, *Proof Committee Hansard*, 9 October 2009, p 20.

16 Robert Barro, 'Are government bonds net wealth?', *Journal of Political Economy*, November 1974, pp 1095-1117; David Ricardo, *The Principles of Political Economy and Taxation*, 1817, Chapter XVII.

17 Dr David Gruen, Treasury, *Proof Committee Hansard*, 9 October 2009, p 19.

18 Ricardo makes the theoretical point but warns that in practice people do not behave this way. See the Ricardo reference above and Andrew Abel, 'Ricardian equivalence theorem', *New Palgrave Dictionary of Economics*, 1987, p 175.

19 Max Corden, 'The theory of the fiscal stimulus: how will a debt-financed stimulus affect the future', *Melbourne Institute working papers*, no 15/09, June 2009, p 9.

20 Dr David Gruen, Treasury, *Proof Committee Hansard*, 9 October 2009, p 19. The research is described in David Gruen, 'What people know and what economists think they know: Surveys on Ricardian equivalence', *Australian Economic Papers*, June 1991, pp 1-9.

'Crowding out'

3.19 Critics of the Keynesian approach argue that even in a recession, government spending displaces private spending:

Public debt has the effect of crowding out private investment and increasing interest rates. So we would have expected Australia to be paying slightly higher interest rates than it would be if it were not for that net debt. Certainly I think a very low, negative net debt position is prudent fiscal policy, and a balanced budget.²¹

3.20 Economists generally agree that crowding out can be a problem. Witnesses disagreed about the extent it would apply in Australia.

Open economy crowding out

3.21 Professor Makin argued that the Keynesian arguments are less applicable, and crowding out concerns starker, in an open economy. His interpretation is that:

...the budget deficit will add to the foreign borrowing. Other things remaining the same, this is going to increase interest rates. It must increase interest rates...there would be a higher risk premium on Australian borrowing, and the consequence of that will be two losses to the Australian economy. The first loss will be: the higher interest rates will crowd out private investment. That private investment means we will have a lower capital stock than we would have otherwise had, and into the future we will have a lower growth path. The second cost is the sheer payment of interest abroad, which will be significant. It is a significant part of Australia's external position.²²

The Nobel Prize winner Robert Mundell demonstrated that quite some time ago—that if you expand fiscal policy you push up interest rates. This induces capital inflow, the exchange rate appreciates, and this worsens competitiveness and worsens the trade account.²³

3.22 The Reserve Bank Governor's interpretation was that to the extent that the stimulus package made the economy stronger, this would lead to a higher exchange rate:

...economies which are stronger rather than weaker typically have a firmer currency relative to what they would have if they were weak. One reason for that is that in such economies return on capital tends to be positive and higher rather than lower, which means that foreign funds find it attractive to come there. Of course, one dimension of that is that such countries, not always but typically, have a higher interest rate structure across the board

21 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 44.

22 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 77.

23 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 77.

than a country that is comatose. We have low but still positive interest rates, whereas Japan has them at zero as do a number of countries now.²⁴

3.23 A similar view was expressed by some business representatives:

We think that the stimulus package has improved domestic confidence in the Australian economy, the level of investment and the level of activity, beyond what would otherwise have been the case. We think that that level of confidence and activity has given foreign investors greater confidence in the Australian economy and that has contributed to the higher dollar by making us a more attractive place for investment.²⁵

3.24 There could be (partly) offsetting effects whereby the stimulus package puts downward pressure on the exchange rate as some of the extra spending leads to higher imports:

Any increase in imports must then lead to depreciation of the exchange rate...any reduction in demand for domestic goods caused by a leakage into imports will be offset by an increase in demand for domestic goods caused by a rise in exports.²⁶

3.25 In total, witnesses did not highlight any impact of the stimulus measures on the exchange rate, particularly as most of Australia's trading partners also implemented stimulus packages themselves. Treasury commented:

We have also seen significant movements in the exchange rate, most of which we would judge to be unrelated to domestic policy settings.²⁷

The substantial movements in the exchange rate over the past 12 months are likely to reflect not only shifts in underlying demand for Australia's commodity exports and subsequent terms of trade impacts, but also shifts in both risk aversion among investors and sentiment regarding Australia's relative economic prospects. While the initial fall in the exchange rate has been a positive for growth, the relatively short duration of the exchange rate trough, the volatility and the subsequent sharp reversal mean that the contribution to growth over the past year is likely to have been modest. In practice, it usually takes some time for trade flows to respond to exchange rate changes.²⁸

24 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 19.

25 Dr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, pp 64-5.

26 Max Corden, 'The theory of the fiscal stimulus: how will a debt-financed stimulus affect the future', *Melbourne Institute working papers*, no 15/09, June 2009, p 4.

27 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 2.

28 *Treasury briefing paper*, p 9.

The hallmarks of a well-designed fiscal stimulus

3.26 There are three criteria which seek to take into account some of the arguments against fiscal stimulus measures outlined above to ensure fiscal stimulus packages are successful.²⁹

3.27 The stimulus needs to be *timely*, with the stimulus being applied while the economy is in a downturn and is operating beneath productive capacity. If a stimulus occurs too late, there is increased danger that the government spending will occur on top of recovering private demand. As well as being too late to have any positive effect during the downturn, this would also increase the risk that the excess demand would fuel inflation and higher interest rates to the detriment of the economy's recovery. This argument is often used to prove the superiority of monetary policy as being more responsive and not subject to political delay or an implementation lag.

3.28 A second criterion is that the stimulus be well-*targeted*. The stimulus needs to be directed in ways that maximise the multiplier effect of the government expenditure.

3.29 The experience shown by the fiscal stimulus packages have tended to be of low value and much of the investment by the Government has been of poor quality that does not provide an economic benefit. Many of the projects were poorly conceived and have provided very little to the wider community – that could be perhaps viewed as "make-work" projects, which are very expensive and provide little benefit.

3.30 Over longer time periods, direct government spending also has a high multiplier effect. Indeed, every dollar of direct government spending flows through to the economy directly. However, direct government expenditure can take some time to be approved by parliament and then further time to get underway. For instance, the lead time on infrastructure projects such as highway construction can take months to years, potentially coming too late to be useful. As a result, direct government expenditure in the form of infrastructure projects will generally have an implementation lag.

Standard textbook analysis will tell you that fiscal stimulus in an open economy with a floating exchange rate is ineffective, except if it is productive. That is to say fiscal stimulus in the form of a consumption-enhancing expenditure is ineffective.³⁰

3.31 The third criterion is that stimulus measures should be *temporary*. This is because the longer stimulus measures are applied, the greater effect they have on the long-term national budget. The effects of higher national debt are discussed above.

29 The three criteria are attributed to Larry Summers (currently the director of the US National Economic Council, a professor at Harvard University at 28 and later its president and formerly US Treasury Secretary) by Douglas Elmendorf and Jason Furman, 'If, when, how: a primer on fiscal stimulus' Brookings Institution, January 2008, p 5.

30 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 88.

3.32 The stimulus package, as announced by the Government, is planned to continue to roll out until 2012. This is clearly not a temporary fiscal stimulus.

3.33 Despite this, the Governor of the Reserve Bank believed the stimulus packages well met the temporary and timely criteria, although acknowledged the questions about the effectiveness of the targeting.

I think it is pretty hard not to conclude that it was quite timely. It was very fast. The bulk of it is temporary. Notwithstanding the discussion earlier about 2011 effects, the big impacts are in 2009, which is presumably the year in which the economy would need the most support. On the targeting, that is probably where people are going to differ about just what should be targeted.³¹

Interaction between fiscal and monetary policy

3.34 While three per cent was the lowest the Reserve Bank's official cash rate has ever been, and similar interest rates had not been this low since the 1950s, nonetheless it would have been possible for the Reserve Bank to take them down to (near) zero as has been done in some overseas countries. This would have been consistent with a less expansive fiscal policy, as discussed by Professor Tony Makin.³²

3.35 However most economists believe that taking interest rates this low would not have been a desirable setting for monetary policy:

Yes, monetary policy becomes less effective the closer you get to zero.³³

I think it is immeasurably to Australia's advantage that, however we have arrived where we are, we do not find ourselves with the overnight rate at zero,³⁴

...cutting interest rates to very low levels is something that you do if there is no alternative, but that there are attendant dangers in having extremely low interest rates, certainly for any extended period of time...After all, one of the arguments presented about what led to this global mess was an extended period of ultra-low interest rates in the US.³⁵

3.36 The Governor of the Reserve Bank elaborated on this trade-off:

In principle, at the level of logic, of course I guess they [the Government] could take a sequence of decisions which slow down the demand in the economy which would otherwise be occurring and that would presumably have some impact on the outlook, including for inflation, and therefore we

31 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 22.

32 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 89.

33 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 26.

34 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 22.

35 Dr David Gruen, Treasury, *Proof Committee Hansard*, 9 October 2009, p 5.

would be on a different course from the one we would otherwise be on. So in principle that is possible. I still think though that one should also ask the prior question of whether that is a better set of outcomes. Is it the best outcome to have a huge budget surplus and very low interest rates? There is often a presumption that that is good. I am not sure I share that presumption because there are things that go wrong with very low interest rates and there are possibly reasonable things that the governments can do with the money. I am a bit reluctant to accept that presumption.³⁶

3.37 It is hard to quantify the trade-off between monetary and fiscal policy settings:

There is an interesting question out there as to what expenditure is fiscally equivalent to a one percentage point cut in interest rates. I wanted to have that number to present to you today but...My quick skim of the literature suggests it is not there.³⁷

3.38 The Committee acknowledges the lack of desirability of reducing the official cash rate to zero. However, the Committee does consider that scope existed to lower it further, without leading to a huge budget surplus.

3.39 One view is that monetary policy is more nimble and can 'fine tune' around fiscal policy:

We are sufficiently uncertain as to what the path out of the downturn will be that I think it makes sense just to let fiscal policy roll and let monetary policy, which takes effect much faster, do the finetuning.³⁸

The consensus that emerged in the 1980s...was that there were considerable limitations in using fiscal policy to finetune the economy...monetary policy is probably better able to play that role. But certainly I never interpreted that consensus as implying that, when an economy is hit with an unprecedented negative shock, one should expect that monetary policy could play all of the role.³⁹

3.40 It can be argued that the present crisis was unusually well-suited to allowing consideration of how best to employ both monetary and fiscal policy:

One of the things that made this crisis so unusual and unprecedented—certainly from Australia's perspective—was that we got such a strong and unequivocal signal from the rest of the world in the middle of September that something truly catastrophic was happening in the global capital markets. We were very confident—and that confidence grew over a period of just a couple of weeks—that an enormous negative shock was coming our way. The shock had arrived in the sense that it had already had an impact on share markets and the exchange rate, as you explained, and it was very clear that that was going to lead to a very substantial negative shock to

36 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 24.

37 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 32.

38 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 23.

39 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 4.

the real economy...That is an extremely unusual situation and it radically changes the calculus of whether discretionary fiscal policy is a good idea or not.⁴⁰

3.41 An alternative view is that monetary policy is always far more effective than fiscal policy:

Unquestionably monetary policy is more effective. Monetary policy in an open economy works largely through the exchange rate, and we saw that. We saw that the relaxation of monetary policy by 425 basis points over a short period of time was a reason for the exchange rate depreciation...⁴¹

3.42 There is general agreement that it is undesirable for monetary and fiscal policy to be at odds. However evidence was received arguing both that this was the case in Australia and not. The Committee considers that Australia is facing a distinct likelihood that these two arms of policy will be working against each other. Indeed, the recent twenty five basis point increase in the official cash rate is specifically intended to slow the economy being sped up by the Government's fiscal policy.

Alternative stimulus approaches

Tax cuts as an alternative

3.43 Many economists argue that tax cuts would be a more effective means of stimulating the economy than one-off payments or government spending:

Had they gone down the road of, say, finding ways to reduce taxes...which would have a direct effect on business profitability and on cash flow then the reaction within the business community would have been a lot stronger. Not only would employment have been protected in the way that the stimulus was intended but it would be much more general... using the payroll tax system might have been the optimum.⁴²

a [income] tax cut would be better than a spending initiative...it would allow individuals to spend the money in better ways than those in which the government would spend the money.⁴³

3.44 Other economists prefer spending to tax cuts as a short-term stimulus:

My read of that [summary of economic literature] is that the multipliers are highest for infrastructure, next highest for consumer handouts and lowest

40 Dr David Gruen, Treasury, *Proof Committee Hansard*, 9 October 2009, pp 13-14.

41 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 88.

42 Dr Steve Kates, *Proof Committee Hansard*, 21 September 2009, pp 6 and 9.

43 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 48.

for business tax breaks. The impact of business tax breaks on the economy seems to be fairly low.⁴⁴

Some have argued that these should have been permanent tax cuts. The difficulty with that is that it does put you into a fiscal position which is pretty hard to unravel unless you are willing to make some hard choices on the expenditure side.⁴⁵

3.45 Treasury considered the cash payments to be superior to a tax cut on the grounds that they were faster to implement and would have a one-off effect on the budgetary fiscal balance. Permanent or semi-permanent tax cuts would have built in a long-term decrease in tax revenues and negative effect on the fiscal balance.⁴⁶

3.46 Behavioural economic theory suggests that cash payments administered in a lump sum were more likely to be spent when compared to the smaller, regular amount that would result from tax cuts.⁴⁷

3.47 However, the work of Milton Friedman and his permanent income hypothesis states that the choices made by consumers regarding their consumption patterns are determined not by current income but by their longer-term income expectations. In essence, transitory, short-term changes in income have little effect on consumer spending behaviour.⁴⁸

Other alternatives

3.48 There are other alternative approaches to preserving employment in a downturn, such as more direct labour market programmes. Views differed about their effectiveness:

...a lot of the stimulus might be better spent through direct job creation, particularly through community organisations and local councils—again, I think, an effective way of not just spending money but spending it in regions that can absorb it and also in a way that can create jobs where they are needed most.⁴⁹

My read of the literature on active labour market programs is that wage subsidies are more effective than direct job creation schemes. But we do not have a great deal of high-quality evidence on how best to create jobs in the

44 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 28. This is consistent with Douglas Elmendorf and Jason Furman, 'If, when, how: a primer on fiscal stimulus' Brookings Institution, January 2008, pp 15-17 and the OECD's *Economic Outlook Interim Report 2009*.

45 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 37.

46 *Nation Building Report*, p 47.

47 *Nation Building Report*, p 49.

48 Milton Friedman (1957), *A Theory of the Consumption Function*, Princeton University Press, chapter 2, 'The Permanent Income Hypothesis', pp 20-37.

49 Dr Richard Denniss, *Proof Committee Hansard*, 21 September 2009, p 62.

Australian context. It would be nice to have some really rigorous studies and randomised trials that compared wage subsidies, direct job creation and training, which are the three main things we think about doing in a downturn.⁵⁰

Preparation for future recessions

3.49 Some witnesses commented that the quality of spending in the stimulus packages would be better if thought had been given to possible projects before the recession hit:

In a perfect world, you would have a long list of infrastructure things that you would get out, dust off and turn on when the need comes. I have been through a few cycles now and I have not seen that happen quite so easily yet, because it is not feasible to do that.⁵¹

The main lesson is that it is actually hard to spend a lot of money quickly. I think that, given that Australia can and will have other recessions in the future, we would be well served by beginning to prepare for recessions before they occur. By that I mean that, if people find it a challenge to spend a lot of money very quickly, there is no reason we cannot have a list of important but not urgent projects that are ready to go at any point in time. There is no reason that local councils and other organisations could not be encouraged to prepare lists of exactly such shovel-ready projects...⁵²

3.50 The problem with this idea is that while economic theory operates in a perfect world, the real world is not like this and it appears that a number of the projects have been selected on the grounds of being more in the vein of political spending rather than income-generating infrastructure.

3.51 This idea could be aligned with another recent proposal to deal with lags in implementing fiscal policy. A paper cited by witnesses to this inquiry refers to a proposal that the legislature agree to a fiscal stimulus package that would take effect only if a specific triggering event occurred. The trigger suggested was a three-month fall in employment. As well as allowing negotiations to occur *before* the stimulus was needed, a further benefit could be that:

...this approach could boost household and business confidence by making clear that fiscal stimulus would be used against a serious economic slowdown.⁵³

50 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 39.

51 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 21.

52 Dr Richard Denniss, *Proof Committee Hansard*, 21 September 2009, p 62.

53 Douglas Elmendorf and Jason Furman, 'If, when, how: a primer on fiscal stimulus' Brookings Institution, January 2008, p 11. The original proposal is attributed to Martin Feldstein, a Harvard professor, long-time president of the National Bureau of Economic Research and former chair of the US Council of Economic Advisers.

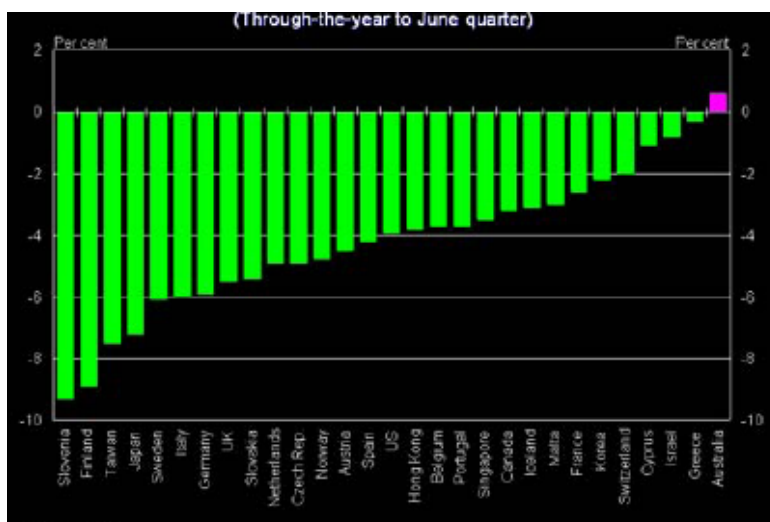
Chapter 4

Impact of the stimulus packages

Australia outperforms

4.1 Australia is the only advanced economy in which real GDP in the June quarter of 2009 was higher than in the June quarter of 2008 (Chart 4.1).

Chart 4.1: Real GDP growth rates



Source: Dr Ken Henry, Treasury, speech to Australian Institute of Company Directors, 23 September 2009.

4.2 This is clearly an impressive performance by Australia. It is not clear to what extent this is attributable to the stimulus packages, or the legacy of prior sound economic management, or the relative contributions of these or other factors.

