AUSTRALIA AND THE GREAT RECESSION

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ABSTRACT

This paper investigates the role of fiscal stimulus in helping Australia avoid recession during the global financial crisis (GFC) and ensuing "Great Recession". It examines the most recent figures to show the contribution of fiscal stimulus to Australian growth, and critically evaluates the major criticisms of fiscal stimulus in the light of subsequent events, concluding that fiscal stimulus was a necessary condition for keeping Australia out of recession. The paper then evaluates why fiscal stimulus was relatively more successful in Australia. It first separates out the elements of Australia's outperformance that were due to either strong pre-crisis economic foundations (such as better financial regulation and a strong fiscal position) or good fortune, (such as Chinese stimulus) and finally focuses on government actions during and immediately before the crisis which made discretionary fiscal policy successful in the Australian case (principally: early warning systems, preparatory work, implementation architecture, the corporate memory of policy advisers and policymakers and the responsiveness of a new administration).

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Purpose of this paper

Few people with an interest in economics will soon forget the extraordinary events of the global financial crisis (GFC) and what is often termed the "Great Recession" of 2008/09. Beyond the mere academic interest (and much more importantly) many millions of people suffered real and enduring hardship as a consequence of those events, and for them, memories will fade even more slowly.

These were events I experienced professionally as chief of staff to Australia's Treasurer Wayne Swan between late 2007 and 2010, and this paper is an account of this period. In truth, this would be worth doing simply for the historical record of how the crisis evolved and how Australia was affected. But in Australia's case, the government took a series of unprecedented policy measures to try and lessen the blow for our citizens. And while many of the policies we pursued may have been common to other countries, the results certainly were not: Australia was virtually alone among International Monetary Fund (IMF) advanced economies in not experiencing a recession during this period, and had the strongest growth of any of these economies in 2009.

Even the most disinterested observer (and of course as a participant, I am not one of those) would have to agree that Australia's performance merits examination for what it can tell us about the contribution policy decisions made to this outperformance. I intend to look at the most extensively debated of those policy interventions: the fiscal stimulus packages announced in October 2008 and February 2009. With more than a year elapsed since the end of such a dreadful year for the global economy in 2009, it is timely to look back on the latest data and analysis to draw some conclusions about the impact of fiscal stimulus during this period.

There are two broad questions I will answer in this paper: (1) did fiscal stimulus prevent an Australian recession, and if so, (2) why did it do so in Australia when it didn't in other countries?

As to the first question, I will show that fiscal stimulus did prevent Australia from experiencing a recession, firstly by using the most recent figures and my own analysis to show the contribution it made, and secondly, by rebutting the major counterclaims that it did not.

As to the second question, I will show the elements of Australia's outperformance that were good fortune and those that were good policy decisions, with a particular focus on those elements which made discretionary fiscal policy successful in the Australian case.

I begin with the question of the impact of fiscal stimulus.

1. Would Australia have experienced a recession without fiscal stimulus?

1.1 Evidence from the most recent figures

This section examines whether fiscal stimulus actually did what it was designed to: to prevent a recession in Australia, but more importantly than that, to save jobs and businesses.

Let me begin by saying, as I will throughout this paper, that the ex-post judgment is less important than the ex-ante one. The test should be whether the government's actions were reasonable given the information available to it at the time. It has only become easier with the passage of time to forget the terrible outlook of late 2008 and early 2009 from the vantage point of a global economy now emerged from recession.

But an ex-post analysis is not entirely about being wise after the event: it can be useful in disentangling the influence of different events, and helping us in the event we face such a set of circumstances again.

There are broadly two ways of estimating the effect of stimulus, best described as bottom-up and top-down. The bottom-up method builds a model of the Australian economy, and runs it for a scenario without fiscal stimulus (but including all other effects such as currency depreciation, China stimulus, monetary policy easing, etc.). This is the approach taken, for example, by McKibbin and Stoeckel[1] and which I discuss later in this paper.

By contrast, the top-down method takes the actual observed path of Australian GDP[2], and then subtracts the estimated value of the fiscal stimulus from that path. If the growth figures absent fiscal stimulus show a recession, we can conclude the fiscal stimulus was a necessary (though not necessarily sufficient) condition for Australia's avoiding recession.

The obvious merit of this approach is that it leaves all other policy variables intact: looser monetary policy, China's stimulus, the exchange rate and indeed anything else one can think of will be in the absent-stimulus growth path.

1.1.1 Quarterly path of growth

The Australian Treasury has produced a version of this analysis. In a speech in December 2009, the head of Treasury's macroeconomic group Dr David Gruen cited Treasury modelling on the estimated effect of fiscal policy:

…absent the discretionary fiscal packages, real GDP would have contracted not only in the December quarter 2008 (which it did), but also in the March and June quarters of 2009, and therefore … the economy would have contracted significantly over the year to June 2009, rather than expanding by an estimated 0.6 percent.[3]

My analysis uses updated figures incorporating the most recent revisions from the Australian Bureau of Statistics to test if this basic conclusion still holds true. I begin by deriving a "no fiscal stimulus" growth path by subtracting the estimated impact of stimulus from the actual growth path observed in the economy. I am looking just at the period from late 2008 to the end of 2009, as this was the time of maximum risk to growth in the Australian economy.

For my analysis, I have taken the ABS's December 2010 revised quarterly growth figures (released in March 2011). I have then compiled approximate quarterly cashflows from the major stimulus packages.

I have broken these into cash payments (such as tax bonuses and direct payments through Centrelink) and investment spending (such as direct infrastructure investments in schools and insulation and incentives for business investment). The reason for the different treatment is the different expected economic effects of such spending.

For the investment spending, I have allocated spending as closely as possible to the timetable of when the funds *were actually spent* (not budgeted or allocated) gleaned from the reports of the Commonwealth Coordinator-General:

- Approximately $14 billion in investment spending was outlaid over the course of calendar 2009, with effectively none of it in the first half of the year, $3 billion in the June quarter of 2009, and the remainder split between the September and December quarters.[4]
- In addition to this, there were cash payments totalling $8.7 billion paid during the month of December 2008, and $12.2 billion in the June quarter of 2009.[5]
- First homeowners' boost payments of $830 million in 2008/9[6] have been distributed 15% to the December quarter 2008, 35% to the March 2009 quarter and 50% to the June 2009 quarter, using applications data from NSW's Office of State Revenue as a proxy for applications nationwide.[7] Using the same method, payments of $1121 million in 2009/10[8]

have been allocated 43% and 35% to the September and December quarters 2009 respectively.