Australia was in a singularly strong position before the crisis

4.3 Australia was in a stronger position before the crisis than were most comparable countries. Treasury note:

An additional factor that is likely to have contributed to Australia's resilience during the crisis is the structural reforms to financial, labour and product markets undertaken over recent decades. These structural reforms have lifted the economy's productive capacity and improved the flexibility and speed with which both firms and individuals respond to both positive and negative economic shocks. The resilience of the Australian financial system to the Global Financial Crisis illustrates this point. Macroeconomic stability also reinforces the economy's structural flexibility and efficiency by providing businesses and households with more certainty in making their decisions.¹

1 Treasury briefing paper, p 10.

4.4 The Governor of the Reserve Bank cited three reasons why Australia's performance has been better than that in other OECD economies:

Firstly, our financial system was in better shape to begin with...Secondly, some key trading partners for Australia have proven to be relatively resilient in this episode...Finally, Australia had ample scope for macroeconomic policy action to support demand as global economic conditions rapidly deteriorated, and that scope was used. The Commonwealth budget was in surplus and there was no debt, which meant that expansionary fiscal measures could be afforded. In addition, monetary policy could be eased significantly without taking interest rates to zero or engaging in the highly unconventional policies that have been needed in a number of other countries.²

4.5 Elaborating on these points, Australia was well prepared to face an external shock as its financial system was sounder. This is particularly significant given that the current crisis had its source in the financial sector. In a number of countries large banks have had to be 'rescued' by governments injecting equity, making emergency loans or even (temporarily) nationalising them. By contrast, none of these measures have been necessary in Australia. The four major Australian banks now constitute four of only nine among the world's largest 100 banks which are rated AA or better.³

4.6 Australia was also supported by the important role played by its mineral exports. A large proportion of these go to China, whose economy continues to be the strongest growing in the world. This is partly a fortunate accident of geography: the tyranny of distance has become the blessing of propinquity. But it also reflects diplomatic efforts by previous Australian governments to develop trade ties with China, particularly in the minerals sector. China is now the major purchaser of Australian iron ore and coal, particularly in Western Australia. In the earlier part of 2009 the level of Chinese imports of iron ore and coal increased significantly which in turn provided a boost to the Australian economy which made an important contribution to preventing this country going into a technical recession.

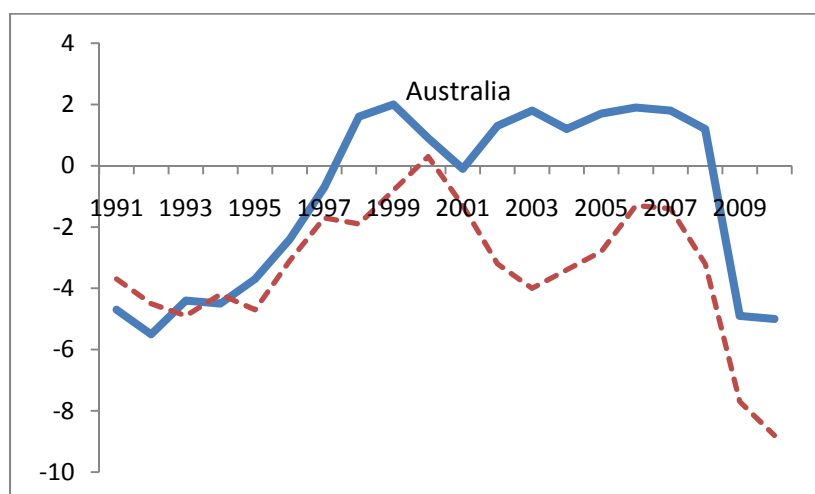
4.7 Another important difference between Australia and most other OECD countries has been the greater fiscal discipline exercised here. Like the average OECD economy, Australia had a significant budget deficit during the early 1990s recession. But unlike many other countries, Australia moved back into surplus as the economy recovered and maintained a surplus for most years until the current downturn (Chart 4.2).

4.8 This fiscal prudence meant that Australia entered the financial crisis with a much smaller government debt than most other countries (Table 4.1).

2 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 3.

3 Reserve Bank of Australia, *Financial Stability Review*, September 2009, p 24.

Chart 4.2: General Government Financial Balances: Australia vs OECD
(1991-2010; per cent to GDP)



Source: Secretariat, based on data in *OECD Economic Outlook*, June 2009.

4.9 Chart 4.2 shows that economic management over the last decade set Australia apart with the capacity to *afford* a stimulus – leaving aside the question of its efficacy or desirability – giving Australia the "ample scope" for fiscal action referred to by the RBA Governor in his opening statement to the committee.⁴ The chart also illustrates the magnitude of the impact of the Rudd government's fiscal spending on Australia's financial position compared with the OECD average.

Table 4.1: General government financial liabilities

Per cent to GDP, 2008

	gross	net		gross	net
Australia	14	-7	Netherlands	65	25
Austria	66	33	New Zealand	26	-16
Belgium	93	74	Norway	56	-125
Canada	68	22	Sweden	47	-14
France	76	42	Switzerland	46	10
Germany	69	45	United Kingdom	57	34
Japan	172	84	United States	71	48

Source: *OECD Economic Outlook*, June 2009.

4 Mr Glenn Stevens, Governor, Reserve Bank of Australia, Proof Committee Hansard, 28 September 2009, p 3.

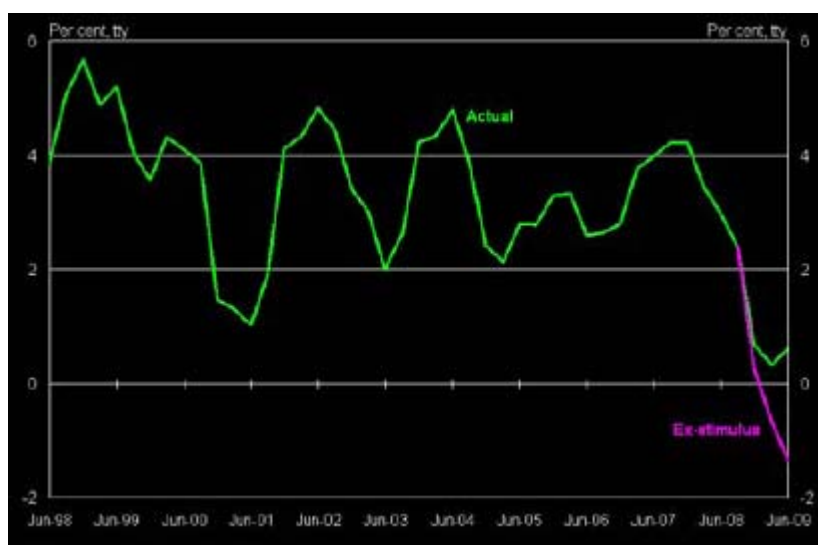
The impact of the fiscal stimulus in Australia

Overall impact

4.10 Treasury is the premier source of economic advice to the government of the day and was the architect of the various spending initiatives outlined in Table 2.2.

4.11 Treasury estimate that in the absence of the fiscal stimulus measures, rather than recording modest growth, GDP would have instead fallen by 1.3 per cent through the year to the June quarter 2009 (Chart 4.3).⁵

Chart 4.3: Australian real GDP growth rate



Source: Dr Ken Henry, Secretary, Treasury, speech to Australian Institute of Company Directors, 23 September 2009.

4.12 Elaborating to the Committee, the Treasury Secretary said:

Without this stimulus, we estimate that the economy would have contracted not only in the December quarter of 2008 but also in the March and June quarters of this year. Our estimates of these impacts are based on internal modelling informed by studies of the effects of fiscal stimulus by the International Monetary Fund, the OECD and a range of academic researchers. They are corroborated by ABS data, by private sector surveys on how the stimulus was spent and by an examination of the experience of countries that have not had such a large stimulus in place.⁶

4.13 Asked about the relative contribution of fiscal and monetary policy, Treasury opined:

5 Dr Ken Henry, Secretary, Treasury, *Proof Committee Hansard*, 9 October 2009, p 8.

6 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, pp 2-3. The basis for these calculations is discussed later in this chapter.

...fiscal policy's contribution to growth over that period has been substantially larger than the contribution of monetary policy...⁷

4.14 The reasoning behind this conclusion was set out in Treasury's written contribution:

The official (nominal) cash rate was reduced from 7.25 per cent at the end of August 2008 to its current level of 3.00 per cent in April 2009,⁸ a reduction of 4.25 percentage points...[as] underlying inflation fell by $\frac{3}{4}$ of a percentage point between the September quarter 2008 and the June quarter 2009...[the] real official cash rate has fallen by 3.50 percentage points...However, bank lending rates have fallen by less than the reduction in the official cash rate...about 2½ percentage points. Using the findings of Gruen, and Naveen⁹, a 2½ percentage point reduction in the real interest rate would contribute 0.85 per cent to GDP in the first year. However, the majority of the cash rate reductions occurred less than a year ago.¹⁰

4.15 This analysis may, however, have underestimated the contribution of monetary policy to GDP growth. It is not real rates which matter to households but rather the change in their nominal household disposable income resulting from changes in nominal interest rates. These effects were very large. For example, a 3 per cent reduction in nominal interest rates on outstanding household debt of \$1.3 trn (including households and unincorporated enterprises) increases household income by \$39 bn each year, and that is about 3 per cent of GDP in a year.

4.16 As can be appreciated this is a very significant impact of monetary policy on potential consumer spending and thereby business confidence. Arguably the reduction of interest rates (monetary policy) had a much greater impact than the cash contributions provided by the government in the so-called "\$10bn cash splash".

4.17 The Committee would be interested in the outcome of Treasury analysis of the relative contributions of monetary policy compared to fiscal policy in stimulating consumer spending and business confidence,

4.18 The underlying strengths of the Australian economy particularly the level of government debt and the strength of the banking system which as has been stated elsewhere includes four of the 9 AA- or better rated banks in the world's largest 100 banks.

7 Dr David Gruen, Treasury, *Proof Committee Hansard*, 9 October 2009, p 20. This accords with a US study which concluded 'true fiscal stimulus implemented promptly can provide a larger near-term impetus to economic activity than monetary policy can'; Douglas Elmendorf and Jason Furman, 'If, when, how: a primer on fiscal stimulus' Brookings Institution, January 2008, p 8.

8 Since this was written the cash rate has been increased to 3.25 per cent.

9 David Gruen, John Romalis and Naveen Chandra, 'The lags of monetary policy', *Reserve Bank of Australia Research Discussion Papers*, no 9701, June 1997.

10 *Treasury's briefing paper*, p 8.

4.19 Another undoubted factor in preventing the Australian economy going into recession was the rebound in the Chinese economy leading to China substantially increasing purchases of Australian iron ore and coal.

4.20 When asked by Senator Eggleston what would have been the consequences for the Australian economy if the China factor had not been in play, Glenn Stevens, Governor of the RBA, replied that other measures would have been taken. The form of such other measures was not identified by the Governor.

The impact of the cash payments

4.21 There was debate over whether the cash payments were spent or saved and this was relevant to the extent that they acted to stimulate demand. One approach to assessing the efficacy of the cash payments was to examine retail sales data to see whether there appears to have been an associated increase:

An analysis undertaken by Tony Meer of Deutsche Bank—and reported at Peter Martin’s blog and then in *The Age*—tends to suggest that retail sales were far in excess of what we might otherwise have thought. But Ashton and I have undertaken an analysis of the retail sales, and our argument is that, simply by extending the ABS trend data—which they stopped doing in November last year—and putting in another very commonly used trend figure, retail sales trends are not unusual at the moment and retail sales are at about trend.¹¹

...we undertook a forecasting exercise and we imagined that we were back in May 2008...and tried to forecast retail sales... by and large, the actual retail sales is within a 95 per cent confidence band of what we would have expected in May last year—which again suggests to us that retail sales are not that unusually different from what they might otherwise have been if we could forecast this from almost over a year ago.¹²

4.22 The Reserve Bank regards the stimulus package as having supported demand:

If the intention was to support demand in the economy... my conclusion would be that those measures have supported demand quite materially over the last... nine or 10 months.¹³

4.23 A similar view was expressed by the business community:

With the rationale that government spending be provided to promote stimulus in the economy, we considered it should initially be provided to households to promote private spending...Support to households has

11 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 42.

12 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 42.

13 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 6.

bolstered retail spending, and this evidence has been recorded amongst our retail members and those in the hospitality and restaurant-cafe sector.¹⁴

4.24 Clearly this is the case. Much of it was spent. The real question is whether the level of support justified the cost and represented best value for money.

Eligibility

4.25 Some argued that the cash payments could be more equitably and efficiently targeted:

In terms of equity, I think that we could, should and still can do more to help those who are most adversely affected by a slowdown in the economy—that is, of course, the unemployed and those people who share a house with the unemployed. It was an unfortunate irony that the unemployed did not receive the \$900 bonus payment. I think that providing money to unemployed people directly is likely to have a very positive stimulatory effect not just on the national economy but on the local economy in which those people live. There is no better way to target money towards the regions that are experiencing the most unemployment than to provide increased payments to those who are unemployed.¹⁵

The impact of the infrastructure spending

4.26 Accepting for the sake of argument that stimulus spending is an efficient and effective use of resources – and the committee notes there was credible opinion contrary to this view – it makes sense at least to have a mix of types of stimulus, and it needs to be noted that there have been several examples of inflexibility and waste in the application of the fiscal stimulus packages:

Certainly the standard wisdom on fiscal stimuluses is that you get a smaller multiplier from household handouts but you can do them quickly. You want a mix of quick, less effective household handouts and slower but possibly higher multipliers through infrastructure spending.¹⁶

In terms of the formulation, there may not have been a more sensible package...There was the cash splash designed to support the household sector ASAP. Then there was the idea of supporting economic activity more generally...Then there are some of the longer term projects. To me that make sense...I think most financial market economists...would think the

14 Mr Greg Evans, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 28 September 2009, p 54.

15 Dr Richard Denniss, *Proof Committee Hansard*, 21 September 2009, p 61. This concern was also raised during the Senate Finance and Public Administration inquiry. In addition, there were concerns that students who enrolled late may miss the training bonus.

16 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 30.

package was reasonably well structured given the economic circumstances.¹⁷

4.27 There has been differing views about the infrastructure spending:

Analysis of the efficiency of how the money is being spent needs to be undertaken from the perspective that the primary objective was to spend money quickly. The purpose of the stimulus package was to stimulate the economy. That must be the primary criteria against which it is judged. Of course, the more we can achieve along the way with the expenditure of that money the better. But the objective was to spend a large amount of money quickly, not to spend money perfectly in a drawn out fashion.¹⁸

4.28 Business is more supportive, at least in respect of some of the infrastructure spend:

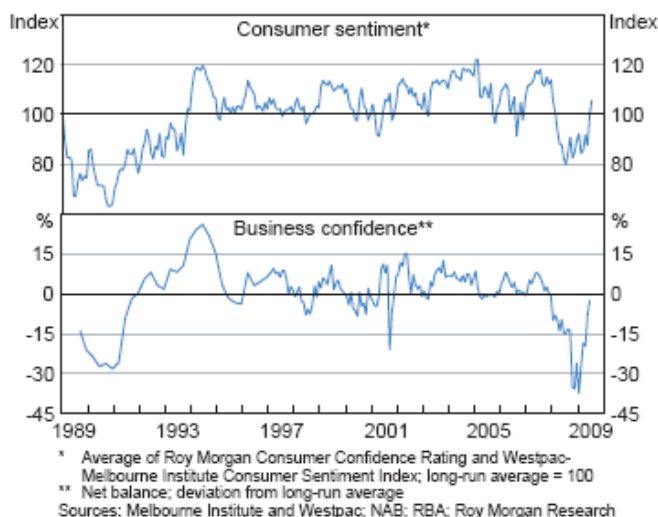
... But we have some confidence that there will be expansions of capacity that will come from some of the investments in infrastructure...¹⁹

That would increase productivity, yes.²⁰

The effects on business and consumer confidence

4.29 Both business and consumer confidence has picked up since late 2008, as shown by the RBA compilation of consumer and business sentiment in Chart 4.4.

Chart 4.4: Sentiment indicators



Source: Reserve Bank of Australia, *Statement of Monetary Policy*, August 2009, p 35.

17 Mr Rory Robertson, *Proof Committee Hansard*, 28 September 2009, p 43.

18 Dr Richard Denniss, Australia Institute, *Proof Committee Hansard*, 21 September 2009, p 61.

19 Dr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, p 64.

20 Dr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, p 64.

4.30 The Committee heard evidence that the business community would have responded with even more vigour to alternative measures directed to the business community:

Had they gone down the road of, say, finding ways to reduce taxes—payroll taxes and other kinds of taxes related to business—which would have a direct effect on business profitability and on cash flow then the reaction within the business community would have been a lot stronger. Not only would employment have been protected in the way that the stimulus was intended but it would be much more general. In fact, a higher profitability for business and higher cash flows would actually have led to, I believe, an actual improvement in the level of economic activity relative to what we have seen here.²¹

4.31 There was a compelling argument that the stimulus has led to a degree of unproductive, even counterproductive, investment through the creation of artificial supply chains:

On the second issue, of structural balance: what I mean here is that, if we are going to have recovery, that recovery will come through private-sector businesses again generating their own growth. The important thing here is that the supply chains are related, so you not only will have growth in final demand at some level but the actual supply chains within the economy that are feedstock into those businesses will also be growing.

Having the kinds of structural imbalances that the stimulus has—which mean that, ultimately, it will have to be wound back; you cannot continue with these forms of expenditure—means that all the structural aspects that go into these expenditures will also have to be wound back. Had we instead opted for an approach that went towards raising the profitability of private-sector businesses, then the actual structures that we put in place, the supply chains, would themselves have been productive because they would have been feeding into the ability of firms to actually produce what other people are willing to buy. In that way, rather than being a structure that has to be wound back as the stimulus is withdrawn, this would have been a structure that would have become a permanent feature of the Australian economy and contributed to growth.²²

4.32 In the absence of fiscal stimulus, the Reserve Bank of Australia would have responded by further lowering interest rates and would have had the capacity to do so. As a result, the exchange rate would also have been lower.

21 Dr Steve Kates, *Proof Committee Hansard*, 21 September 2009, p 6

22 Dr Steve Kates, *Proof Committee Hansard*, 21 September 2009, p 9.

Effects of higher national debt and implications for future taxation and long bond yields

4.33 The fiscal stimulus packages will obviously add to government debt. However, the bulk of evidence is that prudent fiscal policy in the decade before the crisis means that government debt will remain manageable. The Committee does note, however, that there are consequences attached to the payment of this debt, such as the wiping out of the surplus, higher taxation and higher interest rates. At best, it will take 10 years to pay the entire debt off, and at worst, decades... was this really necessary? The Committee believes that there are opportunities to minimise some of these consequences if the fiscal stimulus packages were recalibrated.