- Finally, additional funding flowing from the November 2008 Council of Australian Governments (COAG) deal with the States has been allocated as follows: $3 billion in new funding for 2008/9 split evenly between the March and June quarters of 2009, and the first six months of the $1.7 billion in new funding for 2009/10 allocated evenly between the September and December quarters of 2009. [9]

Allocating these outlays in this way gives us a cashflow profile as follows:

Table 1: (outlays in $A billions)

	Sep 2008	Dec 2008	Mar 2009	Jun 2009	Sep 2009	Dec 2009
Cash payments	0.0	8.7	0.0	12.2	0.0	0.0
Investment outlays	0.0	0.0	0.0	3.0	4.4	6.6
FHOB	0.0	0.1	0.3	0.4	0.5	0.4
COAG	0.0	0.0	1.5	1.5	0.4	0.4

The cashflows do not all affect growth in the same way. Therefore, I make a series of assumptions about timing and multipliers. For cash payments, I assume these operate incompletely, and with a lag:

- 30% of the payment is spent in the quarter in which it is paid;
- 20% is spent in each of the next two quarters;
- The remaining 30% is saved; and
- All payments are adjusted down by 15% to account for spending on imports.

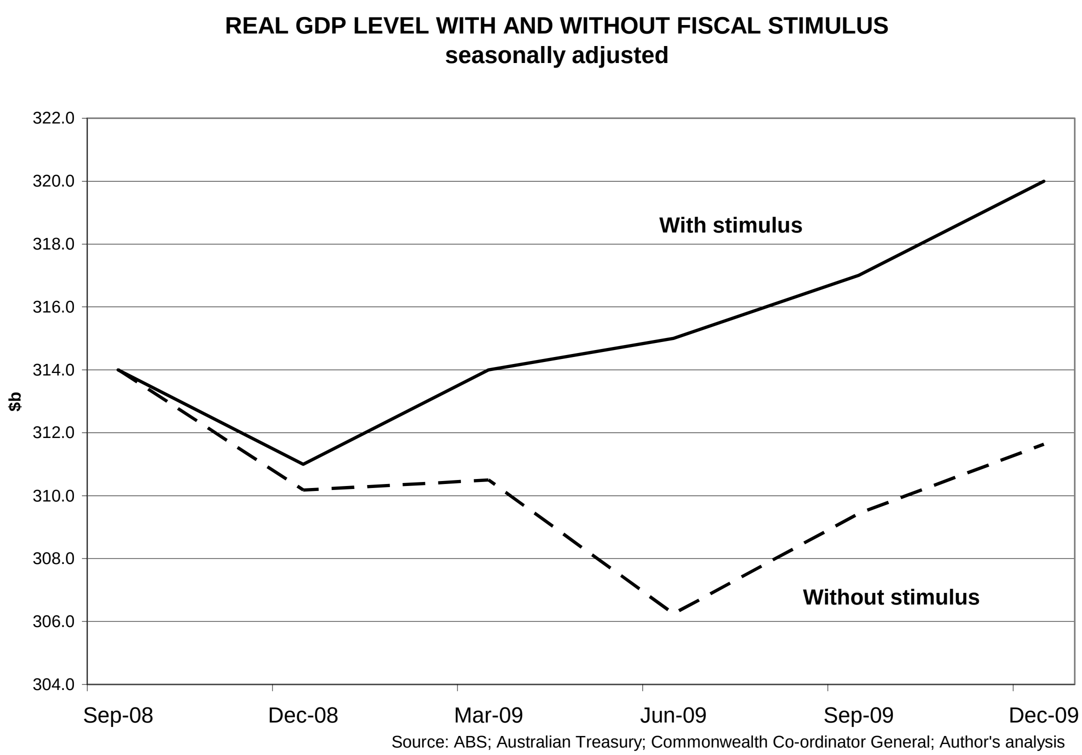
For investment outlays, I assume a multiplier of one, i.e.: the spending adds in its entirety to aggregate demand in the quarter in which it is spent (although I have adjusted it by assuming 15% is spent on imports). These multipliers are the same ones used by Dr Gruen in his analysis, and which he in turn derived from empirical research cited in the footnotes to his speech.[10] They also fall at the conservative end of the ranges used by both the IMF and the Organisation for Economic Cooperation and Development (OECD) as I discuss in more detail below.

Table 2 below therefore transforms the raw cashflows in **Table 1** above into quarterly impacts on GDP. The biggest difference is in the cash payments line, as the large cashflows in the December 2008 and June 2009 quarters are spread out over subsequent time periods.[11]

Table 2: (impact in $A billions)

	Sep 2008	Dec 2008	Mar 2009	Jun 2009	Sep 2009	Dec 2009
Cash payments	0.0	0.7	2.0	4.6	3.1	2.1
Investment outlays	0.0	0.1	1.5	4.2	4.5	6.3
Total growth impact	0.0	0.8	3.5	8.8	7.6	8.4

The next step is to subtract these growth impacts from the observed changes in GDP, as indicated in **Chart 1:**



This chart shows the *level* of GDP, and the estimated impact of stimulus. We can deduce the GDP *growth* impact from the slope of the different lines. The quarter-on-quarter slopes of the “without stimulus” line are the ones to look at. They show a slightly deeper downturn in the December quarter 2008 (-1.2% versus actual -0.9%), basically no growth in the March 2009 quarter (0.1% versus actual 0.9%), and then a second and much larger fall in the June quarter of 2009 (-1.4% versus actual +0.4%).

This tells us something very important. Ever since Australia’s growth surprised on the upside through the crisis, there has been a current of opinion that fiscal stimulus was not required after all, and that looser monetary policy, a lower exchange rate and China’s stimulus were sufficient for Australia to avoid recession.

My analysis suggests Australia would have suffered two large negative quarters of growth without fiscal stimulus. In fact, the figure for the 2009 June quarter of a 1.4 percent fall in GDP compares to the worst negative quarter of the early 1990s recession (-1.3% in March 1991).

This should not be a surprising result. The economy in **Chart 1** is growing at just 1.7% over five quarters, while fiscal stimulus of $40 billion (peaking at over 2% of the quarterly GDP level) is injected.

As noted above, this analysis has been done using fiscal multipliers supported both by empirical evidence and international bodies such as the OECD and IMF. It is worth delving into this topic further by focusing more closely on the multipliers themselves.

1.1.2 Backsolving for the multipliers

This section looks at the amounts that were spent by government and the final path of GDP, and derives from these variables the multipliers for which stimulus was (or was not) decisive in Australia’s avoiding recession.

First let us look at actual levels of GDP over the period examined above and compare those to the stimulus entering the economy at the same time. **Table 3** lines up the level of GDP (seasonally adjusted), added GDP and the raw stimulus cashflows from **Table 1** above for each quarter.

Table 3:

Quarter	Real GDP ($b)	GDP added vs Sep 2008 ($b)	Stimulus ($b)
Sep-2008	314	0.0	0.0
Dec-2008	311	-3.0	8.8
Mar-2009	314	0.0	1.8
Jun-2009	315	1.0	17.1
Sep-2009	317	3.0	5.3
Dec-2009	320	6.0	7.4
	Total:	7.0	40.4

The "GDP added" column shows the difference between the actual path of GDP and flat GDP by subtracting September 2008 GDP of $314 billion from each quarterly figure. From this we can see there was a cumulative $7 billion (accounting for negative and positive growth) added during this period. Yet we can also see that there was $40 billion of fiscal stimulus entering the economy over the same period.