4.34 This tax burden that will be necessary to repay the debt incurred as a result of the stimulus package was acknowledged by the Treasury Secretary and other witnesses:

Of course the stimulus that is being provided at the moment, to the extent that it is debt financed, will have to be repaid in the future. That means that at some stage in the future either government spending will be lower than it otherwise would have been or tax settings will be higher than they otherwise would have been. But that future time will be a period of faster growth in private sector activity and the judgement has been made that in those circumstances where the private sector is growing much faster than it is at the moment the government will have the ability to repay debt without doing damage to gross domestic product growth.²³

...it is inevitable that these payments have to be paid for in some sense, but how the fiscal tightening is done is a matter entirely for policy. You could do it through expenditure cuts or tax increases... An inevitable impact of Keynesian fiscal policy is that if you inject money into the economy in bad times then you are going to have to get it back in good times.²⁴

The raising of taxation to pay interest on and repay debt will reduce to some extent the productive capacity of the economy. For moderate amounts of debt this is likely to be small in comparison with the waste of productive resources through unemployment.²⁵

4.35 The actual cost of raising taxation to meet the debt will depend on the quantitative effect of the 'dead weight loss' arising from taxation (which is a reflection of the extent to which it discourages economic activity). There is debate about the size of this effect:

People estimate between 20 and 80 per cent for a deadweight cost...²⁶

23 Dr Ken Henry, Secretary, Treasury, *Proof Committee Hansard*, 9 October 2009, p 10.

24 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, pp 23 and 27.

25 Professor Ross Garnaut, *The Great Crash of 2008*, Melbourne University Press, October 2009, p 157.

26 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 50.

To those who are terrified of tax rates destroying incentive, there are plenty of ways to increase tax revenue in a way that would minimise that. The first would be to abolish the enormous range of tax concessions that currently exist—the 50 per cent capital gains tax concession or the enormous concessions on superannuation. If the actual income tax rate for high-income earners were increased, there is virtually no chance that rich people will decide to be poor because the tax rate is just too high for them...If the parliament wants to increase taxes, it should, and the economic effects of doing it wisely would be low.²⁷

...taxes do distort economic activity. Those tax driven distortions either reduce the size of the economy below the size that it would otherwise be or in other ways impose welfare losses on citizens. That is generally the case. It is certainly not the case always, and as you would be aware, Senator, it is not the case if the tax is being used, for example, to correct for an environmental externality—and there are a large number of other interesting cases in which taxes that raise revenue actually turn out to be welfare enhancing rather than welfare detracting. But as a general point it is true. What is also true—and this is the reason why people get interested in tax policy—is that different taxes have different effects.²⁸

4.36 There are varying views about the impact of higher (prospective) government debt on the interest rate that needs to be paid on that debt. The Reserve Bank does not see this impact as significant, but their words sound a note of warning about the global impact of government debt on borrowing costs, and hence the risks for Australia:

I do not think that, at the moment, it is easy to discern much impact here. The long range in Australia is between five and 5½ per cent, which is about normal. It has been around that, on average, for the last decade. For a country like Australia, what we are talking about in government long-run borrowing costs is that there is a global rate which, roughly speaking, is the US Treasury rate, and we will be paying above or below a little margin, depending on our individual soundness. If we find that government borrowing rates are a lot higher in the years ahead, I do not think it will be because of Australia's outcomes. It will be because there is a lot of government debt being issued around the world by countries that have really serious fiscal problems, like the Americans and the British...²⁹

4.37 The Australian Office of Financial Management put more emphasis on domestic influences:

In particular, the relative strength of the economy and the expectations about inflation and exchange rates can have an impact.³⁰

27 Dr Richard Denniss, *Proof Committee Hansard*, 21 September 2009, p 64.

28 Dr Ken Henry, Secretary, Treasury, *Proof Committee Hansard*, 9 October 2009, p 8.

29 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, pp 11-12. See also his comments on pp 14-15.

30 Mr Neil Hyden, Chief Executive Officer, Australian Office of Financial Management, *Proof Committee Hansard*, 28 September 2009, p 30.

4.38 It also described a countervailing influence on long bond yields, referring to the:

...changed attitude to risk on the part of many investors which has led to a flight to quality and safety. So there has been an increased availability of funds for investment in government debt. While governments have had a very much increased volume of borrowing, that has been able to be satisfied by an increase flow of funds into the sector.³¹

Assessing the stimulus package with models

4.39 A perennial problem in macroeconomics is that there are no controlled experiments. We cannot take two identical economies and subject just one of them to a stimulus package. There is always room for debate about how the economy would have evolved in the absence of a stimulus package. As the Treasury Secretary remarked:

...we will never know the precise impacts of the fiscal stimulus on the economy.³²

4.40 It should be noted that there are no absolutes in any of this modelling, and it will never be known the precise impact of each element of the fiscal stimulus package, and therefore claims about jobs saved need to be considered against that background.

4.41 One approach is to use a macro-econometric model to address these 'what if' questions. But confidence in the results will depend on confidence in the model used. More usual is to use economy-wide models, a range of single-equation studies and other sources such as surveys and business liaison to form a view about the impact of alternative policies.

4.42 The Committee asked Treasury for more information about their calculations on the impact on employment of the stimulus package. Treasury explained that they first calculated the impact on real GDP:

Taking the dollar amount of spending in the fiscal stimulus package, we then make adjustments for behavioural responses by households and businesses. For one-off transfer payments to households, we assume the spending propensity to be 0.7 in the forecast period. The remaining amount of the transfer payments is assumed to be saved by households, at least over the forecast horizon. In contrast, for direct government spending, the spending propensity is assumed to be 1...the next step is to...apply an import share of 0.15...This gives us direct (or first round) fiscal multipliers to GDP of 0.6 for transfer payments and 0.85 for direct government

31 Mr Neil Hyden, Chief Executive Officer, Australian Office of Financial Management, *Proof Committee Hansard*, 28 September 2009, p 32.

32 Dr Ken Henry, Secretary, Department of the Treasury, *Proof Committee Hansard*, 9 October 2009, p 2.

spending...To estimate the effects on real GDP, we adjust the nominal spending numbers for inflation...³³

4.43 The impact of the stimulus as calculated in this way is subtracted from the real GDP forecasts to give alternative 'pre-stimulus forecasts', shown in Table 4.2, and illustrated by Chart 4.3 above.

Table 4.2: Treasury forecasts of real GDP with and without stimulus

(annual percentage change)

	2008-09	2009-10	2010-11
Pre-stimulus	-0.9	-2.0	3.4
Contribution of stimulus	1.0	1.6	-1.2
Post-stimulus	0.1	-0.4	2.1

Source: *Treasury briefing paper*, p 4.

4.44 Treasury then calculated the employment impact:

The modelling work suggests...a 1 per cent increase in GDP leads to a $\frac{3}{4}$ per cent increase in employment over time...The peak impact of the stimulus packages estimated at Budget was the addition of 210,000 jobs and the level of employment remains higher through to the end of the forecast period...The peak unemployment rate was estimated to be $1\frac{1}{2}$ per cent lower as a result of the fiscal stimulus.³⁴

4.45 Dr Kates is very sceptical about Treasury's modelling showing the stimulus package having a significant impact:

...the Keynesian model cannot be used to demonstrate that a Keynesian stimulus has a positive effect on the economy.³⁵

4.46 Dr Kates states that in the absence of the stimulus package the unemployment rate would have been 0.3 percentage points higher. This represents 34,000 people. On this basis he concludes that, given a \$43 billion cost for the stimulus package, it has cost over a million dollars per job saved.³⁶ Other estimates of the employment impact of the package are much higher. As noted above, Treasury puts it at over 200,000 jobs. This would imply the cost per job saved is much less than this. (Furthermore, such calculations ignore the additional taxation paid by those in work and the savings from lower unemployment benefits. It also assumes the spending brings no other benefits than creating jobs.)

33 *Treasury briefing paper*, p 3.

34 *Treasury briefing paper*, p 5.

35 Dr Steve Kates, *Proof Committee Hansard*, 21 September 2009, p 4.

36 Dr Steve Kates, *Proof Committee Hansard*, 21 September 2009, p 5.

4.47 Professor McKibbin, noted economist and member of the Reserve Bank Board, submitted the results of his global modelling using the G-cubed model. This suggested that the global fiscal stimulus would increase real GDP in all countries in the first year, but higher real interest rates would then moderate the impact.³⁷ His modelling led him to argue for a fiscal stimulus in Australia about half as large as that proposed by the Government.³⁸

37 Professor Warwick McKibbin, *Submission 15a*, pp 24-26.

38 Professor Warwick McKibbin, *Submission 15*, p 1.

Chapter 5

Should the package be scaled back?

5.1 Even if there was a case for timely large fiscal stimulus packages to meet an imminent recession, it can be argued that the economic environment has improved significantly and so a smaller stimulus would now be appropriate.

5.2 Those witnesses who opposed the stimulus package argued that the stimulus was far too large and were of the opinion that the scaling back of the stimulus package should happen sooner rather than later to ensure that the cost to the economy did not exceed the benefits.

...I thought it was unnecessarily large at the outset. So: winding it back, scaling it right back, and trying to prevent any further commitments that do not meet a basic cost-benefit test, essentially. All projects from now on should be rigorously examined as to their benefits because the ultimate test is whether the benefits exceed the costs in terms of the interest paid abroad to foreigners.¹

5.3 Given the recent economic data that has been published by a number of outlets including the Treasury and the Reserve Bank of Australia, it is the opinion of the Committee that the three 'T's that have been espoused by Treasurer Swan needs to be expanded to include a fourth "T", tweakable. This would reflect the ability of the Treasurer to work with the new economic data and make effective decisions about future spending in the Australian economy.

We set clear criteria that stimulus be timely, temporary and targeted. And we met them.²

But perhaps the lesson from the crisis that his stimulus needed a fourth T – tweakable.³

The change in the economic outlook since October 2008

5.4 The first stimulus package was introduced in October 2008 when the collapse of Lehman Brothers had shaken global financial markets. The IMF's October 2008 *World Economic Outlook* stated:

1 Professor Tony Makin, *Proof Committee Hansard*, 21 September 2009, p 81.

2 The Hon Wayne Swan, *One Year On: Fiscal Stimulus and the Path Ahead*, Address to the Australian Business Economists, Sydney, 12 October 2009, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2009/028.htm&pageID=005&min=wms&Year=&DocType=>, accessed 19 October 2009

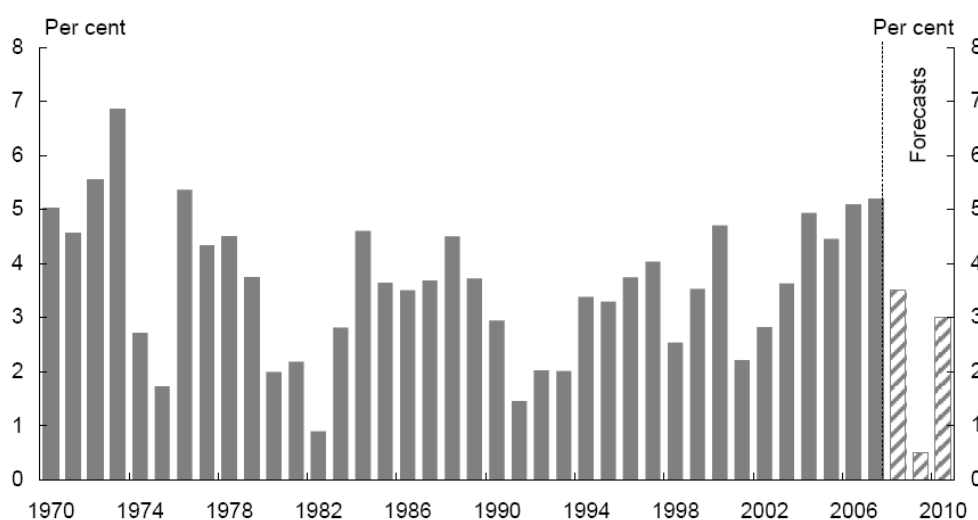
3 Mike Stutchbery, 'Make stimulus timely, temporary, targeted and tweakable', *The Australian*, 15 October 2009, pp 28.

The world economy is entering a major downturn in the face of the most dangerous financial shock in mature financial markets since the 1930s...The situation is exceptionally uncertain and subject to considerable downside risks. The immediate policy challenge is to stabilize financial conditions, while nursing economies through a period of slow activity and keeping inflation under control.⁴

5.5 The *Mid Year Economic and Fiscal Outlook 2008-09* released in November 2008 commented that the global financial crisis had 'entered a new and dangerous phase.' While Australia was better placed than most to withstand the fallout, it 'was not immune from the effects of the global financial crisis and the global downturn'.⁵

5.6 In February 2009, the *Updated Economic and Fiscal Outlook* noted that the global outlook for the global economy had deteriorated sharply, with the IMF cutting its forecast (Chart 5.1) for global growth and now forecasting a deep global recession.⁶

Chart 5.1: World GDP growth



Source: IMF and Treasury.

5.7 It warned that 'the weight of the global recession is now bearing down on the Australian economy. Growth is expected to be significantly weaker than previously anticipated and unemployment will be higher.'⁷

4 International Monetary Fund, *World Economic Outlook*, October 2008, p.xv, <http://www.imf.org/external/pubs/ft/weo/2008/02/pdf/text.pdf> (Accessed 7.02.09).

5 The Hon. Wayne Swan, MP, Treasurer and the Hon Lindsay Tanner, MP, Minister for Finance and Deregulation, *Mid Year Economic and Fiscal Outlook 2008-09*, 2008, p.1

6 The Hon. Wayne Swan, MP, Treasurer and the Hon Lindsay Tanner, MP, Minister for Finance and Deregulation, *Updated Economic and Fiscal Outlook 2008-09*, 2009, p.1

7 The Hon. Wayne Swan, MP, Treasurer and the Hon Lindsay Tanner, MP, Minister for Finance and Deregulation, *Updated Economic and Fiscal Outlook 2008-09*, 2009, p.1.

5.8 The recent economic evidence suggests that the *Updated Economic and Fiscal Outlook* greatly over predicted the impact on Australia, regardless of the impact or otherwise of domestic stimulatory policies.

He agrees the stimulus has limited the downturn. "But there are hard times ahead," he writes. "Sustainable full employment will require reduction of average incomes and living standards below those to which Australians became accustomed before the crash. The Australian government, community and business leadership has barely begun to contemplate the adjustment that is required."⁸

5.9 The economic outlook now looks more favourable. The IMF's *World Economic Outlook Update* of July, 2009 states:

The global economy is beginning to pull out of a recession unprecedented in the post–World War II era, but stabilization is uneven and the recovery is expected to be sluggish. Economic growth during 2009–10 is now projected to be about ½ percentage points higher than projected in the April 2009 World Economic Outlook (WEO), reaching 2.5 percent in 2010.⁹

5.10 The Australian economy has rebounded far better than Treasury estimated, and the Governor of the Reserve Bank provided three reasons as to why Australia has been the best performing economy in the OECD:

Firstly, our financial system was in better shape to begin with, being relatively free of the serious problems that the British, the Americans and the Europeans experienced.

Secondly, some key trading partners for Australia have proven to be relatively resilient in this episode... China will easily achieve their eight percent growth target for 2009, led by domestic demand. Many of our other Asian trading partners also have returned to growth recently. Ongoing strength and demand for resources has kept Australia's exports growing and ours terms of trade, even though well off their peak, remain quite high by historical standards.

Finally, Australia had ample scope for macroeconomic policy action to support demand as global economic conditions rapidly deteriorated, and that scope was used. The Commonwealth budget was in surplus and there was no debt, which meant that expansionary fiscal measures could be afforded. In addition, monetary policy could be eased significantly without taking interest rates to zero or engaging in the highly unconventional policies that have been needed in a number of other countries.¹⁰

5.11 The fact of the matter is that the Australian economy has rebounded from the global financial crisis as a result of the strong prudential regulations and other

8 Ross Garnaut, 'Garnaut warns PM on stimulus', *The Australian*, 9 October 2009, p 1.

9 *World Economic Outlook Update*, 8 July 2009, p1.

10 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 3.

legislative instruments that kept the Australian financial sector out of most of the trouble associated with the problems in other countries.

Our banking system has continued to earn a positive return on its capital, unlike those in a number of other countries.¹¹

5.12 Both official and private sector economic forecasters have become more optimistic. As an example, the evolution of the Reserve Bank's forecasts is shown in Table 5.1.

Table 5.1: RBA forecasts of through-the-year growth in real GDP, by date of forecast

	Nov 2008	Feb 2009	May 2009	August 2009
2009	1½	½	-1	½
2010	2	2½	2	2¼
2011	n.a	n.a	3¾	3¾

Source: RBA, *Statement on Monetary Policy*, various issues.

5.13 Treasury spoke of their improved confidence:

...it is no secret that the next set of economic forecasts will likely include stronger forecasts of gross domestic product growth and a peak unemployment rate lower than the 8½ per cent that was forecast at the time of the budget. Much economic data released since the budget has been more favourable than we or indeed others expected. Business and consumer confidence in particular have proved to be remarkably resilient. Australia's export performance has also been surprisingly strong...¹²

5.14 This is reflected by the Reserve Bank's decision to increase the cash rate to 3.25 per cent and it could result in an increase in unemployment or a reduction in the number of hours worked.

Our job is to not only try to manage that path in a way that pays due regard to the unemployed and all that goes with that, of course, but also to try to make sure that we do not give ourselves some bigger problems down the road – which, if we had those, would be very detrimental to the unemployed.¹³

5.15 However, Treasury were cautious about the outlook, despite the Reserve Bank of Australia considering the balance of risks now rendering the current very expansionary setting of policy no longer necessary or possibly imprudent:

11 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 3.

12 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 3.

13 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 9.

The world recovery is only in its early stages. Those elements of domestic demand that have performed the strongest have been assisted by fiscal and monetary stimulus and, in particular, household consumption and parts of business investment have been greatly assisted. Evidence of a self-sustaining recovery in private activity remains tentative at this time. ...all credible forecasters are expecting the economy to continue to operate below its productive capacity in the next year or two, even taking into account the stimulus still to come.¹⁴

5.16 It was pointed out by Treasury, the Reserve Bank and ACCI that the package always envisaged a gradual withdrawal of the stimulus (see Chart 2.1 and Table 2.1 above):

We are beyond the period of peak impact of the fiscal stimulus. From that point, as stimulus is to be gradually withdrawn, the contribution to economic growth will subside and it will soon turn negative. Indeed, on our estimates, the fiscal stimulus package will make a negative contribution to GDP growth in every quarter in 2010...¹⁵

In due course both fiscal and monetary support will need to be unwound as private demand increases. In the case of the fiscal measures, this was built into their design. The peak effect of those measures on the rate of growth of demand has probably already passed. The extent of support will tend to tail off further over the next year or so.¹⁶

...within the fiscal stimulus arrangements proposed by the government there is an inbuilt winding down in any case. For example, the household spending initiatives are gone; the first home owners boost is being wound down from the end of this month; and the investment allowance proposals for large business ended on 30 June and for small business will end at 30 December.¹⁷

5.17 The debate is therefore more properly about whether the withdrawal should be accelerated.

As things change, you need to recalibrate your policy.¹⁸

By the government's own account, growth (in 2011) would be at 4.5 per cent, so why are we still stimulating the economy.¹⁹

14 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 3.

15 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 3.

16 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, pp 3-4.

17 Mr Greg Evans, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 28 September 2009, p 60.

18 Stephen Walters, JPMorgan chief economist, quoted in David Crowe and Adrian Rollins, 'Calls mount to cut stimulus spending', *The Australian Financial Review*, 8 October 2009, p 6.