In other words, the difference between actual GDP and zero growth was $7 billion, yet the stimulus was $40 billion. We would have to believe the weighted multiplier for this spending was below 0.18 for fiscal stimulus not to have been decisive in maintaining positive growth over these five quarters.

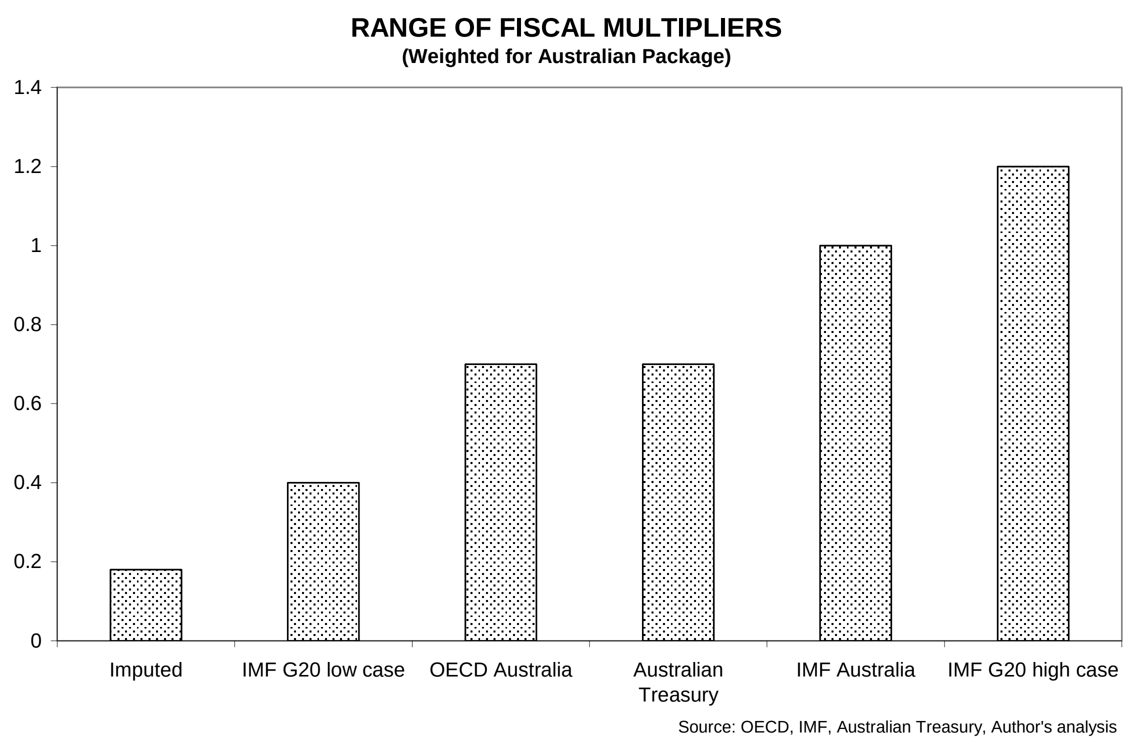
Let us examine the plausibility of this. The academic literature on fiscal multipliers is voluminous, and I don't propose a detailed survey here. What is relevant here is the question of whether very low multipliers are plausible for Australia in this case.

Chart 2 below documents a range of multiplier estimates provided by the OECD, the IMF and the Australian Treasury. It also records the 0.18 threshold multiplier imputed from my analysis immediately above, for ease of comparison. The sources are as follows:

- In a staff note for the G-20 Ministerial Meeting in March 2009, IMF economists provided a set of multipliers, ranging from a "high" case of 0.6 on revenue and 1.8 on capital spending (for a weighted average – since the cash and investment components are basically equal – of 1.2) to a "low" case of 0.3 on revenue and 0.5 on capital spending (for a weighted average of 0.4).[12]

- In the OECD's survey of fiscal stimulus across member economies, they estimate multipliers for Australia of 0.4 on transfers to households and 0.9 on government investment for a weighted average of 0.7. They note that they have deliberately selected multipliers at the "conservative" end of the range in the academic literature.[13]
- In Dr Gruen's analysis and in my own analysis discussed above, the multipliers were 0.6 for the cash payments and 0.85 for the investment spending, for a weighted average multiplier of 0.7.[14]
- The IMF's specific work on Australian multipliers assumes a multiplier for the cash payments of 0.54, and for public investment spending of 1.37 – this would translate to a multiplier of approximately 1 for the Australian stimulus.[15]

Chart 2:



In this company, a multiplier of 0.18 is an outlier – lower than even the IMF's low case for the G20 as a whole (and *much* lower than the OECD and IMF estimates for Australia specifically).

This comparison doesn't surprise – the idea that four-fifths of a total stimulus of $40 billion would not make its way through into economic activity stretches credulity in all but the most extreme circumstances, and in fact, the extreme circumstances in this case suggest *higher* fiscal multipliers, not lower ones: Spilimbergo, Symansky and Schindler have a useful survey of the literature, prepared as an IMF staff note in May of 2009. Their summary suggests multipliers will be higher when the following conditions prevail:

1. Cash payments are targeted towards liquidity-constrained consumers;
2. The post-stimulus fiscal position is sustainable;
3. The ratio of government spending to tax cuts in stimulus is relatively large;
4. The economy is relatively less open to trade;
5. The output gap is large and monetary policy is accommodative; and
6. The marginal propensity to consume is high.[16]

Australia fulfilled all of these conditions during the crisis period: conditions (1) and (2) are undisputed. On (3) and (4) though it may surprise many Australians to hear it, the OECD judges Australia's fiscal stimulus to have been the "clear exception" in the high proportion of the package devoted to government spending, and also concludes Australia is the third-least open economy in the OECD.[17] On condition (5), cash rates fell dramatically through the crisis period and growth (as noted above) was below trend. On condition (6) retail sales surged in December 2008 as the cash payments first hit[18] and household consumption was a strong contributor to GDP growth in calendar 2009.[19]

Clearly, a multiplier of 0.18 is implausibly low given both the estimates of respected international organisations and Australia's economic circumstances of the time. From this, we can conclude that fiscal stimulus was indeed critical in keeping the Australian economy in positive growth through the crisis period.

A further very important point: the analysis here has asked whether fiscal stimulus made the difference between positive and negative growth. That is important for the technical debate about whether or not there would have been an Australian recession without fiscal stimulus, but of course the intent of policymakers should never be to get growth as close to zero as possible.

If fiscal stimulus was overdone, as many critics argue, it is incumbent on those critics to explain why growth of just 1.7% between September 2008 and December 2009 is too high and should have been lower. Such an explanation should also take account of the fact that unemployment rose by 1.1 percentage points over this period.[20]

1.2 Evidence from the drivers of growth

As a final point, the path of GDP with and without fiscal stimulus is of course critical, but it is also important to cross-check whether stimulus affected the economy's growth pattern in the manner we would expect it to, given the sectors it targeted.