19 Scott Haslem, UBS economist, quoted in David Crowe and Adrian Rollins, 'Calls mount to cut stimulus spending', *The Australian Financial Review*, 8 October 2009, p 6.

5.18 Making judgements about the direction of the stimulus package requires balancing risks, and when asked about the need for an alternative plan to use the remaining stimulus in the face of an overheating economy, the Governor of the Reserve Bank was open to the recalibration of the packages.²⁰

5.19 The Committee considers that we need to take into account a serious risk that maintenance of excessive stimulus for too long could raise unemployment through its effects on interest rates and the crowding out of more productive private investment. More recently, it has been suggested that the fiscal stimulus should be unwound more quickly than scheduled.

If growth is stronger than Treasury had anticipated at the time it was put in place then it would be appropriate to bring it back faster.²¹

5.20 The view that accelerated withdrawal of the stimulus package now would be premature is not shared by the Committee. The Committee strongly believe that the recalibration is warranted and fortified by the recent increase in the official cash rate, and are of the opinion that the fourth "T" must now come into play.

As the economy picks up, the fiscal stimulus could push up interest rates... Swan this week suggested that Australia's fiscal stimulus was "best practise". First, it was much more "timely" than the delayed Keating government stimulus response to the early 1990s recession... Second, Swan suggested that his stimulus was well "targeted" because the first stage of cash handouts to lower income earners and families provided a quick-acting boost to consumer spending... Third, Swan told an Australian Business Economists lunch that the clear timetable for withdrawing the stimulus meant it was suitably "temporary". But perhaps the lesson from the crisis is that his stimulus needed a fourth T – tweakable.²²

5.21 The Reserve Bank of Australia agrees that the fiscal stimulus should be wound back but does not state that it should be done as urgently:

I think it is a bit hard to claim that as of this moment there is too much growth in the economy. I have not had a serious problem with what has occurred on the fiscal front thus far. The presumption we are making is that things will be delivered and then wound back more or less on the schedule that is set out in the budget... I am not sure that I would say that that outlook is a terribly worrying outlook really. This has been a good episode for Australia. We have come through this well. We are in recovery now, I

20 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 20, 24 and 25.

21 Mike Stutchbery, 'Make stimulus timely, temporary, targeted and tweakable', *The Australian*, 15 October 2009, pp 28.

22 Mike Stutchbery, 'Make stimulus timely, temporary, targeted and tweakable', *The Australian*, 15 October 2009, pp 28.

think. It is important that these measures be wound back over time, but they are on track to be so.²³

5.22 Additionally, there is concern that the maintenance of the package for an extended period of time will result in an increase in government investment and the crowding out of more productive private investment.

Public debt has the effect of crowding out private investment and increasing interest rates.²⁴

5.23 Respected economic commentator Professor Ross Garnaut has warned the Government of the dangers associated with maintaining the inefficient and wasteful fiscal spending:

By further fuelling excess spending, the Rudd Government's budget stimulus will have to be followed by "hard times" and lower living standards that the government has "barely begun to contemplate".²⁵

He argues Australia's macro-economic policy response to the global financial crisis has relied heavily on one of the biggest and earliest budget expansions of any high-income country and less on lower interest rates.²⁶

5.24 The Governor of the Reserve Bank was asked as to the impact on interest rates if the remaining stimulus spending was not spent and clearly stated that it would impact on interest rate pressures:

If the presumption is an impact on demand that is \$20 billion of \$30 billion less, over three years that is a level of demand that is nearly a percent of GDP a year lower. So, all other things being equal, the course of the economy would be a bit different. What we are responding to is total demand, more or less, rather than where it comes from. It is really the total that counts more. So in that hypothetical scenario, yes, I think that would have some bearing on the future path of interest rates.²⁷

The fiscal package as a commitment

5.25 The Committee also heard the argument that the package should be implemented as promised even if it now may be viewed as slightly larger than required, but does not accept this in itself as a valid reason to continue fiscal policy of a size and spend that is capable of distorting the economy:

...when you are announcing the program you have got to understand that circumstances may well change and you should stick with that program.

23 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 7.

24 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 44.

25 Ross Garnaut, 'Garnaut warns PM on stimulus', *The Australian*, 9 October 2009, p 1.

26 Ross Garnaut, 'Garnaut warns PM on stimulus', *The Australian*, 9 October 2009, p 1.

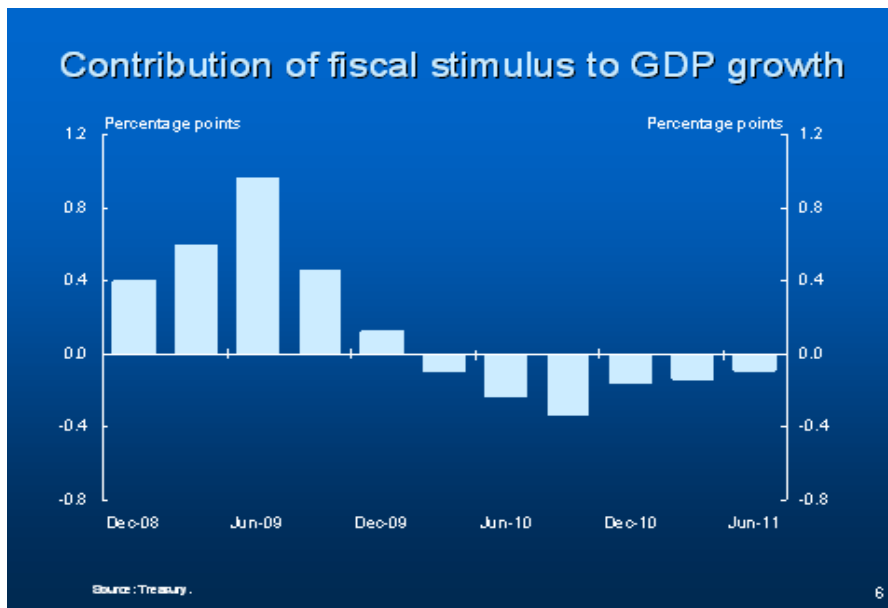
27 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 26.

Because of the change in direction that you give, the signals that you give economic actors to their businesses and the people who will be employed in them, quite deliberately, you ought to stick with them.²⁸

5.26 It can be argued that this is a rather empty argument and a result of the poor design of the stimulus package to start with. The cost to the economy for maintaining the stimulus package at the current rate could result in negative pressure on GDP growth (see chart 5.2).

The stimulus will be detracting from GDP growth from the start of 2010...²⁹

Chart 5.2: Contribution of fiscal stimulus to GDP growth



Source: Treasury³⁰

5.27 Given the design of the stimulus packages, there has been some media comment as to how the packages could be tweaked to maximise their benefit to the Australian economy.

It could have begun with a burst of cash handouts and an initial capital works budget for the first nine months of so. Then the Treasury could have produced an updated economic assessment to guide the final size and

28 Dr Peter Burn, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, p 66.

29 Mike Stutchbery, 'Make stimulus timely, temporary, targeted and tweakable', *The Australian*, 15 October 2009, p 28.

30 The Hon. Wayne Swan, MP, Treasurer, 'One Year On: Fiscal Stimulus and The Path Ahead', *Address to the Australian Business Economists*, 12 October 2009, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2009/028.htm&pageID=005&min=wms&Year=&DocType=>, accessed 19 October 2009.

withdrawal of the remaining stimulus. That might conclude some of the investment spending should be delayed, better planned or shelved.³¹

5.28 As an alternative means of reducing the stimulus package expenditure, given that much of the stimulus package has already been spent and the remaining expenditure could be delayed or spent over a longer period of time which would have the effect of reducing annual expenditure but retaining the total spending over a longer timeframe.

In summary, it notes that around \$79 billion of what may broadly be characterised as fiscal stimulus measures are expected to impact on the economy over three years from 2008-09 through to 2010-11.³²

Inflation and unemployment – the balance of risks

5.29 Many witnesses are concerned about inflationary risks from the package:

...given the qualitative easing which may have occurred and given the fact that the Reserve Bank may have compromised the quality of its balance sheet, that there may well be inflation down the track. I think the ball is very much in the Reserve Bank's court. If it will accommodate the amount of spending which the government has undertaken and is continuing to undertake then inflation can arise out of all of this.³³

5.30 Others are focused more on unemployment risks:

We know that the best predictor of poverty in Australia is not having a job, so trying to minimise job loss is important in the short term and, as I think we spoke about earlier, the long term. If kids experience a period of unemployment early in their careers, you can see that in their wage trajectory and their occupation later on in their careers. They recover, but not fully. I think that is partly due to the loss of skills, the absence of gaining experience and just the psychological impact of the feeling that you are not worth employing. So, to the extent that policy can ameliorate unemployment, I think that should be a top policy goal.³⁴

There has been no evidence presented to this committee that I am aware of, and certainly none presented by the Governor, that suggests that we have any imminent inflationary pressures.³⁵

5.31 Despite this, the October 2009 minutes of the Reserve Bank of Australia meeting clearly indicate the RBA holds concerns about underlying inflation and now

31 Mike Stutchbery, 'Make stimulus timely, temporary, targeted and tweakable', *The Australian*, 15 October 2009, p 28.

32 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 2.

33 Professor Sinclair Davidson, *Proof Committee Hansard*, 21 September 2009, p 52.

34 Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p 36.

35 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p 18.

predict that the expected trough in inflation will be significantly higher than earlier thought.³⁶

5.32 Over the course of the inquiry, the Government has been changing its rhetoric and appears to be preparing to recalibrate the remaining components of the fiscal stimulus packages.

36 Reserve Bank Board Minutes, 6 October 2009, <http://www.rba.gov.au/MonetaryPolicy/RBABoardMinutes/2009/rba-board-min-06102009.html>, accessed 20 October 2009.

Chapter 6

Conclusion and Recommendations

6.1 The Report shows that there is a range of opinions from credible economists on the need for and the appropriate size, timing and duration of economic fiscal stimulus in Australia.

6.2 The Report also shows there is a range of views as to the appropriateness of reconfiguring the package given the improvement in underlying economic conditions.

6.3 At one extreme was a view that a more rapid winding back of the fiscal stimulus would reduce economic growth and increase unemployment from what it would otherwise be. An alternate view was that continuing an inappropriate degree of poorly targeted fiscal stimulus would also have costs. These would include higher inflation, higher interest rates, a crowding out of more productive private sector investment and therefore higher unemployment.

6.4 This shows that continuing with an inappropriate degree of fiscal stimulus is not a cost-less option.

6.5 In this regard the Committee notes that the RBA has recently stated that its expansionary monetary policy settings are no longer appropriate and indeed may be imprudent.

In particular, underlying inflation was still, on the latest data, above the target and, while current forecasts suggested it would fall in the coming year, the expected trough in inflation was significantly higher than earlier thought. Keeping interest rates at very low levels for an extended period could therefore threaten the achievement of the inflation target over the medium term. More generally, very expansionary policy could result in the build-up of other imbalances in the economy, which would ultimately be detrimental to economic growth.

Overall, members concluded that, while downside risks to the domestic economy could not be ruled out, they had diminished significantly over recent months. This meant that the balance of risks was now such that the current very expansionary setting of policy was no longer necessary, and possibly imprudent. The Board therefore decided in favour of raising the cash rate.¹

6.6 This opinion lends weight to the view that an expansionary fiscal policy is also no longer necessary and possibly imprudent, leading to the Committee's view that the fiscal stimulus package should also be recalibrated with a view to maximising value for money from all remaining projects.

1 Reserve Bank Board Minutes, 6 October 2009, <http://www.rba.gov.au/MonetaryPolicy/RBABoardMinutes/2009/rba-board-min-06102009.html>, accessed 20 October 2009

6.7 There was no evidence taken as to which unspent fiscal stimulus elements could be reduced, postponed or offset and will otherwise lead to imbalances.

6.8 The overall stimulus imparted to the economy from fiscal policy could be reduced in a number of ways.

6.9 One way would be to focus only on the components of spending that are classed as part of the fiscal stimulus package and to reduce or reschedule these expenditures over a longer period of time. It would appear that there is approximately \$31 billion of discretionary stimulatory spending out of the remaining \$45 billion over the forward estimates unspent.

6.10 An alternative approach would be to reduce the total stimulus injected into the economy by identifying offsetting cuts to other areas of government spending.

6.11 There was a consensus view that a range of factors have contributed to Australia's exemplary economic performance. These include the continuing strong growth of China and demand for Australia's exports; the legacy of rapid growth, strong budget position and sound prudential regulation of the financial system that was left by the previous Coalition government; the rapid move to strongly accommodative monetary policy; the fall in the A\$ in the second half of 2008; and the fiscal stimulus.

6.12 There was a range of opinions as to the relative contributions of each of these factors to the exemplary performance of the Australian economy. What was clear though was that fiscal policy alone was not the only significant factor.

6.13 No evidence was submitted on one of the terms of reference, specifically an evaluation of the environmental impacts of the spending to date. Consequently, no comments have been made on this issue.

6.14 The committee notes that the economy has strengthened and that the rationale for maintaining the proposed spending levels by the Rudd Government are no longer valid and is of the firm opinion that the levels of spending need to be reduced, postponed or offset to prevent the economy from overheating, in line with the Reserve Bank's Board view as expressed in their latest Board minutes of 6 October 2009.

Recommendation 1

6.15 The Committee recommends:

That the Government commission an urgent independent report to be prepared on the fiscal stimulus packages listed in Appendix 3 to include

- (a) A cost benefit analysis of all the remaining projects, including the timing implementation for spending on those projects**

- (b) Recommendations on the feasibility of reducing, postponing or recalibrating the remaining discretionary funding, on a project by project basis.**

That the Report be published on the Department of Treasury's website within 14 days of its receipt.

**Senator Alan Eggleston
Chair**

Government Senators' Minority Report

Introduction

Terms of reference

On 8 September 2009, the Senate, on the motion of Senator Bob Brown, resolved to refer to the Senate Economics References Committee a range of matters concerning the Government's economic stimulus package for inquiry and report by 2 October 2009. Subsequently, the reporting date was extended to 27 October 2009.

The inquiry was conducted in accordance with the following terms of reference:

1. That the following matter be referred to the Economics References Committee for inquiry and report by 2 October 2009:

The economic stimulus initiatives announced by the Government since October 2008.

2. That the Senate requests the committee:

- (a) to invite the Secretary of the Treasury, accompanied by any other officials he considers appropriate, to appear before the committee, on or after the morning of Monday, 14 September 2009, for the purpose of giving evidence on the matter;
- (b) to invite the Reserve Bank Governor, Mr Glenn Stevens, and other independent pre-eminent economists to appear before the committee, on a date to be determined by the committee, for the purpose of giving evidence on the matter; and
- (c) to hold public meetings to take evidence from those witnesses, in the form of a full update on the economic stimulus initiatives, which addresses:
 - (i) the efficacy of the spending measures to date,
 - (ii) the anticipated costs and benefits of continuing the spending measures,
 - (iii) consequent change in the stimulus 'roll out' that ought to be entertained given the changed economic circumstances,
 - (iv) anticipated impact of the stimulus spending on future interest rate movements and taxpayer liabilities,
 - (v) an evaluation of the environmental impacts of the spending to date, and
 - (vi) other related matters.

Background to the economic stimulus initiatives

The global financial crisis and global recession

From the middle of 2007, financial markets began showing signs of considerable turmoil as the realities of trade in exotic financial derivatives and the explosion in sub-prime lending that had characterised the finance market boom became clear.

As subsequent events would reveal, inadequate regulation and greed on the part of financial market players would set in train a sequence of events in the United States, the United Kingdom and Europe that would culminate in the collapse, nationalisation or government bailout of major banks, insurers and credit providers. These included Citigroup, American International Group, Northern Rock, Fannie Mae, Freddie Mac, Bank of America, Goldman Sachs, Morgan Stanley, Royal Bank of Scotland, Lloyds TSB, HBOS and a number of major continental European financial institutions. The list of institutions involved reads like a veritable Who's Who of those who only months earlier would have considered themselves "masters of the universe". As we now know, these emperors had no clothes.

Following the collapse of Lehman Brothers, it was clear that the world financial system was on the brink of collapse. Banks lacked the confidence to lend to one another and credit markets froze as financial markets began to price in the risk of a catastrophic systemic failure. Share markets experienced the steepest and most rapid falls in stock prices in nearly 80 years. Major currencies around the world, Australia's included, came under abnormally heavy selling pressure, although in Australia's case this has proved to be short term.

All of these circumstances fed into a dangerous feedback loop that saw market confidence crash, creating the conditions for an unprecedented falls in global trade, production and investment. By October 2008, it was clear that without government intervention, every advanced economy was heading for a deep and protracted recession.

Governments the world over, with the encouragement of the IMF and OECD, put in place fiscal stimulus packages while central banks added monetary stimulus by reducing official interest rates to unprecedented lows. In some cases, governments resorted to what is called "quantitative easing". By January 2009, the International Monetary Fund was forecasting the first worldwide recession in the post-World War II era.

The consequences of the global financial crisis have been pervasive. Since October 2008, there have been nearly 50 government sponsored bailouts of major banks around the world. Financial institutions have suffered losses and asset write-downs totalling around A\$1.9 trillion. The banking system aggressively deleveraged resulting in huge increases in costs of capital and investment funds drying up around the world including in Australia.

Virtually every major advanced economy with the exception of Australia has fallen into recession and taken together, the G7 economies have contracted for five consecutive quarters.

Some of these countries would suffer their biggest falls in output on record. In the year to June 2009, GDP in the United States fell by 3.9%, in the United Kingdom by 5.5%, and in Japan, GDP fell by 6.4%. Collectively, the world's advanced economies have shrunk by 4.3% in the year to June 2009, with 29 out the world's 33 advanced economies experiencing recession. Only Australia, Greece, Korea and Slovakia have avoided technical recession.

The global financial crisis quickly developed into a global crisis of employment. In the United States alone, almost six million jobs have been lost since September 2008. Worldwide, the International Labour Organisation estimates that 60 million jobs will have been lost by the end of this year as a result of the global economic downturn.

Australia was not immune to the effects of the global financial crisis and took swift and decisive steps to cushion the Australian economy, community and families from the worst effects of the global financial crisis. On the Friday before the government acted (October

12, 2008) to introduce the Retail and Wholesale Bank Guarantee, the Australian share market suffered its biggest fall since the 1987 stock market collapse. Share prices fell 8.3 per cent in one day, wiping nearly \$73 billion from the value of the share market, and taking the total loss for that week to just under 16%. In the week before the introduction of the bank guarantees, the Australian dollar fell 12.5 cents (16%) against the US dollar, the biggest weekly fall since the Australian dollar was floated in 1983.

The human impact of the global financial crisis has been severe and the Government was determined to cushion Australians from the worst impact of the crisis. Despite unfounded claims over the effect of the stimulus on interest rates and debt raised by the Coalition, the evidence to the inquiry from the Reserve Bank, Treasury, business and market economists demonstrates the correctness of the Government's approach.