Tony Makin has offered a criticism here, namely that "federal public investment *actually contributed negatively* to total expenditure over the critical December 2008 and March 2009 quarters" (italics his).[21] This is correct, but is also an unusual criticism to make of stimulus for two reasons:

(1) There was no substantial public investment spending announced until the Nation Building and Jobs Plan in early February 2009[22]; and

(2) The vast majority of the public investment spending was transmitted through the States, so we wouldn't expect it to show up in the federal spending line.

And in fact, when we consider the effect of the investment spending both in terms of the intended timing and the transmission mechanism, the December quarter 2010 national accounts show that total public gross fixed capital formation contributed 1.2 percentage points to growth of 1.7 percent over the last three quarters of 2009 – the largest contribution of any category.[23]

Makin also argues the cash payments were ineffective in boosting household consumption. He points to a weak result for consumption in the December quarter of 2008 (since revised to an actual negative). This also is a curious criticism, given the Economic Security Strategy (ESS) bonuses were not paid until mid-December, when that quarter was virtually over.

If we look forward to the next few quarters – to where the literature on cash transfers would expect these bonuses to have an effect – household consumption rises modestly in the March quarter 2009, but then jumps substantially in the June quarter (when the tail end of the first set of cash payments overlaps with the start of the second) and contributes 1.1 percentage points over the last three quarters of 2009.[24]

Finally, Makin argues the most important factor protecting Australia from recession was the performance of net exports, driven by the falling exchange rate in late 2008 and early 2009. In particular, he cites the "sustained demand for commodities from key Asian trading partners, including China" during the December 2008 and March 2009 quarters.

In fact, it is incorrect that commodity exports to China held up through this period: Australia's merchandise exports to China fell by almost one third from October to November 2008. They did not recover this level until February of 2009.[25]

This has become a common fallacy of many accounts of this period, of a piece with the oft-repeated argument that the mining industry saved Australia from recession. As former Treasury Secretary Ken Henry has pointed out:

> *In the first six months of 2009, in the immediate aftermath of the shock waves occasioned by the collapse of Lehman Brothers, the Australian mining industry shed 15.2 per cent of its employees. Had every industry in Australia behaved in the same way, our unemployment rate would have increased from 4.6 per cent to 19 per cent in six months.*[26]

This point is reinforced, for example, by the experience of Western Australia. Its heavy reliance on mining industry employment saw its state unemployment rate more than double from a trough of 2.3% in October 2008 to 5.7% in September 2009.[27]

In fact, of all the meetings I recall in late 2008 with businesses telling us of their plans to lay off workers, it was the ones with the major miners that were the most distressing, both because they came first and because of the numbers of workers involved (in the tens of thousands).

1.4 Evaluating the criticisms of fiscal stimulus

As the final part of this analytical section, I evaluate the criticisms of fiscal stimulus. I will focus on the criticisms of academic economists, since these were made with accompanying predictions and evidence we can evaluate, and were generally picked up in political debate at the time.

I will also place more weight on criticisms offered at the time the stimulus decisions were being made, rather than those voiced many months or even years later. These critics were working with the same set of facts the government was working with, and their judgments can be assessed in the light of subsequent events in the same way government judgments are.

In this section, I want to document these as clearly as I am able, and evaluate how accurate they turned out to be. I should for the sake of completeness note that many academics and commentators (clearly a majority) broadly supported the government's intervention, and still do. In summary, there were six key criticisms:

1. That stimulus was too large;
2. That cash payments would be ineffective;
3. That permanent tax cuts would be preferable;
4. That fiscal stimulus would be negated by higher interest rates;
5. That the government's forecasts were unrealistic; and
6. That no cost-benefit analysis of stimulus was performed.

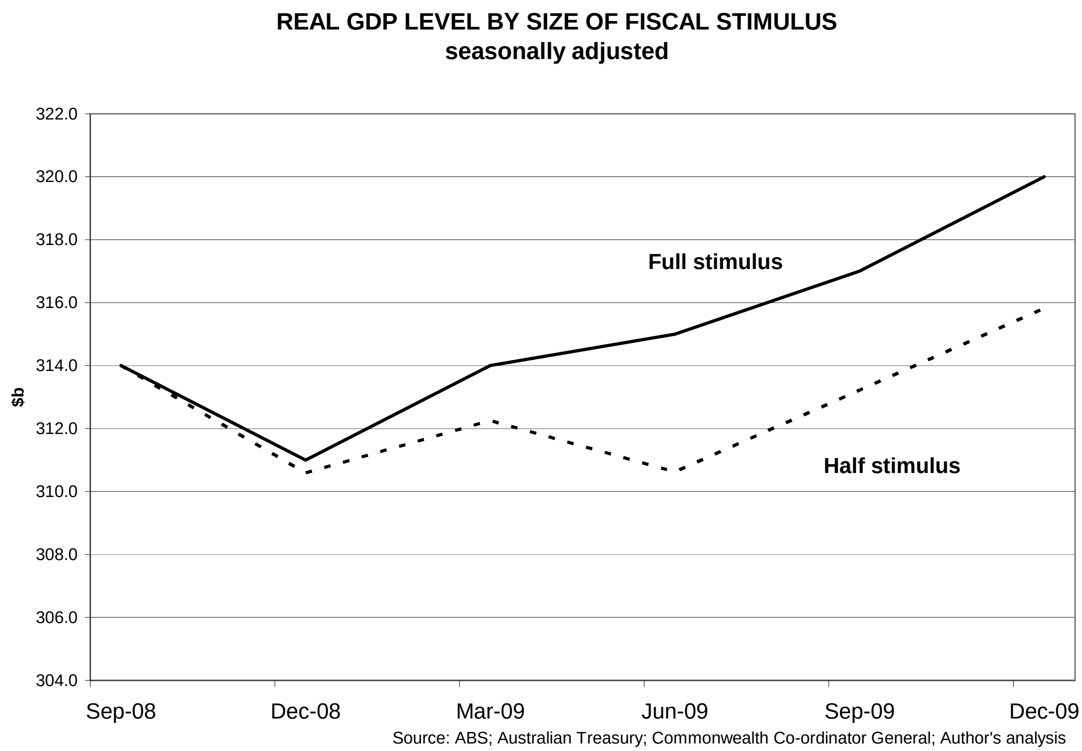
1.3.1 Fiscal stimulus was too large

This criticism was most extensively documented by Warwick McKibbin in his testimony before the Senate Committee on Finance and Public Administration on 9 February 2009. At that time, he argued that the package was too large, and should be below the 2% of GDP recommended by the IMF.[28] This in turn followed his general view at the outset of the crisis that it would be mild, and largely confined to the United States.[29]

This goes to the core of a critically important issue for the policy response. For the sake of a simple comparison, I produce below another version of **Chart 1** above which tracked the path of GDP before and after stimulus. I have done nothing to this chart other than halve the effect of the stimulus to simulate a smaller package and see what it does to growth.