Economic and social costs of severe economic downturns

Protracted downturns result in permanent dislocation from the labour market, skills atrophy, and risk creating an entire generation of unemployed. Otherwise viable businesses are destroyed and productive investments are foregone. This capital and skills destruction can permanently reduce an economy's long-term capacity, to say nothing of the "scarring" effects of unemployment to the individuals involved.

Evidence presented to the Committee demonstrates that the human, social and economic costs of severe downturns can be substantial and long-lasting. Professor Andrew Leigh highlighted the pervasive long-term costs of joblessness:

"I think it is important to bear in mind how slowly economies tend to recover from recession. The unemployment rate of the late eighties was not again achieved until the late 1990s, and the scarring cost of unemployment is pretty substantial. I left school in 1990, just as the economy was hitting the skids, and that was a terrible time for young kids to leave school. So I think it is important, where government can, to try to smooth the economic cycle and not simply to see this additional two percentage points of unemployment as being a statistic but as being many young people whose livelihoods will be better if they do not spend a scarring period of unemployment early in their careers."¹

"We know that the best predictor of poverty in Australia is not having a job, so trying to minimise job loss is important in the short-term and, as I think we spoke about earlier, the long-term. If kids experience a period of unemployment early in their careers, you can see that in their wage trajectory and their occupation later on in their careers. They recover, but not fully. I think that is partly due to the loss of skills, the absence of gaining experience and just the psychological impact of the feeling that you are not worth employing. So, to the extent that policy can ameliorate unemployment, I think that should be a top policy goal."²

For these reasons, limiting the more severe consequences of economic downturns can have long-lasting benefits. This view was put by a number of witnesses before the Committee:

"It is hard to imagine that anyone would strongly argue with the view that keeping people in work pays enormous dividends over the medium-term. Not only do we spare

¹ Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p.28.

² *Ibid*, p.36.

them the pain and the inconvenience and the cost of a period of unemployment, but we spare the economy all the flow-on effects of them losing their jobs."³

"Long term joblessness leads to poverty (for example, Newstart Allowance is just \$228 per week for a single adult), poor health, a loss of confidence and skills, tensions within families, and often the need to move to areas where housing is cheaper, which concentrates these social problems in the same areas. This means that many Australians will not 'bounce back' as the economy recovers. For example, over one on five Newstart Allowance recipients lack a decent and secure home, over one in four could not pay a utility bill (within the last 12 months) and over four in ten are unable to afford necessary dental treatment. If we can prevent high levels of long term joblessness from becoming entrenched, many of these social problems, and their high costs to Governments in future years, can be avoided. This should be a major objective for economic and social policy over the next two years. It is vital that the Government apply the same foresight and energy to this problem as it did to avoiding a more severe downturn in the first place."⁴

The Australian Government response to the global recession

The Australian government's stimulatory response to the collapse of financial markets and the looming collapse of the real economy has been part of an internationally coordinated response and has been four-fold.

The government:

1. Guaranteed the deposits of financial institutions and offered access to a government guarantee for their wholesale funding, a response made necessary by the extraordinary events up to October 2008.
2. Provided direct cash support to households to support consumer confidence, consumption and housing investment.
3. Committed to direct public investment in local infrastructure projects that could be undertaken immediately; providing support to employment in labour intensive construction and associated industries.
4. Committed to direct public investment in critical long-term economic infrastructure necessary for creating the conditions for a step up in productivity and thus, accelerating Australia's recovery from the effects of the global financial crisis.

The majority of evidence presented to the Inquiry was that the fiscal stimulus was an appropriate response given the scale and severity of the global crisis and that the stimulus has been effective in averting a much sharper and deeper downturn in the Australian economy:

"Avoiding the mistakes of the past, a consensus emerged to undertake speedy fiscal stimulus and monetary easing. The Australian government was right to take this path and in fact to act more quickly and decisively than most. While the return to more normal growth levels is still some time off, at the time of the announcement of the

³ Dr Richard Denniss, *Proof Committee Hansard*, 21 September 2009, p.64.

⁴ Australian Council of Social Service, *Submission 2*, p.2

December and February stimulus arrangements the economic outlook was deeply concerning and, given this, the scope and scale of stimulus was entirely warranted."⁵

"I think the international consensus, including the OECD and the International Monetary Fund, is that Australia's policy settings, at least to date, have been quite consistent with what is generally regarded as an appropriate stance, including in respect of timeliness and being temporary and well targeted."⁶

"I think the governments and central banks of the world did the right thing by acting as quickly and as forcefully as they could. I genuinely do believe the world was on the brink of a catastrophic economic and financial meltdown. I think that policymakers everywhere moved sharply in the right direction."⁷

"It made sense for policymakers in Canberra to ensure that fiscal policy also put its shoulder more firmly to the wheel. Other economists can speak for themselves, but my guess is that the majority of financial-sector economists with public-policy backgrounds at the RBA and Treasury also felt that the February stimulus package made a great deal of sense."⁸

A view was expressed by a minority of academic economists that Governments should do little, if anything, to limit the impact of deep recessions on the economy and workers. The retrospective advice from a minority of academic economists who are completely opposed to government intervention in the economy demonstrates the difference between "blackboard economists" and those economists who have responsibility for fiscal and monetary policy of a real and practical nature.

The government set clear criteria that the stimulus be timely, targeted and temporary. The impact of the intervention through the stimulus package has assisted the economy avoid a recession with all of the associated negative social and economic implications.

The stimulus was designed intentionally to reach its maximum impact on growth quickly and then to gradually withdraw as a recovery in private sector activity builds. By design, the fiscal stimulus will be withdrawn gradually as the economy strengthens. This ensures that both arms of macroeconomic policy – fiscal and monetary policy – continue to work consistently during the economic recovery, as they did during the downturn.

⁵ Greg Evans, Director, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 28 September 2009, p.54.

⁶ Dr Ken Henry, Secretary of the Treasury, *Proof Committee Hansard*, 9 October 2009, p.15.

⁷ Rory Robertson, Economist, Macquarie Bank, *Proof Committee Hansard*, 28 October 2009, p.50

⁸ Rory Robertson, Economist, Macquarie Bank, *Opening Statement to the Senate Economic Committee Inquiry*, 28 October 2009, *Proof Committee Hansard*, p.2

The size and composition of the stimulus

The table below sets out the size and scope of the economic stimulus measures adopted by the government since October 2008. The measures include the Economic Security Strategy (October 2008), the Nation Building Package (December 2008), the Nation Building and Jobs Plan (February 2009) and measures included in the 2009-10 Budget.

Table 1: Composition of the fiscal stimulus⁹

Composition of fiscal stimulus (\$b)	2008-09	2009-10	2010-11	2011-12
Transfers	20.44	4.22	1.78	1.59
<i>Major fiscal stimulus packages</i>				
Economic Security Strategy (consumption) (Oct. 2008)	9.55	0.65	0.07	0.00
Nation Building & Jobs Plan (consumption)	10.49	1.72	0.00	0.00
2009-10 Budget measures				
2009-10 Budget net pension spend ^a	0.39	1.86	1.71	1.59
Investment	4.52	21.93	17.27	4.91
<i>Major fiscal stimulus packages</i>				
Economic Security Strategy (investment) (Oct. 2008)	0.12	0.07	0.00	0.00
Dec. 08 Nation Building Package (all investment)	0.88	1.95	0.39	-0.19
Nation Building & Jobs Plan (investment)	2.04	16.19	10.03	1.67
2009-10 Budget measures				
2009-10 Budget infrastructure (investment) ^b	1.48	3.72	6.85	3.43
COAG Reforms	3.50	1.78	2.23	3.57
COAG funding package (transfers)	3.50	1.78	2.23	3.57
TOTAL	28.46	27.93	21.27	10.07

a. This is the net effect of the pension and carer reforms and structural savings

b. These amounts do not include the provisions for future equity injections for the National Broadband Network, which are subject to the outcome of the Implementation Study and subsequent commercial negotiations.

⁹ Source: Treasury Briefing Paper for the Senate Inquiry into the Economic Stimulus Package; received by the Senate Economics References Committee, 2 October 2009.

Efficacy of the spending measures

Design of the fiscal stimulus measures

Against the criteria that the Government set for the design of the stimulus package – that it be timely, targeted and temporary – the majority of evidence to the Committee found that these objectives were met. The Governor of the Reserve Bank noted that:

"The three Ts—temporary, timely and targeted—are a standard set of desirable criteria amongst people who talk about this. I think it is pretty hard not to conclude that it was quite timely. It was very fast. The bulk of it is temporary. Notwithstanding the discussion earlier about 2011 effects, the big impacts are in 2009, which is presumably the year in which the economy would need the most support. On the targeting, that is probably where people are going to differ about just what should be targeted. That inherently is, I think, largely a set of decisions which are properly made in the political realm. It is the job of the political process to make that decision."¹⁰

A similar view was put by one market economist:

"In terms of the formulation, there may not have been a more sensible package. It is an unprecedented episode, but I am not sure there has been a package like this one. There was the cash splash designed to support the household sector ASAP. Then there was the idea of supporting economic activity more generally. Someone thought of building in pretty well every school in Australia, so there will presumably be nearly 10,000 buildings. That is obviously designed to generate extra economic activity in every community in the country. Then there are some of the longer term projects. To me that make sense. Other economists can speak for themselves, but I think most financial market economists, many of whom grew up in the Reserve Bank and Treasury, would think the package was reasonably well structured given the economic circumstances."¹¹

Professor Andrew Leigh was asked his view on the efficacy of various stimulus measures, in particular the effect of the consumption and infrastructure elements of the Nation Building and Jobs Plan on employment and aggregate demand, as opposed to alternative proposals for tax cuts that have been advanced over the past year.

"Senator CAMERON—One of the other arguments we heard this morning was that it would be better if we simply reduced taxes to business and let business get on with the job. What is your analysis of that approach?

"Prof. Leigh—My favourite primer on multipliers is a Bookings Institution paper by Doug Elmendorf and Jason Furman that you are probably aware of and that I regard as a nice review of the literature. My read of that is that the multipliers are highest for

¹⁰ Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p.22

¹¹ Rory Robertson, Economist, Macquarie Bank, *Proof Committee Hansard*, 28 October 2009, p.43

infrastructure, next highest for consumer handouts and lowest for business tax breaks."¹²

The economic impacts of the Government's stimulus measures

Treasury presented evidence to the Committee on the economic impacts of the fiscal stimulus packages. This analysis, outlined in the briefing paper¹³ and confirmed in its appearance before the Committee, demonstrated the fiscal stimulus had played a critical role in keeping Australia out of recession.

"Senator BOB BROWN—Thanks, Chair, and thank you, Dr Henry and gentlemen. The first question, of course, is: without the stimulus package—and we were talking with you last about the \$42 billion stimulus package that was being considered in February—would we have moved into recession?

"Dr Henry—It is our view that yes, we would. It is our view that, as I indicated in my opening remarks, in the year 2008-09, the fiscal stimulus accounts, on our estimates, for all of the growth that occurred in that year. Dr Gruen or others at the table may correct me if I get this wrong, but I think, in through-the-year terms to the June quarter of 2009, the Australian economy grew by 0.6 per cent, and our view is that without the fiscal stimulus the Australian economy would have contracted by 1.3 per cent through the year to the June quarter 2009. I think a contraction in the economy of 1.3 per cent through the year would be regarded by most people as a fairly significant recession."¹⁴

Treasury's analysis shows that in the absence of the fiscal stimulus, the Australian economy would have contracted for three consecutive quarters – in the December quarter of 2008, and the March and June quarters of 2009 – and by 1.3 per cent over the year to June.¹⁵ Instead, in large part due to the fiscal stimulus, the Australian economy recorded positive growth of 0.6 per cent, making Australia the only advanced economy to grow in the year to June.

As to its effects on household consumption, Treasury's modelling, supported by two recent Australian studies cited in the briefing paper, indicate that the transfer payments to households have led to growth in household consumption of 1.7 per cent over the year to June 2009, as opposed to a contraction of 1.3 per cent that would have occurred in the absence of the stimulus.¹⁶

Overall, Treasury estimated at Budget, that the stimulus measures added 1 per cent to GDP growth in 2008-09 and 1.6 per cent to GDP growth in 2009-10. In terms of its impact on employment, Treasury estimated that the peak impact of the stimulus at Budget was the

¹² Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p.28

¹³ Treasury Briefing Paper for the Senate Inquiry into the Economic Stimulus Package; received by the Senate Economics References Committee, 2 October 2009.

¹⁴ *Proof Committee Hansard*, 9 October 2009, p.8.

¹⁵ Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, p.2.

¹⁶ Treasury, Briefing Paper, op cit, p.6.

addition of 210,000 jobs, which in turn leads to higher employment levels throughout the forecast period. The peak unemployment rate is therefore estimated to be 1.5 percentage points lower than it would otherwise have been in the absence of the stimulus.¹⁷

The Governor of the Reserve Bank presented a similar view that the stimulus measures had been effective in supporting economic activity:

"A straightforward reading of the economic outcomes would, I think, suggest that the various policy measures have been effective in supporting demand."¹⁸

"If the intention was to support demand in the economy in a period in which we had a very serious global downturn and which all the indications were that that was going to affect Australia significantly, and if the intention is to provide some temporary support to demand in such a period, my conclusion would be that those measures have supported demand quite materially over the last—it is now September—probably nine or 10 months."¹⁹

Governor Stevens agreed with Treasury's view that the stimulus measures had kept the Australian economy out of recession.

"**Senator BOB BROWN**—Do you think we would have faced a recession and/or depression in this country had these stimulus packages not been there?

"**Mr Stevens**—I do not think we would have faced 'the Great Depression'. For the reasons I set out in my opening remarks—the root problem here of financial excesses, too much leverage, too much risk taken, housing market collapses et cetera that you have seen in these other countries — we did not really have that problem. We would have been affected. We would have had recession. I am not sure we would have had depression—personally I would not have thought that—but we certainly would have faced a deeper downturn than we have ended up having. And that is costly, of course."²⁰

The view that the economic stimulus had been effective in supporting economic activity and employment was also shared by business groups:

"Our assessment of the measures is that, in combination with interest-rate reductions and similar policy actions in other parts of the world, they have made a material difference to economic activity over the past nine months, and, had they not been in place, the economy would have deteriorated much more sharply than it has done."²¹

One of the principal motivations for the Government's economic stimulus package was to support employment. High unemployment has a human as well as an economic cost. Although Australia's unemployment rate has increased and may not yet have peaked, there

¹⁷ Ibid, p.5.

¹⁸ Mr. Glenn Stevens, Reserve Bank Governor; *Proof Committee Hansard*, 28 September 2009, p.3.

¹⁹ *Proof Committee Hansard*, 28 September 2009, p.6.

²⁰ Mr. Glenn Stevens, Reserve Bank Governor, *Proof Committee Hansard*, 28 September 2009, p.7.

²¹ Dr Peter Burn, Associate Director, Public Policy, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, p.63.

can be no doubt that had the Government not acted to support demand, the situation would have been much worse.

"In terms of reducing unemployment relative to what it otherwise would have been, I think that it was an effective package."²²

The majority of evidence presented to the Committee was that stimulus had been effective in limiting the impacts of the global recession on economic activity and employment in Australia.

It became apparent during the course of the inquiry that there is a significant divergence of opinion between those charged with the on-the-ground management of the Australian economy and those who could be referred to as "blackboard" economists about the efficacy of the stimulus measures undertaken so far. This divergence was put to the Secretary of the Treasury by Senator Cameron:

"Senator CAMERON—We have had lots of academic economists come before us and argue, I suppose, their academic bias in terms of some of these issues. We have had lectures on Say's law, we have had lectures on the evils of Keynesianism and why we should be looking at Hayekian economic approaches. I am just wondering if all that lecture we got was really relevant in terms of the practical circumstances that governments and treasuries around the world face. Have you got any views on that? I am sure you have looked at some of the commentary and analysis that has been put to the committee. We have got to weigh all this up, I suppose.

"Dr Henry—I used to be an academic economist myself. It is easier to be an academic economist.

"Dr Gruen—Are you going to leave it there?

"Dr Henry—No, look, the issues that have been raised in testimony before the committee, on my brief reading of them—and I have not read them perhaps as closely as I might have in answering this question—it is not that the issues that have been raised should be entirely discounted in all circumstances; certainly not. But, whilst being very aware of those issues for many years, I can tell you that, confronted with the crisis that the world has been dealing with these past 12 months or so, those few quibbles with the use of expansionary fiscal policy—or expansionary monetary policy, for that matter—or other actions of governments to prop up credit markets are not ones that I considered should detain us for too long. They were rather quickly put aside."²³

Differences of opinion between economists are as old as the economics profession itself. The conduct of inquiries such as this will occasionally provide a battleground for the prosecution of economic debates which are at times essentially ideological in nature. One of the defining features of the global financial crisis is that its causes and remedies have undermined the central tenets of neo-liberal economics. Those academic and business economists who subscribe to neo-liberal economic theory have been quite active in recent

²² Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p.22.

²³ *Proof Committee Hansard*, 9 October 2009, p.13.

times defending their faith.

This is perhaps understandable; however, what government senators are mindful of is the need for public policy to reflect real-world circumstances and the needs of the people who are most likely to be hard hit by an economic crisis such as that which we have witnessed over the past year.

Government senators are of the opinion that in the absence of the stimulus, Australia's aggregate economic performance would have been far worse over the course of the past year than would have otherwise been the case in the absence of fiscal stimulus. Indeed, in the absence of the stimulus, Australia would have joined the rest of the developed economies in recession with its consequent catastrophic effects on employment, consumer and investor confidence and Australia's medium and long term economic prospects.

Costs and benefits of continuing the spending measures

Rationale for continuing with fiscal stimulus

The Australian government's response to the global financial crisis is part of a global response coordinated by the G20 in what has been an unprecedented global effort to support the level of economic activity to avert the worst consequences of a global recession.

The most significant decision of the G20 governments has been to inject US\$5.5 trillion worth of stimulus to the global economy. The result of this coordinated action has seen the thawing of credit markets, recovery in equity markets, stability begin to return to labour markets and a return of consumer and business confidence. Despite this, 'there continue to be strong headwinds in the global economy'.²⁴

Earlier this month, IMF Managing Director, Dominique Strauss-Kahn cautioned governments of the risks of premature withdrawal of fiscal stimulus:

"For a start, the crisis is not over. The recovery will be sluggish, and private demand is not yet self-sustaining. The spectre of de-leveraging will be with us for some time. And on the demand side, consumption is still tentative, especially in countries where household balance sheets remain weak. Rising unemployment is likely to cast a long shadow. Even as growth recovers, it will take some time for jobs to follow suit. Indeed, unemployment will continue rising in many countries through 2010...So, the global economy remains in a very precarious position. Premature withdrawal of policy support could kill the recovery. For sure, policymakers should design credible exit strategies. But it is too soon to implement them."²⁵

The view presented by business groups is that the Australian economy has not reached the point where the fiscal stimulus should be withdrawn.

"Despite improving economic news and improving consumer and business confidence levels, the fundamentals of the economy remain fragile. This is according to both official statistics and the surveys of the ACCI. We expect the labour market to

²⁴ Dr. Ken Henry, *Proof Committee Hansard*, 9 October 2009, p.14.

²⁵ Dominique Strauss-Kahn, Managing Director, International Monetary Fund, Opening Address to the 2009 Annual Meetings of the Boards of Governors of the World Bank Group and the International Monetary Fund, Istanbul, October 6, 2009.

continue to worsen and note the shift from full-time to part-time employment has to some extent masked the severity of the slowdown. Retail trade remains subdued, as does business investment, and credit conditions continue to constrain opportunities for business. Most importantly, international conditions amongst our trading partners remain weak. In conclusion, we do not believe these are the circumstances where fiscal stimulus should be withdrawn; noting that in any case the design of these arrangements sees a phased wind-down."²⁶

"While we see the measures as having made a very positive contribution, we do not think we can say that the economy is out of the woods yet. We remain concerned that a considerable share of the promising signs that we see in the economy are closely related to the stimulus itself rather than to a self-sustained rise in demand. We expect further rises in unemployment and further falls in hours worked, both of which will flow through the economy more broadly, and we remain conscious of the lagged impacts of the falling commodity export prices on company profits, investments and dividends and the impacts that that will also have as they flow through the economy. For these reasons we are very wary of calls for the fiscal measures to be wound back ahead of the inbuilt schedule for their withdrawal. We think that this could undermine the recovery that appears to be taking hold."²⁷

Indeed, Dr Henry pointed out that if the stimulus package were to be withdrawn now, it would risk stalling the economy and a further 100,000 jobs could be lost.²⁸

Several witnesses were concerned at the dollar cost of the jobs created as a result of the stimulus packages.²⁹ However, these concerns ignore the fact that tens of thousands of Australians have kept their jobs as a result of the stimulus. This affords the economy a measure of protection in the medium term as people still in employment continue to support demand in that they still have income to spend.³⁰

The economic impact of unemployment has the potential to cause irreversible damage in local economies. This is especially so in rural and provincial centres. Even during the boom of recent times, there were regions in which unemployment remained unacceptably high. The loss of further jobs in many of these places could lead to irreversible decline.³¹

A significant feature of the labour market changes resulting from the effects on Australia of the global financial crisis is the fall in aggregate hours worked, in the order of 3.5%.³² Rather than shedding labour as has been the case during earlier economic downturns, employers and employees have been agreeing to reduce hours. While this reduction has not always been voluntary, the shift from full-time to part-time employment has to some extent masked the downturn in the labour market. As Dr. Burn of the Australian Industry Group noted:

²⁶ Greg Evans, *Proof Committee Hansard*, 28 September 2009, p.55.

²⁷ Dr Peter Burn, Associate Director, Public Policy, Australian Industry Group, *Proof Committee Hansard*, 28 September 2009, p. 63.

²⁸ Dr. Ken Henry, *op cit*, p.14.

²⁹ For example, Dr Steven Kates, *Proof Committee Hansard*, 21 September 2009, pp 4-5, 8.

³⁰ Dr Richard Denniss, *op cit* p.64.

³¹ Dr. Richard Denniss, *op cit* p.67.

³² Mr. Rory Robertson, *op cit* , p.40.

"I think the reduction in hours worked works out at about an equivalent of 250,000 (full-time equivalent) jobs fewer than a year ago."³³

The most recent labour market data indicates that Australia's rate of unemployment fell in September to 5.7 per cent; making Australia the only developed economy to experience relatively stable labour market conditions in recent months. There is however no cause for complacency over Australia's employment performance. Close inspection of the employment data reveals that over the past twelve months, full-time employment has fallen by a little over 151,300 jobs, equivalent to about two per cent of the workforce. The stark fact remains that there are still 658,000 Australians who want a job but do not have one.

The reality is that total employment is a lagging economic indicator and a number of recent economic forecasts point to continuing softness in the labour market over the next year. As indicated above, unemployment may not have yet reached a peak and in the opinion of government senators, any withdrawal of the fiscal stimulus to which the government has committed itself would have the very strong potential to lead to further, unnecessary job losses.

A particular area of concern to government senators is the unacceptably high level of youth unemployment and the dramatic decline in apprenticeship commencements over the past year. The Minister for Employment, Education and Workplace Relations recently told the House of Representatives that this decline is in the order of 20 per cent.³⁴

The Minister informed the House that in order to arrest this decline, the government is making some minor adjustments to the stimulus package to encourage an increase in the number of apprenticeship commencements. This entails redirecting \$100 million of Job Fund money toward a concerted effort to "kick-start" apprenticeships.³⁵

Long-term benefits of fiscal stimulus

One of the central elements of the Government's stimulus spending has been spending on infrastructure, including the Building the Education Revolution program and transport infrastructure projects. Several witnesses were concerned that the infrastructure program was not good value for money.³⁶ However, it was also noted that infrastructure spending can and does create jobs.³⁷ Building essential roads does have a payoff.³⁸ Much of the planned infrastructure will have an impact on the supply side capacity of the economy, which will increase the economy's long-term productivity level.

³³ Dr. Peter Burn, *op cit*, p 67.

³⁴ Hon. Julia Gillard MP, *Proof House Hansard*, 19 October 2009, p.27.

³⁵ *ibid*

³⁶ See, for example, Dr. Steven Kates, *op cit*, p E5; Professor Sinclair Davidson, RMIT University and Institute of Public Affairs; Proof Committee Hansard, 21 September, 2009 p.49; Professor Tony Makin, *op cit*, pp 81, 87

³⁷ Professor Andrew Leigh, *op cit*, p.29

³⁸ Professor Andrew Leigh, *op cit*, p.31

"But we have some confidence that there will be expansions of capacity that will come from some of the investments in infrastructure."³⁹

"But it is certainly the case that that capital or infrastructure spending component of the fiscal stimulus package—significant pieces of it, at least—is intended to enhance future supply capacity. We would generally expect that that would have some positive implications for future labour productivity growth."⁴⁰

Dr Gruen, Executive Director, Australian Treasury also highlighted the long-term economic benefits from the fiscal stimulus that arise from limiting the skill and capital erosion typically associated with deep and protracted economic recessions.

"It is also reasonable to argue that to the extent that you avoid a more serious downturn you get less loss of skills and you do less damage to the human capital formation that goes on the job. It is reasonable to argue that the fact that Australia has managed to have a much smaller rise in unemployment, both up until now and in prospect, than in other countries probably means that there are some—they are modest but nevertheless they exist—long-term productivity benefits. Deep downturns have a scarring effect on people."⁴¹

In the opinion of government senators, the view that stimulus spending in the circumstances that have accompanied the global financial crisis should only be seen as incurring costs is disingenuous.

The view that there only costs associated with fiscal stimulus ignores the very great costs to business, their employees and to the economy and society as a whole that would accompany not undertaking fiscal stimulus measures.

Consequent changes in the stimulus "roll out" given the changed economic circumstances

Based on the evidence put before the Committee confirming the remaining fragility of the global economy, despite signs of nascent recovery in some areas, government senators are of the opinion that no persuasive evidence was put to us that would persuade us to adopt the view that economic conditions have changed sufficiently to warrant withdrawal of the fiscal stimulus measures.

Indeed, it is the view of government senators that the considerable weight of the evidence to this inquiry favours the continuation of the stimulus measures to provide appropriate support to the economy and employment.

The package of stimulus measures has built into it a staged withdrawal of the measures. This is a prudent design measure and we consider calls at this stage for immediate withdrawal of the stimulus would cost more jobs and threaten Australia's economic recovery.

³⁹ Dr. Peter Burn, *op cit*, p.68

⁴⁰ Dr. Ken Henry, *op cit*, p.15

⁴¹ Dr David Gruen, Executive Director, Macroeconomic Group, Treasury, *Proof Committee Hansard*, 9 October 2009, p.15

In this regard, we note the following remarks of Dr. Henry:

"Some commentators seem to have interpreted our peak unemployment rate forecast of 8½ per cent as a target. Apparently, if the forecast were then to be revised down to, say, seven per cent, we should revise the stance of fiscal policy in order to get our forecast back up to 8½ per cent. Needless to say, we find that sort of argument a little peculiar.

"The effect of fiscal stimulus on growth likely peaked in the June quarter of 2009. We are beyond the period of peak impact of the fiscal stimulus. From that point, as stimulus is to be gradually withdrawn, the contribution to economic growth will subside and it will soon turn negative. Indeed, on our estimates, the fiscal stimulus package will make a negative contribution to GDP growth in every quarter in 2010—that is, commencing in just a few months time.

"It is on the public record that the Treasury has advised the government that withdrawing the stimulus more quickly could risk stalling the economy and causing a steeper rise in the unemployment rate. To illustrate the point, if all the stimulus scheduled to impact in 2010-11 were cancelled, that would mean a further detraction of 1½ per cent from GDP growth and the loss of up to an additional 100,000 jobs. I say 'further detraction' because on our figuring the fiscal stimulus package, in the way it has been constructed, is already likely to detract about 1¼ per cent from growth in that year. It is unlikely that the recovery in private sector demand would be sufficiently strong for the economy to withstand such a sudden withdrawal of public sector activity without significant costs in terms of lost output and higher unemployment."⁴²

Impact of spending measures on interest rates and taxpayer liabilities

Interaction of fiscal stimulus and monetary policy

It was pointed out by both Treasury and the Reserve Bank that the in-built withdrawal of fiscal stimulus will ensure that both arms of macroeconomic policy – fiscal and monetary – will be working in the same direction during the economic recovery.

The Governor of the Reserve Bank, Mr. Stevens, observed that interest rate rises would be the natural result of moving into a phase of economic expansion and that during this recovery phase both fiscal and monetary policy would be working consistently. He told the Committee:

"In due course both fiscal and monetary support will need to be unwound as private demand increases. In the case of the fiscal measures, this was built into their design. The peak effect of those measures on the rate of growth of demand has probably already passed. The extent of support will tend to tail off further over the next year or so. In the case of monetary policy, the bank has already signalled that interest rates can be expected at some point to move off their current unusually low levels as recovery proceeds. These adjustments back towards more normal settings for both types of macroeconomic policy are what should be expected during the recovery phase of a business cycle. Our most recently released set of forecasts—the ones

⁴² Dr. Ken Henry, *op cit*, p.3.

released in August—assume that that occurs. Such an outcome would mean that fiscal and monetary policy would be acting broadly consistently, as they did when they were moved in the expansionary direction when the economy was slowing."⁴³

ACCI also noted that rising interest rates were a product of the economic recovery:

"Interest rates will go up as the economy recovers. That is quite separate from anything the government is doing with respect to fiscal stimulus."⁴⁴

Government borrowing and crowding out

In evidence to the Committee, Governor Stevens rejected the proposition put by Coalition senators and Professor Sinclair Davidson that government borrowing would “crowd-out” private investment and raise interest rates. Governor Stevens made the point that Australia’s debt level is low and manageable by international standards and that government borrowing occurs on global markets and therefore has no material impact on interest rates.

"My point is that the Australian government borrows in a global market. There are free global capital flows here and long rate in Australia is driven more strongly by what happens in global markets than by what happens here, frankly, at the sorts of debt levels we are talking about."⁴⁵

"If we find that Government borrowing rates are a lot higher in the years ahead, I don’t think it will be because of Australia’s outcomes."⁴⁶

Government finances

The Australian Government budget – like budgets of governments around the world – has been impacted by the global recession, which has resulted in sharp falls in expected tax revenues. The Government has had to borrow to meet the revenue shortfall caused by the global recession and to support economic activity and employment.

At Budget, it was made clear that early and decisive fiscal stimulus was "essential to support economic activity and jobs, along with investment in the economy's future productivity. Investment in nation building infrastructure and world-class universities and hospitals will position Australia to take full advantage of the global recovery."⁴⁷

Notwithstanding the impacts of the global recession, the Australian government’s balance sheet remains strong. The Australian government has lower debt and lower deficits than any of the major advanced economies and the Government’s fiscal strategy will ensure that as the economy recovers, the budget will return to surplus, and government debt will fall.

While the United Kingdom, the United States and the Euro zone economies are expected to face public debt levels in excess of 80 per cent of GDP by 2014, and Japanese public debt

⁴³ Mr. Glenn Stevens, *Proof Committee Hansard*, 28 September 2009, p. 4.

⁴⁴ Mr Greg Evans, ACCI, *Proof Committee Hansard*, 28 September 2009, p. 57.

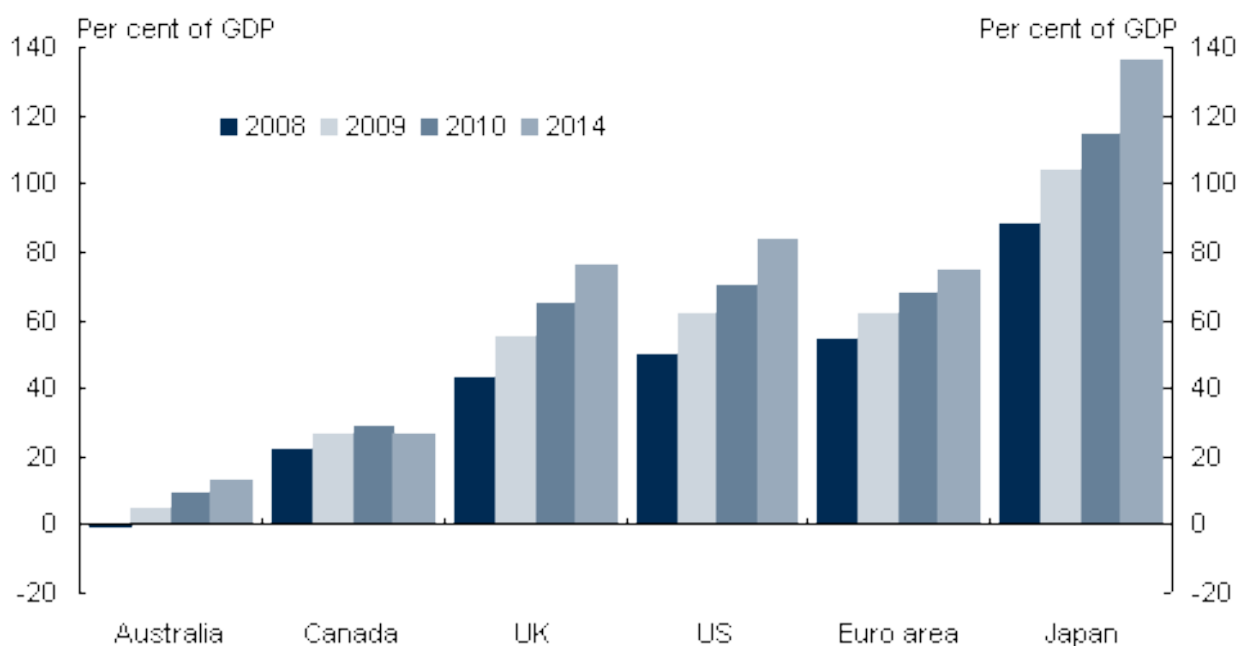
⁴⁵ Mr. Glenn Stevens, *op cit*, p.15

⁴⁶ *Ibid*, p.12

⁴⁷ Budget Paper No. 1 2009-10, p.1-51

will approach 140 per cent of GDP, Australian public debt 'will peak at 13.8 percent of GDP in 2013-14 declining to around 3.7 per cent in 2019-20.'⁴⁸

Australia's net debt position relative to selected advanced economies over the period to 2014 is set out in the following chart:



Source: Budget Paper No. 1 2009-10, p.1-52

There can be no argument that the state of Australia's government accounts is superior to any other comparable economy. The evidence presented to the Committee was that the projected levels of government debt are small by international comparison and manageable.⁴⁹ These points were summed up by the testimony of the Reserve Bank Governor, who noted that:

"I would have to say that I think the prospective debt that we are going to have—according to the budget outlook—for a country like Australia ought to be seen as quite manageable."⁵⁰

"There is not much argument that the state of the government accounts in this country is just so superior to virtually anybody with whom we would want to compete."⁵¹

⁴⁸ *ibid*

⁴⁹ Mr. Glenn Stevens, op cit, p.9; Mr. Neil Hyden, CEO, Australian Office of Financial Management, *Proof Committee Hansard*, 28 September 2009, p.32; Mr. Rory Robertson, Economist and Division Director, Macquarie Bank, *Proof Committee Hansard*, 28 September 2009, p.41; Dr Ken Henry, Secretary, Department of Treasury, *Proof Committee Hansard*, 9 October 2009, p.16; Professor Andrew Leigh, *Proof Committee Hansard*, 21 September 2009, p. 34

⁵⁰ Mr. Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p.9

⁵¹ Mr. Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p.16

The Government outlined in the Budget a clear fiscal strategy to return the budget to surplus and reduce debt. As the economy strengthens, stimulus will be phased down by design, revenues will recover and the Government has committed to holding real spending growth to less than 2 per cent a year until the Budget returns to surplus. At Budget, it was estimated that this strategy would return the budget to surplus by 2015-16 and reduce the level of net debt as a share of GDP to 3.7 per cent by 2019-20.

Impact of fiscal stimulus on the exchange rate

During the course of the inquiry, there was some concern expressed over the impact of the stimulus package on exchange rates. Dr Gruen noted that in a global downturn, when every country is implementing fiscal stimulus at the same time, the exchange rate effects are muted, or non-existent.⁵² Rather, Treasury observed that recent movements in the exchange rate were likely to be unrelated to domestic policy settings.⁵³ Dr Gruen noted that the Australian dollar is sensitive to changes in the global economy, especially to movements in commodity prices and the US stock market. Therefore, working out the impact of the stimulus package on exchange rates is a difficult task.⁵⁴ However, there can be little doubt that the floating exchange rate has allowed us to weather the economic storm better than might have otherwise been the case.

Environmental impact of spending measures

No direct evidence was placed before the Committee or submissions made on this term of reference. However government senators note that as part of phase 3 of the stimulus package, the government has committed \$4.5 billion in the Clean Energy Initiative to assist Australia's transition to a low-pollution economy. This figure includes \$1 billion in existing funds that will deliver a number of substantial measures aimed at enhancing innovation and investment in clean energy generation. There are three core elements to the Clean Energy Initiative:

- A \$2.0 billion investment over nine years in carbon capture and storage (CCS) projects under the CCS Flagships program to support the development of industrial-scale demonstration projects for CCS technology in Australia. The projects are expected to include a carbon dioxide storage hub and projects to demonstrate a range of technologies to capture carbon dioxide from coal-fired power stations. The successful deployment of CCS will facilitate Australia's transition to a low-pollution economy, generate the low-pollution jobs of the future, and help preserve the value of Australia's coal exports.
- A \$1.5 billion investment over six years in the Solar Flagships program that will demonstrate large-scale solar-thermal and solar photovoltaic technologies. The program

⁵² Dr. David Gruen, Executive Director, Macroeconomic Group, Department of the Treasury, *Proof Committee Hansard*, 9 October 2009, p.5.

⁵³ Dr. Ken Henry, op cit p.2.