As in **Chart 1**, the picture below is the *level* of GDP, and the estimated impact of stimulus, and we can see the GDP *growth* impact from the slope of the different lines. The "full stimulus" solid line is the actual path of GDP. The "half stimulus" dotted line shows what GDP might have been with half the stimulus. What we see are two quarters of negative growth – a downturn of 1.1% in the December quarter 2008, and -0.5% in the June quarter of 2009. Even though these quarters are not consecutive, they are substantial downturns nonetheless. Unemployment would unquestionably have been higher (and it rose substantially anyway). Furthermore, this portrayal is optimistic: relationships are rarely linear when we are dealing with such powerful confidence effects. There are good reasons to believe that half the stimulus would have had much less than half the effect, with even lower growth and higher unemployment as a result.

Chart 3:



This point is fundamental because the purpose of intervening in the economy was not a form of statistical target practice to get growth as close as possible to zero.

Given Australia's very strong fiscal position entering the crisis, and the large external demand shock about to hit the Australian economy, policymakers were rightly focused on the risks to growth and employment.[30] As noted above, the economy grew just 1.7% from September 2008 to December 2009 even after the large fiscal stimulus. Unemployment rose by 1.1 percentage points.[31] Had stimulus been smaller, growth would have been further below trend and unemployment higher still. Criticisms of the size of the stimulus package would make more sense if growth had risen above trend during 2009, and inflation had risen. Neither of those things happened. In fact, there was very strong *downward* pressure on inflation: the Reserve Bank's measures of underlying inflation are falling through this period.[32] By the time growth returned to trend, the effect of the stimulus package wind-down was actually *detracting* from growth, as it was designed to do.

As I discussed earlier in this paper, in Senate testimony in September 2009 after the fiscal stimulus had been put in place, McKibbin submitted modelling to show that much less stimulus was required in Australia than elsewhere. This paper, co-authored with Andrew Stoeckel uses a model of the global economy to simulate the effects of the global financial crisis on different countries, including Australia.[33] They administer a number of shocks to expected returns on (1) housing investment, and (2) equity investment, and also to (3) household income risk in this model to find the combination which best replicates the observed path of economic activity during and after the crisis.

Outcomes are highly sensitive to whether these shocks are permanent or temporary. In the simplest terms, they find permanent shocks produce a global recession deeper than the actual experience, while temporary shocks produce one that is too shallow. The authors then postulate in a second paper a set of shocks that are initially assumed by economic agents to be permanent, and then turn out to be temporary.[34] They find these track the actual growth path more accurately. McKibbin uses this work to argue that the impact of the crisis on Australia absent fiscal stimulus would have been relatively mild.

This modelling was not public at the time fiscal stimulus was being decided, but assume for the sake of argument it had been, the difficulty for policymakers would have been how much confidence to have in the prediction that the shocks would be temporary, and hence to reduce or eliminate the fiscal stimulus.

The modelling does not purport to answer this – the shocks are assumed, not derived from the model. The critical difference between a deep recession and a mild slowdown is a matter of the modellers' assumptions.

What decision-makers would quite reasonably have asked their advisers for was a theory to explain what might cause these shocks to be temporary rather than permanent. Here, one of McKibbin's occasional co-authors, David Vines, is helpful:

> *…the authors [McKibbin and Stoeckel] suggest that people must have initially thought that the crisis was permanent and then must have changed their minds and decided that it was temporary after all. What led them to change their minds? Arguably, the public-policy responses to the crisis* [35]

This suggests that in fact it was interventions like Australia's fiscal stimulus that caused the shocks to be temporary – which in fact is exactly what the government was arguing at the time.

1.3.2 Cash payments were ineffective

Additionally, McKibbin argued in his February 2009 Senate testimony that since consumer confidence was very low, the government's cash payments were more likely to be saved than spent, and hence should not be made.[36] This prediction did not come to pass:

- Trend consumer confidence (as measured by the Westpac - Melbourne Institute Consumer Sentiment Index) began rising in February 2009 just as this testimony was being given in a long eight-month upswing that took it back to near record highs.[37]
- As noted above, retail sales increased sharply in December 2008 as the first cash payments were made and household consumption was a strong contributor to GDP growth in 2009.

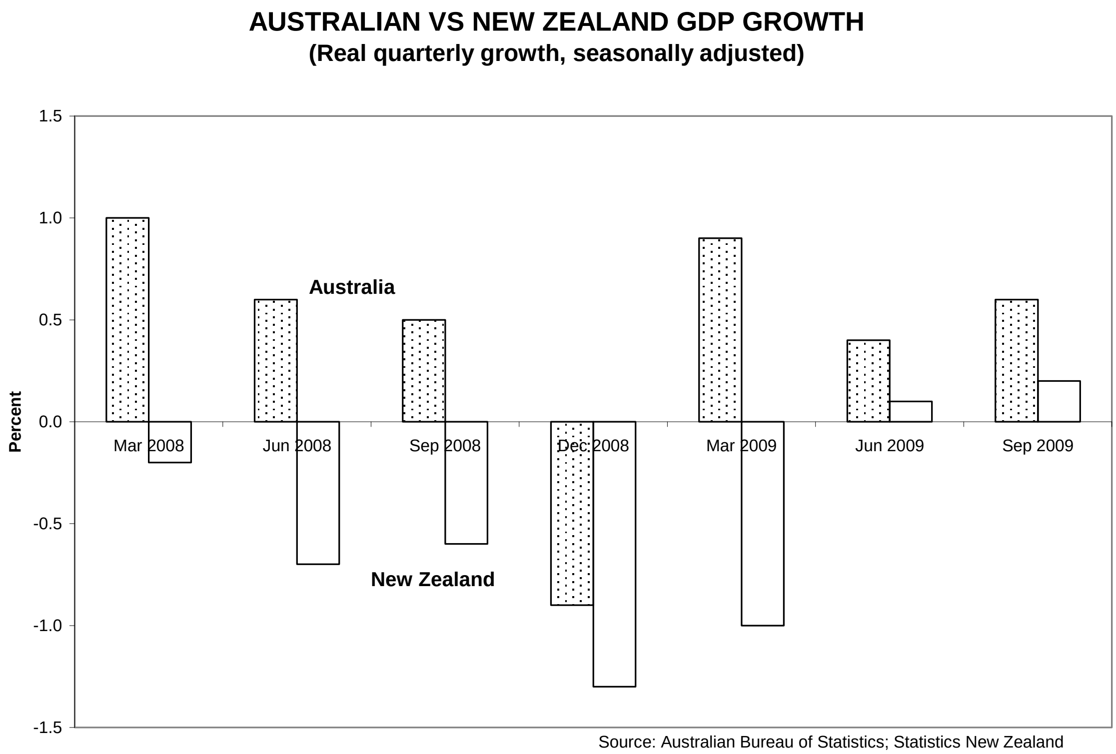
1.3.3 Permanent tax cuts like New Zealand were preferable

The case for permanent tax cuts rather than fiscal stimulus was most strongly made by Tony Makin writing in the *Australian* newspaper in March of 2009. He exhorted the government not to engage in large scale fiscal stimulus, but instead to copy the later and more modest intervention of New Zealand:

> *Rather than following aggregate demand-oriented approaches adopted by the US, Britain and other countries, federal policymakers should look to New Zealand, which so far has avoided measures aimed directly at inflating consumption spending. Instead, the NZ Government has emphasized supply-side measures that will flatten marginal taxes levied on individuals, improve infrastructure and quickly lower the regulatory burden on business.*[38]

With the benefit of hindsight, it is now possible to judge whether this criticism and suggestion to follow the New Zealand example resulted in better growth outcomes there. As can be seen in **Chart 4** below, New Zealand entered a five-quarter recession in March of 2008, during which the New Zealand economy shrank by 3.8 percent.[39]

Chart 4:



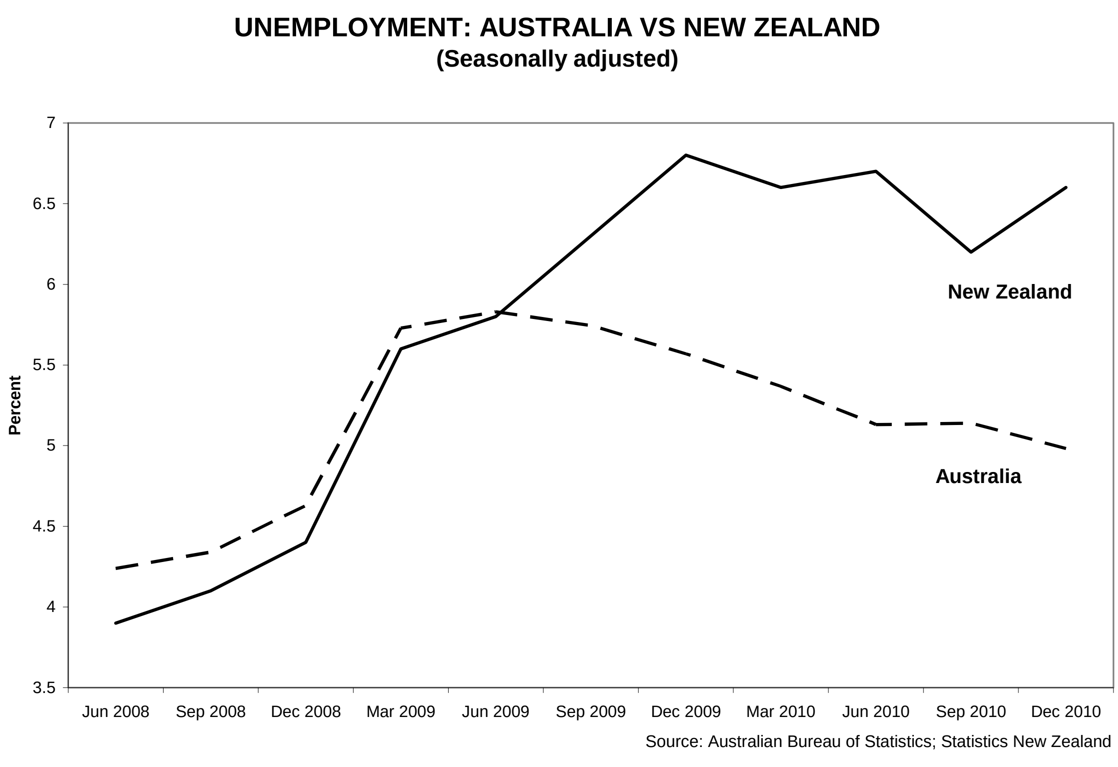
Nevertheless, it must be noted that most of this period of recession in New Zealand pre-dated Makin's article. More interesting were his predictions about unemployment, and praise for New Zealand's response in this context:

> *Unemployment is the scourge of recessions. However, it is the business sector, not households, that ultimately employs most people, creates most of gross domestic product and invests in the economy's future. Hence, it would have been better to assist firms' bottom line directly on the cost side through rapid regulation relief and tax relief, such as payroll tax reduction, than assist indirectly on the revenue side through trickle-down sales.*

Chart 5 below shows the course of unemployment in both countries. Around the time of Makin's article in March 2009, the two countries had very similar unemployment rates. But Australia's rate began to fall very soon afterwards towards 4.9% where it is today, while New Zealand's climbed above 6.5% and remains at that level. Whatever else can be said for New Zealand's approach to economic management, this final comment from Makin's article does not seem to be supported by subsequent events:

> *We all know about NZ's rugby prowess and how often it beats Australia at the game. If we were to score Australia v New Zealand on fiscal responses to the global financial crisis so far, it would be Australia: 0, NZ: 1.*

Chart 5:



1.3.4 Spending would force up interest rates and harm growth

In his submission to the Senate inquiry of September 2009 into the fiscal stimulus, Makin further argues that fiscal stimulus will be self-defeating as the additional borrowing forces up interest rates and punishes private investment.[40] This argument proposes a specific transmission mechanism which is worth examining in context. Makin argues that Australia's additional borrowing to engage in fiscal expansion will push up the interest rate on our debt via the risk premium applied by foreign lenders to Australian borrowings as they increase.

Undoubtedly, a heightened risk premium can apply at higher levels of borrowing, but it seems an extraordinary overstatement to suggest it would apply in any measurable and serious way for a nation accruing such a modest level of debt compared to other countries. For example, the IMF forecasts suggest Australia's gross general government debt (for all levels of government) will grow from $US219 billion in 2011 to $US239 billion in 2015, at which point it will equal 6 per cent of GDP. Over this same period, they forecast US gross general government debt to grow from $US15 trillion to $US20 trillion, and exceed 110% of GDP. The US borrowing requirement would thus exceed Australia's by 250 times over this period.[41]

One would struggle to find another economist who believed the risk premium operated over the section of the supply curve of foreign lenders Australia is operating in. As Reserve Bank Governor Glenn Stevens puts it:

> *I think that if we had much larger debt burdens, like 50 per cent of GDP or something like that, we would see a noticeable premium on Australian debt reflecting that, but I do not really think that one can claim that there is a significant measurable impact on these yields at present.*[42]

The other argument that can be made here is that interest rates could have been cut further if fiscal policy had been loosened by a lesser amount. There are a few problems with this line of argument. The first – which I will elaborate on further below – is that a large part of the fiscal task was to stimulate activity in the period *before* monetary stimulus could take effect. This was based on empirical work showing that it can take on average 15 to 18 months for monetary stimulus to flow through into higher activity.[43]

The second was that the recession itself was caused by a dramatic credit crunch where lack of availability of credit was a far more serious issue than its price, and business and consumer confidence were at extremely low levels. In these circumstances, the effectiveness of monetary policy was potentially impaired.