⁵⁴ Dr. David Gruen, Executive Director, Macroeconomic Group, Department of the Treasury, *Proof Committee Hansard*, 9 October 2009, p.21.

will comprise up to four solar projects operating in the national grid, with an additional capacity of 1,000 megawatts. Together with the existing \$100 million Australian Solar Institute, the Solar Flagships program will help position Australia as a world leader in solar energy generation with clear benefits for the environment.

- A new independent renewable energy innovation body, Renewables Australia, resourced with initial funding of \$465 million over four years to support renewable technology research, commercialisation and deployment. Renewables Australia will support high priority research and investment with the ultimate aim of progressing new technologies to the market while also lowering the cost of existing renewable technologies. Renewables Australia will also support and advise government, industry and the community in the promotion and development of renewable technologies and relevant research and development in essential renewable-related systems, including renewable energy transmission infrastructure.

There is a clear need to persist with the climate change policy agenda despite the current economic circumstances. The Government is committed to tackling climate change and positioning Australia to prosper in a carbon constrained world. Government senators reject the argument put, not necessarily to this inquiry, but certainly elsewhere, that the global financial crisis means that climate change mitigation efforts should be curtailed or abandoned.

Government senators are of the opinion that there are clear environmental benefits to be derived from the investment the government is making in the programs described above and that any winding back of the stimulus would necessarily involve a significant reduction in those benefits.

Conclusion and recommendation

The series of events that began to unfold in the second half of 2007, the effects of which manifested themselves in most dramatic fashion in the last quarter of 2008 have had in many cases a catastrophic impact on many of the world's advanced economies.

Australia was never immune from the global financial crisis and the government took swift, decisive action to avert its worst effects on the Australian economy and the families who rely on secure, long-term employment for their financial security.

The great weight of the evidence on the effectiveness of the government's fiscal stimulus measures is that the government's approach has been the correct one.

Protracted economic downturns have long-lasting and in many cases, permanent detrimental effects on employment, skills, investment and productivity that can reduce the long-term capacity of the economy. The social and economic costs of recessions are pervasive and lasting.

The government's stimulatory response to the very real threats posed by the global financial crisis has been part of a globally coordinated response to the real-economy collapse that loomed in late 2008. The weight of the evidence put before this inquiry leads government senators to conclude that the government's fiscal stimulus was an appropriate response given the scale and severity of the global crisis.

The stimulus has been designed to have its maximum impact on growth and employment

quickly and then to gradually withdraw as private sector activity recovers and the economy strengthens. The design of the stimulus ensures that both arms of macroeconomic policy – fiscal and monetary policy- continue to work consistently during the recovery phase, as they did when the economy turned down.

Government senators are of the opinion that the inquiry demonstrates that in the absence of the fiscal stimulus measures, Australia's overall economic performance over the past year would have been far worse than would have been the case in the absence of any stimulus. Without fiscal stimulus of the scale and structure of that implemented in the past year, there is no doubt that Australia would have experienced a quite severe recession, with all its attendant effects on employment and Australia's longer term economic prospects.

Recommendation 1

Government senators recommend that the government's stimulus packages continue to be implemented to provide appropriate support to the economy and employment.

Senator Annette Hurley

Deputy Chair

Senator Louise Pratt

Senator Doug Cameron

Additional Comments

Senator Bob Brown, Australian Greens

1.1 The Australian Greens support the recommendations of the Committee for ongoing scrutiny of the fiscal stimulus packages.

1.2 The Australian Greens are satisfied with the evidence presented to the Committee by the Treasury Secretary Ken Henry that the Australian economy would have been in recession without the stimulus package.

1.3 In evidence to the Committee, Dr Henry said:

Without this stimulus, we estimate that the economy would have contracted not only in the December quarter of 2008 but also in the March and June quarters of this year. Our estimates of these impacts are based on internal modelling informed by studies of the effects of fiscal stimulus by the International Monetary Fund, the OECD and a range of academic researchers. They are corroborated by ABS data, by private sector surveys on how the stimulus was spent and by an examination of the experience of countries that have not had such a large stimulus in place.¹

1.4 We also note the evidence of the Governor of the Reserve Bank, Glenn Stevens when he said:

If the intention was to support demand in the economy... my conclusion would be that those measures have supported demand quite materially over the last... nine or 10 months.²

1.5 The Majority Report details the different stimulus measures introduced by the Government. It is important to note that in negotiating the passage through the Senate of the \$42b Nation Building and Jobs Plan, the Australian Greens achieved job-rich, environmentally sound and energy efficient changes to the package.

1.6 These changes provided for a \$200m local jobs component in the Nation Building stimulus plan that included \$50m for emergency relief and financial counselling for people affected by unemployment, \$60m for heritage projects, \$40m for bike paths and \$10m for bioremediation of the lower Murray. The Greens also negotiated high level energy efficiency standards to be met by all new building

1 Dr Ken Henry, Secretary to the Treasury, *Proof Committee Hansard*, 9 October 2009, pp 2-3.

2 Mr Glenn Stevens, Governor, Reserve Bank of Australia, *Proof Committee Hansard*, 28 September 2009, p 6.

constructed under the stimulus package and secured fair and equitable access to a \$550m infrastructure programme for all councils in Australia, regardless of their size or location. These measures helped to create thousands of green jobs in communities across Australia, and provide greater financial assistance and support for unemployed and low-income Australians.

Senator Bob Brown
Leader of the Australian Greens

Additional Comments by Senator Xenophon

Introduction

- 1.1 This inquiry was established to examine the economic stimulus initiatives announced by the Government since October 2008, including the efficacy of the spending measures and their environmental impact, the costs and benefits of continuing the measures, whether changed economic circumstances warrant changes to the initiatives and their impact on interest rates and taxpayer liabilities.
- 1.2 Following the shock collapse of international investment bank, Lehman Brothers, in September 2008, the global economic outlook deteriorated sharply, with many nations, including Australia, implementing various form of fiscal initiatives to stimulate their economies.
- 1.3 On 14 October 2008, the Australian government announced the Economic Security Strategy, which included combined expenditure of \$10.4 billion through various cash payments, a boost to the First Home Owners grant and further investment through the National Building Funds.

This was further supplemented in November, when the Council of Australian Governments announced a \$15.2 billion COAG funding package to address housing, hospitals and education.

A further \$4.7 billion in stimulus expenditure – the National Building Plan - was announced in December 2008, followed by the \$42 billion stimulus package, the National Building and Jobs Plan, announced in February 2009.

In total, Treasury calculates that around \$79 billion in fiscal stimulus measures are "expected to impact on the economy over three years from 2008-09 through to 2010-11"¹.

- 1.4 The package also included measures targeted at the Murray-Darling Basin in respect of accelerated water buybacks, funding for stormwater harvesting, funds for communities to cope with drought and climate change, as well as improved irrigation exit packages.

Given the importance of the Murray-Darling Basin to Australia's economy as a key food producing area, these measures were essential to assist and provide stimulus to that region.

¹ Dr Ken Henry, *Proof Committee Hansard*, 09 October 2009, Pg 2

- 1.5 In comparison, the United States of America injected US\$789 billion into its economy, including \$507 billion in spending programs, with more than \$150 billion on public works projects for transportation, energy, and technology, and \$282 billion in tax relief.

Meanwhile, China and Germany proposed economic stimulus plans of US\$586 billion and \$40 billion, respectively; Canada proposed a plan worth about US\$24 billion; France unveiled a \$34 billion plan; and Singapore, a \$15 billion plan.

- 1.6 According to the OECD, Australia's fiscal package over the period 2008 to 2010 amounted to 4.6 percent of its 2008 GDP. Of the 30 OECD members, only the United States and Korea initiated larger fiscal stimulus packages.²

- 1.7 During the Committee hearings, it became apparent that there were two fields of thought regarding the need for and effectiveness of the economic stimulus.

Similarly, the key questions are whether the stimulus was necessary, or whether the markets would have rebounded naturally; and whether the stimulus was effective, or was it just a short-lived exercise which will have long-term consequences. And, finally, what should occur now that Australia's economy is improving?

Distribution of the economic stimulus

- 1.8 One of the key queries around the effectiveness of the economic stimulus was whether, particularly, the \$900 voucher to individuals was spent, saved, or used to pay off debt.

In the quarter in which the payments were delivered, forty percent of respondents said that they spent the money they received from the household stimulus package.³

39.8 percent of respondents said they spent it on things other than bills or debts; 30.2 percent of respondents said they used it to pay bills such as utilities, medical and other services, and 18.7 percent said they saved it.⁴

The remainder used their stimulus to pay their credit cards, mortgage, invested it or didn't know where they spent it.⁵

² OECD 2009, Pg 109-110

³ Professor Andrew Leigh, *Submission 1*, Pg 4

⁴ Professor Andrew Leigh, *Submission 1*, Pg 8

⁵ Professor Andrew Leigh, *Submission 1*, Pg 8

- 1.9 While admittedly the economic situation in Taiwan was significantly different to Australia's in terms of the amount of their stimulus package, the government used a voucher redemption scheme whereby consumers were given shopping vouchers to encourage people to boost spending.

\$88.73 billion (Taiwan dollars) in vouchers were issued to the public between 18 January and 31 March 2009, for spending in the wholesale, retail and food and beverage services, and as of 20 April, more than 78.26 percent (\$65.53 billion) had been used by consumers and cashed by the businesses which received them.

\$30.4 billion (Taiwan dollars) in vouchers, or 46 percent of the stimulus initiative, were spent at general merchandise retail outlets.⁶

- 1.10 A voucher system was also called for by the Australian Retailers Association "to ensure any stimulus funds are injected back into the economy"⁷.

"Cash bonuses from the Federal Government will put economic recovery in the hands of Australian workers who are failing to respond to positive economic conditions at the moment. We are seeing a trend towards saving and paying off debt which is not a bad thing – but for any economic stimulus package to do its job funds must flow through the supply channels."⁸

- 1.11 Given the lack of certainty around how Australians used or spent their stimulus payment, it is difficult to assess its efficacy to boost spending.
- 1.12 According to Roy Morgan Research, consumer confidence in September 2008 was 101.2 and has continually fluctuated between then and current day, but with a steady rise since February 2009⁹, possibly as a result of the low interest rates and economic stimulus measures.

As at 22 October 2009, consumer confidence was 127.1.¹⁰

Effects of the economic stimulus

- 1.13 From the second quarter of 2008 to the second quarter of 2009, the Australian economy grew by 0.6 percent. This is compared to an average contraction across OECD economies of 4.6 percent.¹¹

⁶ China Daily *Govt scheme helps ease drop of consumption*, 24 April 2009

⁷ Australian Retailers Association, *Media Release: Retailers call for debit card stimulus to ensure funds flow*, 11 February 2009

⁸ Australian Retailers Association, *Media Release: Retailers call for debit card stimulus to ensure funds flow*, 11 February 2009

⁹ Roy Morgan research <http://www.roymorgan.com/news/polls/consumer-confidence.cfm>

¹⁰ Roy Morgan Research, <http://www.roymorgan.com/news/polls/consumer-confidence.cfm>

Further, according to the International Monetary Fund, Australia will record modest growth of 0.7 per cent in 2009 and 2.0 per cent in 2010, making Australia will be the only advanced economy to record positive growth in 2009.

1.14 A private survey of consumer confidence in July 2009 recorded an increase of 9.3 percent on the previous this month, to reach a total a 109.4, meaning that those optimistic about the economy decisively outweighed the pessimists for the first time since December 2007.¹²

1.15 Unemployment was forecast to hit 8.5 percent as a result of the global economic crisis and, as at September 2009, it increased to 5.8 percent, up from 4.1 percent in August 2008, before the financial crisis.

It's been estimated that the economic stimulus 'saved' 150,000 to 200,000 people from losing their jobs.¹³

1.16 Professor Steven Kates from RMIT University stated during the Committee hearing that:

"I think in the short term the unemployment rate might have gone to 6.1 percent instead of 5.8 percent had there not been a stimulus. I think it has saved jobs. But I think that the cost of saving those jobs has been so disproportionate to any of the good that it will do that it is a tremendous policy mistake to have done this.

We can see now that everything has calmed down and we are moving towards a platform from which growth can occur. But within that we not have this unbelievably large debt that we are going to have to repay and we have higher interest rates than we otherwise would have had."¹⁴

1.17 Indeed, Australia's net foreign debt now stands at approximately \$200 billion dollars in 2013/14, with a gross debt of approximately \$300 billion, 13.8 per cent of GDP as a result of the economic stimulus packages implemented between October 2008 and February 2009.

Looking ahead

1.18 The government has announced that a coordinated wind-back of stimulus measures by G20 nations will take place once Australia's economic growth returned to a trend level of 3 percent.

1.19 However, economist, Professor Ross Garnaut argues:

¹¹ ACOSS, *Submission 2*, pg 1

¹² Westpac-Melbourne Institute Consumer Sentiment Index 2009

¹³ OECD 2009, *Employment Outlook*

¹⁴ Professor Steven Kates, *Proof Committee Hansard*, 21 September, Pg 9

"It was appropriate to have a big fiscal stimulus, so I don't fault the scale of the stimulus that was given. But once there are signs that the economy is recovering faster than had been anticipated, then it's appropriate to pull back that stimulus at a faster rate."¹⁵

- 1.20 Indeed, Secretary for the Department of the Treasury, Dr Ken Henry, admitted during the Senate Committee hearing that:

"We are beyond the period of peak impact of the fiscal stimulus. From that point, as stimulus is to be gradually withdrawn, the contribution to economic growth will subside and it will soon turn negative. Indeed, on our estimates, the fiscal stimulus package will make a negative contribution to GDP growth in every quarter in 2010..."¹⁶

- 1.21 Reserve Bank of Australia Governor, Mr Glenn Stevens agreed that the stimulus should be wound back, but said:

"I think it is a bit hard to claim that as of this moment there is too much growth in the economy. I have not had a serious problem with what has occurred on the fiscal front thus far. The presumption we are making is that things will be delivered and then wound back more or less on the schedule that is set out in the budget... I am not sure that I would say that that outlook is a terribly worrying outlook really. This has been a good episode for Australia. We have come through this well. We are in recovery now, I think. It is important that these measures be wound back over time, but they are on track to be so."¹⁷

- 1.22 However, Mr Stevens said he would not support further fiscal stimulus.

Senator XENOPHON — Going to your evidence before the House of Representatives Economics Committee on 14 August, you said, 'I am not terribly worried that there was too much fiscal stimulus.' You went on to say:

"If someone wanted to make the argument that there is a need for more fiscal stimulus from here, I do not think I would agree with that, based on the outlook as we see it, anyway."

That was 44 days ago. There are newspaper headlines today saying that there is going to be a \$10 billion turnaround in terms of the budget deficit. There have been a number of economic indicators since that time. Has your level of worry or otherwise changed since you made that statement before the House of Representatives committee?

¹⁵ ABC, *The 7:30 Report: Professor Ross Garnaut*, 12 October 2009

¹⁶ Dr Ken Henry, *Proof Committee Hansard*, 9 October 2009, Pg 3

¹⁷ Mr Glenn Stevens, *Proof Committee Hansard*, 28 September 2009, Pg 7

Mr Stevens—What I was saying then was that the measures that have been implemented and that were in prospect on the plan that was set out earlier by the government is built into the outlook. I was not troubled by that outlook. In fact, I think that it is a rather pleasing one, because it is an economy that has had a pretty shallow downturn and has reasonable prospects for recovery. What I was saying was that if someone came up with a whole lot of new plans now to do more, I do not think that I would agree with that. I still would not. That is what I was saying.¹⁸

- 1.23 Indeed, Professor Garnaut warns that once people come to expect the government to intervene in the economy, it becomes hard to stop doing so.

"...entrenching rationalisations for much more widespread state intervention in markets. This would impose persistent high costs on the integrity of our democracy as well as on our market economy."

"Such attitudes are creating a generalised justification for increased government intervention in the economy."¹⁹

Conclusion

- 1.24 In many ways, the full extent of the effectiveness of the government's stimulus measures, in particular the \$900 cash handouts to households, will be difficult to precisely quantify, as it occurred simultaneously with low interest rates.

Further how the money was spent is not clear – whether the actual \$900 was used in retail or whether it provided families with a buffer to have extra spending money at a later stage. However, it was clearly a factor in bolstering consumer confidence.

- 1.25 More importantly, and given Australia's current positive economic outlook, focus needs to be given to an exit strategy to reduce inflationary pressures and ensure interest rates do not rise unnecessarily.

Recommendations

Recommendation 1

That the government advise the Committee its plans and timeline for a scale back of economic stimulus measures, with and/or without a coordinated approach by G20 nations. Further, that the Government advise what consultation will occur to prepare a clear and effective exit strategy.

¹⁸ Mr Glenn Stevens, *Proof Committee Hansard*, 28 September 2009, Pg 19

¹⁹ Weekend Australian, *Garnaut cool on stimulus*, 10 October 2009

Recommendation 2

Further to the Committee's majority report, that an urgent independent report is conducted, it is recommended that this report include review of the method in which household stimulus incentives are distributed, with a view to assess future options to distribute funds, if needed, via a debit card or voucher system.

A handwritten signature in black ink, appearing to read 'Nick Xenophon', with a long horizontal flourish extending to the right.

NICK XENOPHON
Independent Senator for South Australia

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Professor Andrew Leigh
2	Australian Council of Social Service (ACOSS)
3	Professor Sinclair Davidson and Ashton de Silva, Institute of Public Affairs
4	Henry Ergas and Alex Robson, Crawford School of Economics and Government, Australian National University
5	The Australia Institute
6	Mr Peter Brohier
7	Welfare Rights Centre
8	CPA Australia
9	Dr Steven Kates, School of Economics, Finance and Marketing; RMIT University
10	Mr Alun Breward
11	Professor Anthony Makin, Griffith Business School, Griffith University
12	The Australian Industry Group
13	Mr Rory Robertson
14	Mr Derek Smith
15	Professor Warwick McKibbin
16	Mr Jim Heslop, HillSide Christian School
17	Mr David Allen
18	Mr Matt Mushalik

Additional Information Received

- Received on 15 October 2009 from Treasury. Answers to Questions taken on Notice on Friday 9 October 2009.
- Received on 19 October 2009 from Treasury. Answers to Questions taken on Notice on Friday 9 October 2009.
- Received on 15 October 2009 from Treasury. Answers to Questions taken on Notice on Friday 9 October 2009.

- Correspondence received by the Committee from the Secretary to the Treasury, Dr Ken Henry, dated 17 September 2009.
- Treasury briefing paper prepared for the Inquiry, received 2 October 2009.