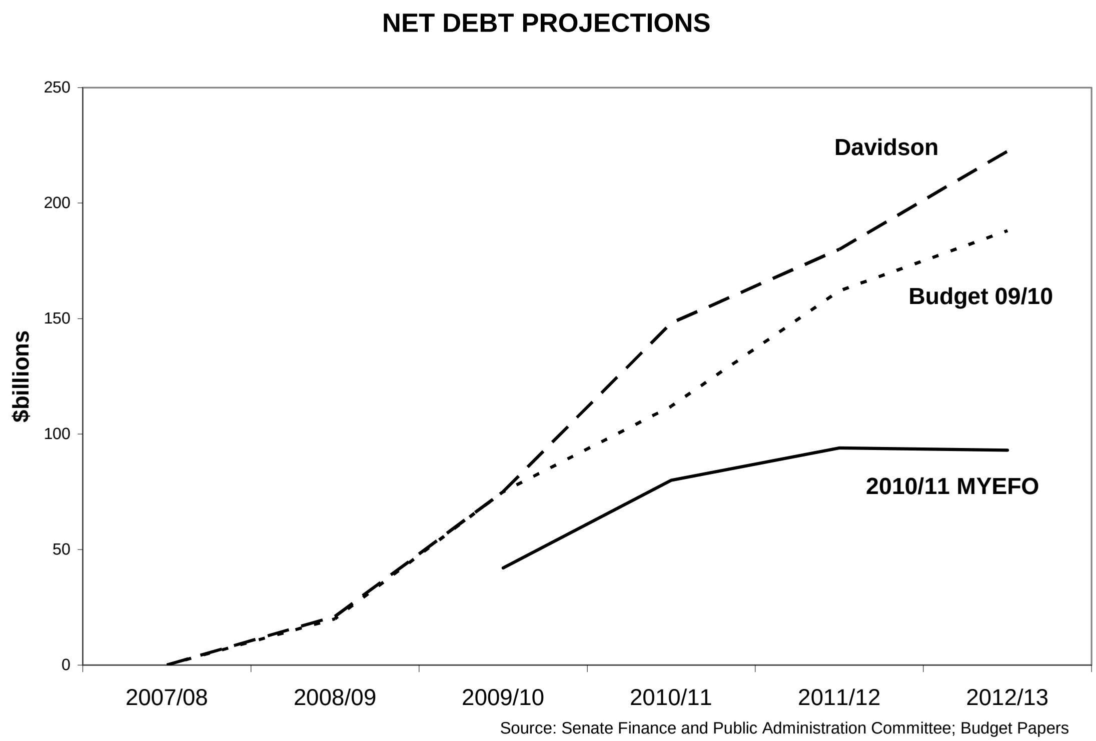
And the third is that the Reserve Bank cut rates very aggressively (by 425 basis points) during this period, and they did not start rising until October of 2009, after the worst period of the global recession had passed, so it is certainly not the case that higher rates impeded the recovery.

1.3.5 Forecasts were unrealistic

A further oft-voiced criticism of the government's policies is that they were based on highly unrealistic assumptions about growth and a number of other important variables. A good example of this is provided by Sinclair Davidson in his submission to the September 2009 stimulus inquiry. He argues that the government's projections for the net debt position resulting from fiscal stimulus were excessively optimistic, and the burden would be nearly $40 billion greater than projected in the budget.

For the purposes of evaluating this claim, I produce below (**Chart 6**) Davidson's projections for net debt, versus what the government projected in the 2009/10 budget. I then add a solid black line (2010/11 MYEFO) showing the actual level of debt in 2009/10, and the forecasts from the latest Mid Year Fiscal and Economic Outlook (MYEFO).[44] As has since become very clear, though the budget projections in the 2009/10 budget were widely criticised as being excessively optimistic regarding the path of recovery, they turned out to be highly conservative, and so far from the path of debt being the one Davidson forecast, it has flattened out and is now projected to be *less than half* the level Davidson forecast for 2012/13.

Chart 6:



1.3.6 Cost-benefit analysis

Finally, there has been some criticism of the government for implementing fiscal stimulus without a cost-benefit analysis, and even some attempts to do so by critics of the government's actions.[45] This criticism is misplaced for two reasons – one theoretical and one practical.

The theoretical objection is that cost-benefit analyses are suited to specific projects where inputs and outputs are easily measured and the causal relationships between them are relatively easily understood. Trying to perform a cost-benefit analysis on what was a step change in the fiscal policy of an entity of the size and complexity of a federal government is necessarily hostage to the assumptions made on the way in.

The practical objection is even more profound in this instance. The idea that the government's first priority before acting should have been a cost-benefit analysis ignores how genuinely and seriously concerning the economic circumstances were at the time. Just two days before we announced our first fiscal stimulus, we had been forced into the extraordinary step of guaranteeing all deposits and wholesale funding for Australia's banks. And this was in a completely sound banking system.

One of the most significant and powerful differences between Australia's response and that of the United States (to take one example) was that ours was much faster, both in conception and execution. This was important for the actual mechanics of supporting aggregate demand, but it was arguably at least as important for reviving consumer and business confidence. Had we been hunkered down in the Treasury conducting a months-long cost-benefit analysis, this precious time would have been lost. And this time would not have been spent in relaxed contemplation – inevitably news of the government's deliberations would have leaked, prompting anxiety and speculation about how bad things were, what we knew, what we weren't telling, and when, finally would we extract ourselves from bureaucratic torpor and just act?