APPENDIX 2

Public Hearing and Witnesses

CANBERRA, MONDAY 21 SEPTEMBER 2009

DAVIDSON, Professor Sinclair,
RMIT University and Institute of Public Affairs

DENNISS, Dr Richard, Executive Director,
The Australia Institute

KATES, Dr Steven Ian,
Private capacity

LEIGH, Professor Andrew Keith,
Private capacity

MAKIN, Professor Tony,
Private capacity

SYDNEY, MONDAY 28 SEPTEMBER 2009

BURN, Dr Peter, Associate Director, Public Policy, Australian Industry Group

EVANS, Mr Greg, Director, Economics and Industry Policy,
Australian Chamber of Commerce and Industry

HYDEN, Mr Neil, Chief Executive Officer,
Australian Office of Financial Management

JOHNSON, Mr Andrew, Head, Compliance and Reporting,
Australian Office of Financial Management

MELVILLE, Mr Anthony, Director, Public Affairs and Government Relations,
Australian Industry Group

ROBERTSON, Mr Rory David, Economist and Division Director,
Macquarie Bank

STEVENS, Mr Glenn Robert, Governor,
Reserve Bank of Australia

FRIDAY, 9 OCTOBER 2009

GRUEN, Dr David, Executive Director, Macroeconomic Group,
Department of the Treasury

HENRY, Dr Ken, Secretary,
Department of the Treasury

McDONALD, Mr Tony, General Manager,
Department of the Treasury

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APPENDIX 3

Composition of stimulus measures

Composition of the Economic Security Strategy

The Economic Security Strategy (ESS) package was announced on 14 October 2008. The combined value of announced measures was \$10.4 billion.

Payments to pensioners

Through the ESS, single pensioners became eligible for one-off payments of \$1400, while pensioner couples received \$2100. Qualifying pension categories were:

- Age Pensioners;
- Disability Support Pensioners;
- Carer Payment recipients;
- Wife and Widow B Pensioners; Partner, Widow and Bereavement Allowees;
- Veterans' Affairs Service Pensioners;
- Veterans' Income Support Supplement recipients;
- Veterans Affairs Gold Card holders eligible for Seniors Concession Allowance;
- those of age pension age who receive Parenting Payment, Special Benefit, or Austudy; and
- Eligible Self Funded Retirees holding a Commonwealth Senior Health Card.¹

In addition, individuals who claimed the Carer Allowance also received \$1000 for each eligible person in their care.

Payments to recipients commenced on 8 December 2008, with the majority of payments made by 19 December 2008.

Payments to families

The ESS included \$3.9 billion worth of lump-sum payments to eligible families for each child in their care. Eligibility was granted to families that received Family Tax Benefit A and families with dependent children that received Youth Allowance, Abstudy or a benefit from the Veteran's Children's Education Scheme. Families received \$1000 for each child in their care.

1 The Hon Kevin Rudd PM and the Hon Wayne Swan, Treasurer, *Joint Press Release, Economic Security Strategy*, 14 October 2008.

Increase of the First Home Owners Bonus

The ESS boosted the First Home Owners Bonus from \$7 000 to \$14 000 when buying an established home and to \$21 000 for first home owners buying a newly-constructed home. Under the ESS, this boost would remain in place until 30 June 2009. However, the 2009–10 budget extended this measure for a further three months at the increased level and three more months after that at the original grant level.²

Increased funding for job training

The Productivity Placements Program (PPP) received an additional \$187 million for the 2008–09 financial year. This expanded the number of places in the programme from 57 000 to 113 000, including 10 000 Structural Adjustment Places for retrenched workers to retrain.

Fast-tracking of the Nation Building Program

As part of the ESS, the government announced that it would bring forward the implementation of the three Nation Building Funds to 2009:

- the Education Investment Fund;
- the Health and Hospitals Fund; and
- the Building Australia Fund (transport and communications).

Composition of the COAG Funding Package

On 29 November 2008, the Commonwealth Government announced a \$15.2 billion funding package for initiatives to be undertaken through COAG over five years. Table A3.1 gives a detailed breakdown of the package by measure and financial year.

Funding for the 2008–09 financial year was \$3.5 billion, but is approximately half that in 2009–10 and then gradually increases to \$4.1 billion in 2012–13.

Health initiatives

The bulk of the November COAG package is expenditure on health initiatives. The single biggest item in the package is an increase in the base Special Purpose Payment (SPP) to states and territories of \$4.8 billion as a result of the renegotiated National Healthcare Agreement. In addition to this general increase in funding for health and hospitals, the government agreed to provide \$750 million as a one-off payment for improvements to emergency departments in hospitals. Other significant measures included \$1.1 billion for health workforce training and \$448 million for various preventative health measures.

2 The Hon Wayne Swan, MP, Treasurer, *Budget Speech 2009–10*, 12 May 2009.

Education initiatives

In total, the COAG funding package included \$3.5 billion for education initiatives. Approximately \$1.9 billion is provided as a result of changes to the Schools SPP. The increase in funding is due to a Commonwealth agreement to align funding rates between primary and secondary schools and to change the indexation rate for government schools. Also included in the SPP is an agreement to provide \$0.8 billion to assist in implementing the National Secondary Schools Computer Fund.

The remainder of the education funding, \$1.7 billion, is provided through National Partnerships aimed at improving the quality of teachers and addressing the needs of disadvantaged schools. Funding for an additional National Partnership aimed at improving literacy and numeracy was announced prior to the November package.

Table A3.1: COAG expenditure package, 29 November 2008 (\$m)

	2008-09	2009-10	2010-11	2011-12	2012-13	Total
Healthcare SPP- additional base and indexation	500	675	914	1,191	1,500	4,779
Healthcare NPs	1,287	212	401	566	594	3,060
<i>Hospitals & health workforce reform</i>	537	166	295	380	376	1,753
<i>Preventative health</i>	-	18	67	145	218	448
<i>E-health (NEHTA)</i>	-	29	39	41	-	109
<i>Emergency departments</i>	750	-	-	-	-	750
Schools SPP	868	171	213	268	334	1,855
<i>Additional indexation</i>	-	41	74	121	177	412
<i>10% AGSRC primary schools</i>	61	131	139	148	157	635
<i>Digital education revolution</i>	807	-	-	-	-	807
Productivity agenda NPs	33	192	265	618	549	1,657
<i>Smarter schools – quality teaching</i>	22	40	60	243	185	550
<i>Smarter schools – low SES schools</i>	11	152	205	375	364	1,107
Skills & workforce development SPP	-	4	10	11	11	37
Disability services SPP	70	23	71	101	143	408
National affordable housing SPP	-	1	7	15	23	46
Affordable housing NPs	200	275	105	110	110	800
<i>Homelessness recurrent</i>	-	75	105	110	110	400
<i>Social housing</i>	200	200	-	-	-	400
Indigenous reform NPs	440	214	245	494	574	1,967
<i>Indigenous economic development</i>	15	40	40	39	40	173
<i>Indigenous health</i>	-	83	157	248	318	806
<i>Indigenous remote service delivery</i>	25	31	32	33	33	154
<i>Indigenous housing</i>	400	60	16	174	185	835
Business regulation & competition NP	100	-	-	200	250	550
Total COAG funding package	3,497	1,768	2,231	3,575	4,088	15,158

Source: *COAG Communiqué*, 29 November 2008.

SPP: specific purpose payment, NP: National partnership.

Indigenous reform initiatives

Almost \$2 billion over five years was provided for four Indigenous Reform National Partnerships aimed at furthering the government's 'Closing the Gap' targets. The majority of this funding is targeted at health and housing outcomes with over \$0.8 billion for each issue. The package also provides funding for initiatives aimed at Indigenous economic development and remote service delivery.

Other initiatives

The COAG package also includes increased funding through SPPs for workforce development, disability services, social housing and deregulation for the business sector.

Composition of the December Nation Building Package

On 12 December 2008, the Australian Government announced a third stimulus package, entitled the 'Nation Building Package'. The Nation Building Package was worth \$4.7 billion and was split evenly between infrastructure development, education and changes to the taxation system.

Infrastructure measures

The package contained a provision to inject \$1.2 billion in equity into the Australian Rail Track Corporation to finance 17 rail projects across Australia.

The government provided \$711 million to bring forward construction on key road development projects, to be balanced by reductions in later years. It announced that \$60 million would be provided for black spot accident reduction projects and \$195 million for investment in agricultural and social infrastructure in the East Kimberley.³

Education measures

The package included an announcement of \$1.6 billion for 13 education projects. Of this figure, \$580 million was to be invested in 11 research facilities at various universities. The government announced \$500 million for a Teaching and Learning Capital fund, a one-off funding round targeting capital expenditure in universities. Finally, \$500 million was used to set up a Teaching and Learning Capital Fund for Vocational Education and Training. This fund is similar to the university fund, but targeted at TAFE institutes and other non-university tertiary education providers.

3 In the accounting used in measuring the overall size of the package, the road, black spot and East Kimberley initiative tally to \$0.4 billion rather than \$0.96 billion. It is assumed this is because the \$711 million for road projects brings forward some previously announced projects in time. Department of Prime Minister and Cabinet, *Nation Building: Rail, Road Education & Research and Business*, December 2008, p. 4.

Investment Allowance

An additional tax deduction for businesses was included in the package. The deduction took the form of an investment allowance for tangible depreciating assets that cost more than \$10 000. Businesses were able to claim a tax deduction of 10 per cent of the value of assets purchased, held under contract or constructed between the date, the package was introduced and 30 June 2009. It was estimated that the cost of this measure to the Commonwealth would be \$1.6 billion.

Temporary changes to taxation

The Nation Building Package included an announcement that the pay-as-you-go payment required from businesses with turnover of less than \$2 million per year would be cut by 20 per cent for the December 2008 quarter. It was expected that this would cost the Commonwealth about \$440 million in 2008–09, but that as it represented a bringing forward of the expected lower revenue from small business in 2009–10, the cost of this measure would be neutral over the forward estimates period.

Composition of the Nation Building and Jobs Plan

The Nation Building and Jobs plan remains the largest of the various stimulus packages at a combined value of approximately \$42 billion. The package consisted of six bills, passed by the Senate on 13 February 2009:

- Appropriation (Nation Building and Jobs) Bill (No.1) 2008–2009;
- Appropriation (Nation Building and Jobs) Bill (No.2) 2008–2009;
- Household Stimulus Package Bill 2009;
- Commonwealth Inscribed Stock Amendment Bill 2009;
- Tax Bonus for Working Australians Bill 2009; and
- Tax Bonus for Working Australians (Consequential Amendments) Bill 2009.

Appropriation (Nation Building and Jobs) Bill (No.1) 2008–2009

This bill appropriated \$89 million, with \$39 million for the Department of Environment, Water, Heritage and the Arts to administer the energy efficiency programmes and \$50 million to allow the Australian Tax Office to administer the tax bonus payments.

Appropriation (Nation Building and Jobs) Bill (No.2) 2008–2009

This bill appropriated \$1.7 billion, with \$987 million for the Building the Education Revolution program, \$260 million for social housing construction, and \$480 million for various road construction and safety initiatives.

Household Stimulus Package Bill 2009

The bill provided for a series of one-off cash payments to individuals who received various forms of welfare from the Commonwealth. The nature of the payments is discussed below.

Commonwealth Inscribed Stock Amendment Bill 2009

This bill amended the *Commonwealth Inscribed Stock Act 1911* to allow the Treasurer to declare that a certain circumstance exists which justifies an increase in the cap of Commonwealth Government Securities (CGS) on issue. The bill allows the Treasurer to issue an extra \$125 billion on top of the existing \$75 billion cap, allowing for the issue of \$200 billion of CGS.

Tax Bonus for Working Australians Bill 2009 and Tax Bonus for Working Australians (Consequential Amendments) Bill 2009

This bill enabled one-off lump sum payments to individuals that had a taxable income of up to \$100,000 in the 2007-08 financial year.⁴

Programmes and Initiatives under the Nation Building and Jobs Plan

The various initiatives under the Nation Building and Jobs Plan took the form of both cash payments and direct government expenditure:

- cash payments to taxpayers (Tax Bonus);
- cash payments to certain categories of welfare recipients (household stimulus payments);
- Building the Education Revolution—school building construction and refurbishment;
- Energy Efficient Homes program, including rebates for insulation and solar hot water systems;
- social and defence housing construction;
- investment in highways and road safety (black spots and boom gates); and
- regional and local community infrastructure program.

Cash payments to taxpayers and certain welfare recipients

Cash payments were made to two broad categories — through a one-off tax bonus, and through a one-off additional payment to recipients of certain welfare payments.

4 The bill authorises the Commissioner of Taxation to pay the tax bonus to eligible taxpayers. The Consequential Amendments bill made amendments to the various acts relating to taxation to ensure that the payments themselves were exempt from tax.

The package created a tax bonus for taxpayers who had an adjusted tax liability and a taxable income of under \$100 000 in 2007–08. Any taxpayer that had a net tax liability after taking into account tax offsets and franking credits, meaning they paid tax, in 2007–08 was eligible, if they earned under \$100 000.

Taxpayers who earned under \$80 000 in 2007–08 were eligible for a \$900 payment. This dropped to \$600 for those in the \$80 000–\$90 000 bracket and \$250 for those who earned between \$90 000 and \$100 000.

The estimated total cost of the tax bonus was originally expected to be \$8.2 billion, assisting 8.7 million taxpayers. However, amendments to the package marginally reduced the size of the payments by \$50 at each level of the payment (i.e. from \$950 to \$900, \$650 to \$600 and \$300 to \$250). This suggests that the revised cost would be in the order of \$7.5–\$8 billion.

The Household Stimulus Package Bill 2009 created a series of one-off \$950 cash payments to certain categories of welfare recipients. These included:

- Training and Learning Bonus—For senior secondary or tertiary students receiving a range of education assistance payments including:
 - Youth Allowance;
 - Austudy;
 - Sickness Allowance;
 - Special Benefit; or
 - Family Tax Benefit Part A (aged 21 to 24 years).
- Farmers Hardship Bonus—For individuals receiving:
 - Exceptional Circumstances Relief Payment;
 - Farm Help Income Support;
 - Transitional Income Support; or
 - Interim Income Support.
- Education Entry Supplement— For individuals receiving an Education Entry Payment between 1 January 2009 and 30 June 2010. The qualification period for receipt of Education Entry Payment was reduced from 12 months to four weeks of continuous receipt of an income support payment during the period 1 January 2009 until 30 June 2010. Eligibility for the Education Entry Payment was also extended during this period to Youth Allowance recipients who are not full-time students.
- Back to School Bonus - For each child aged 4 to 18 years who qualifies for Family Tax Benefit Part A on 3 February 2009. Those who received a Disability Support Pension or Carer Payment who were aged under 19 years on 3 February 2009 are also eligible.

Building the Education Revolution (BER) Program

The BER program had three main elements:

- Primary Schools for the 21st Century provides \$12.4 billion over three years for upgrading or building major infrastructure such as multipurpose halls and libraries. Both government and non-government primary schools are eligible to compete for the available funds, with priority being given to those schools building new facilities;
- Science and Language Centres for 21st Century Secondary Schools provides \$1 billion over three years for the construction of up to 500 science laboratories or language learning centres. Both government and non-government schools are eligible to apply for this funding, which is allocated on the basis of demonstrated need and capacity to complete the project by 30 June 2010; and
- Renewing Australian Schools allocates \$1.3 billion for all Australian schools to undertake maintenance and minor building works. Funding caps were to be determined by school size.

Social and Defence Housing

Under the Commonwealth Social Housing Initiative, up to \$6 billion is provided for the construction of approximately 20 000 dwellings by December 2010. Around \$400 million was also allocated for the repair of currently uninhabitable public housing.

Energy Efficient Homes Program

Under this programme, which applies from 1 July 2009 until 31 December 2011, the Government has offered to install ceiling insulation of up to \$1600 in value in all uninsulated owner-occupied homes. According to the Minister's Second Reading Speech, this will invest \$2.7 billion in housing modernisation by the end of 2011 and result in the insulation of almost all Australian homes.

As a further part of the Energy Efficient Homes program, two pre-existing energy efficiency programs were enhanced through the Nation Building initiative:

- under the Low Emissions Plan for Renters, there was an increase in the maximum rebate (from \$500 to \$1000) until 30 June 2011 for landlords installing insulation in an uncapped number of rental homes. The Government provided additional funding of \$612.5 million under this new arrangement; and
- the Solar Hot Water Rebate was increased from \$1000 to \$1600 for those households that do not access the insulation program and that replace existing electric hot water systems with a solar and heat pump hot water system before 30 June 2012. Means-testing for rebate eligibility was also removed. Additional funding for this program was \$507 million.

Road and transport safety initiatives

The land transport initiatives included additional funding for highway linkages, the installation of boom-gates at rail crossings and additional funding for the Black Spot road safety program.

Community Infrastructure

An additional \$500 million was provided over two years to support large local government strategic projects. Examples include community infrastructure such as halls, community centres and sport and recreation facilities.

Nation Building Infrastructure measures in the 2009–10 budget

Within the context of the national budget, it is difficult to assess which measures should be considered as stimulus initiatives. Technically, the overall size of the budget deficit (or surplus) reflects the ultimate position of government fiscal policy. The projected underlying cash deficit for 2009–10, as at May 2009, was \$57.6 billion. It is possible, in light of better than expected economic performance, that the budget deficit will also be lower than projected.

As the Treasurer indicated in his Budget Speech that the Nation Building Infrastructure measures represented a 'third phase'⁵ of the fiscal stimulus programme, the committee includes them in the government's stimulus initiatives.

Composition of the Nation Building Infrastructure measures

Initiatives categorised in the 2009–10 budget as 'nation building infrastructure' amounted to total new investment of \$22.4 billion. The majority was devoted to roads, rail and port development, with significant funding for the National Broadband Network, clean energy, education, health and hospitals.

Roads, rail and ports

Projects for the improvement of metropolitan rail networks in Sydney, Melbourne, Brisbane, Perth, Adelaide and the Gold Coast will receive \$4.6 billion of funding. The single biggest item in this category was \$3.2 billion for the Regional Rail Express in Victoria.

The package also includes \$3.4 billion worth of major road improvements. The focus of the development is the Network 1 route linking Melbourne to Cairns. The single biggest item of expenditure to accomplish this is \$1.45 billion for the Hunter Expressway in NSW.

5 The Hon Mr Wayne Swan, Treasurer, *Budget Speech 2009–10*, p. 5.

Finally, \$389 million has been included for development of Oakajee Port in West Australia and Darwin Port in the Northern Territory.

National Broadband Network

An initial investment of \$4.7 billion for the National Broadband Network is included in the 2009–10 budget.

Clean energy initiatives

Approximately \$3.6 billion has been provided for the establishment of a new renewable technology innovation organisation, Renewables Australia, investment in Solar Flagships projects and in Carbon Capture and Storage demonstration plants and for energy efficiency programmes.

Education measures

Education investment of \$2.6 billion is included in the 2009–10 budget. The single largest item is \$901 million to build capacity in future industries including space, marine, climate and nuclear science. Other measures include funding for higher education and vocational education projects.

Health and hospital measures

A total of \$3.2 billion has been allocated to health initiatives. Of this, \$1.5 billion is to fund various upgrades to medical facilities around Australia. \$1.3 billion will be invested to improve cancer treatment through the establishment of cancer treatment centres and upgrades for screening equipment. Finally, \$430 million will be invested in research and training programmes around Australia.