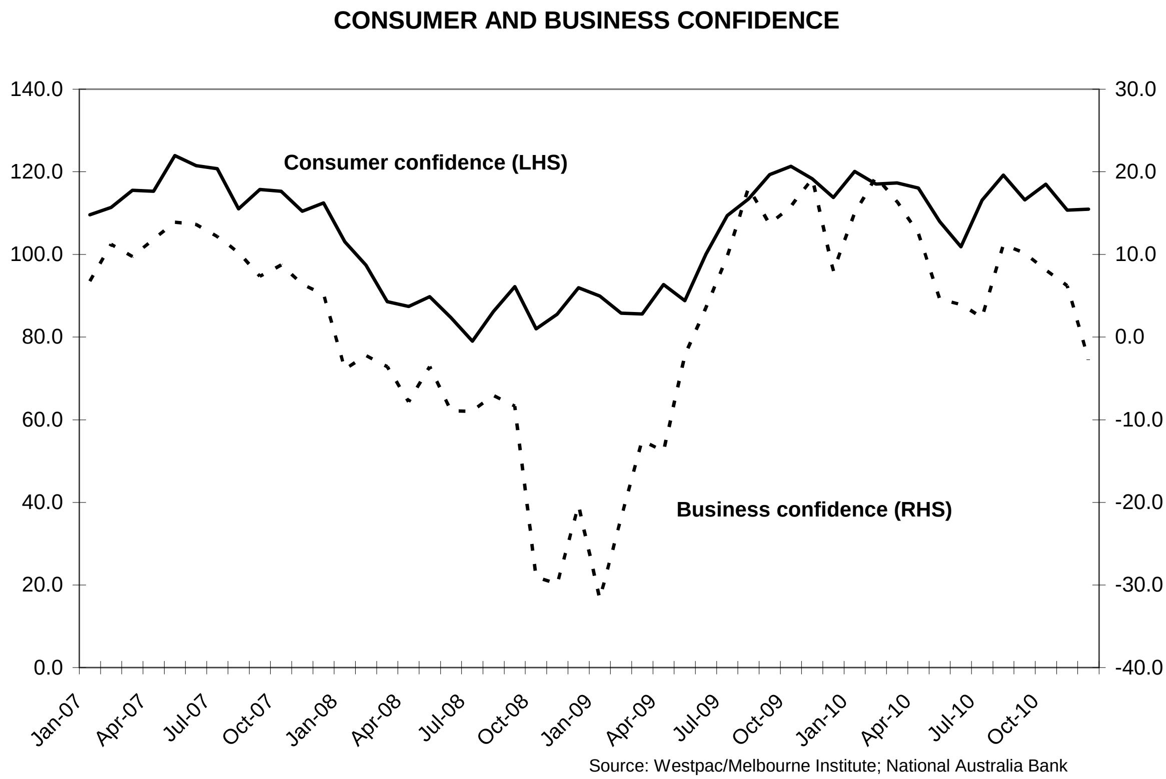
The right cost-benefit consideration at the time had to rely on necessarily subjective and instant judgments about the damaging effects of a loss of consumer and business confidence, and the potential real economy effects of the ructions on financial markets. Sitting around the table at Strategic Priorities and Budget Committee (SPBC) I can attest that this was what all the discussions were about. What – through the fog of such chaotic events – could we anticipate would be the real economy effects, and how could we sustain consumer and business confidence in the teeth of those events?

This leads finally to the problem of bias in the analysis: A cost-benefit analysis conducted many months or even years after the events of that period by its very design excludes one of the most important effects of the government's action – the boost to business and consumer confidence.

There is an instructive difference between the behaviour of consumer and business confidence as shown in **Chart 7**.[46] For consumers, we can see the beginnings of recovery when the cash payments are made in December 2008 and April 2009, but the big surge in consumer confidence comes in June 2009 when the March quarter national accounts show Australia avoiding recession. For businesses, the turnaround comes in February when the Nation-Building and Jobs package is announced. Businesses were effectively told they had a guaranteed pipeline of work whatever the outcome for the global economy and that was enough to impact confidence and no doubt change hiring and spending decisions. When confidence is this responsive to policy announcements and their consequences, delaying stimulus is a significant policy decision in itself.

Unsurprisingly, if confidence effects are excluded from a cost-benefit analysis, that analysis will be fundamentally biased against any government action.

Chart 7:



2. What explains Australia's success?

I now move on to the second half of this paper, namely what factors explain the success of fiscal stimulus in Australia compared to other countries in which it was implemented.

2.1 Documenting the key decisions of the crisis

To explain the success of Australia's crisis response, we must first have an agreed set of facts about which were the most important decisions.

A note before I begin: there have been a number of accounts of this period[47], and mine is narrower in focus than others. It is the account of an adviser, and an adviser essentially within the Treasury portfolio at that. I will necessarily have more insights into, and therefore more to say about, the actions of the Treasurer and his advisers than those of other actors. This is not because I place greater value on those actions, but merely that I saw more of them. For a broader overview, readers should consult Lenore Taylor and David Uren's account of the period: *Shitstorm: inside Labor's darkest days*.[48]

In this brief section, I in fact want to use the Taylor and Uren account as the starting point. I don't propose to re-tell events in any detail here – their book is a readable and engaging assessment of an extraordinary period.

To re-cap, the account tracks our first inkling of the potential dangers of the crisis to a conversation between the Treasurer and US Treasury Secretary Hank Paulson on 10 January 2008. They describe the new Australian government's priority of addressing inflation and capacity constraints in our first budget, and the critical "half-turning" point following the PM and Treasurer's overseas travels in March and April of 2008 when we decided to take out some insurance against a downturn in Australia by not cutting spending as heavily in our first budget.

They then describe in detail the breakpoint of the Lehman Brothers' collapse and the speed with which advice was provided and decisions were made, particularly the short-selling ban, the bank guarantees and the first stimulus payments. They show the PM's strong advocacy of the G20's role as the global steering committee for the crisis response and how influential was the IMF's November 2008 recommendation for a coordinated fiscal stimulus of 2% of GDP. There is an account of the compilation of the Nation-Building and Jobs Plan between November 2008 and February 2009 and then the economic and political results that ensued.

As with any such account, I do have a few differences of emphasis, which I want to mention briefly.

2.1.1 Orthodoxy of inflation first

Firstly, the authors tend to criticise the initial "inflation first" approach of the government in light of the global downturn and emergency response that then ensued.

Judging by the more reasonable standard of what we did with the information available to us at the time, it was eminently sensible to focus intense effort on inflation. It had accelerated beyond the Reserve Bank's target band and was showing no signs of coming back to earth. Government spending may not have been the biggest contributor to this, but it certainly didn't help: real spending had grown by an average of 3.6% a year over the previous 5 years.[49] Moreover, as noted by most commentators at the time and since, much of it was of conspicuously poor quality. The agenda outlined in the Prime Minister's speech in Perth on 21 January 2008 to combat inflation was orthodox, correct and indeed, noted as such by commentators at the time[50] (who were nevertheless skeptical we would deliver on it).

This speech was important in multiple respects. To begin with, it staked out the government's determination to make economic management the bedrock of the new Labor government. Secondly, it neatly framed a departure in economic strategy from the reform torpor of the previous government. A focus on inflation was not only justified in its own terms, it also provided a strong framework for a number of policy initiatives we believed important for Australia's economic future, particularly investment in infrastructure, skills and education. Thirdly, it set our course for the forthcoming budget and allowed us to enforce good fiscal habits on portfolios which would otherwise have spent all the surplus several times over on projects stored up for a new administration.

Probably the best way to judge the strategy at the time is to ask what the reaction of economists and commentators would have been had we not embarked in this direction. It would, of course, have been deeply critical, and rightly so.

2.1.2 Stimulus design and fiscal consolidation

The design of the fiscal stimulus packages also merits some detailed attention. I write elsewhere in this paper of how the success of the stimulus package depended critically on its speed of introduction because I believe this was the most important implementation factor. Taylor and Uren rightly emphasise this too. But we must not overlook two further design elements which quietly accomplished two critical tasks.

The first of these was the very difficult transition between supporting consumption through cash payments and supporting investment through public infrastructure spending and private investment incentives. Cash payments sustained retail sales and consumption through the first half of calendar 2009, and then phased down as the infrastructure spending was able to ramp up from the midpoint of the year. The fact that growth held up over this period, while the stimulus switched from what internally we used to call the "carbohydrates" of stimulating consumption to the "proteins" of stimulating investment is the great success of this design.

The second vital design element was the way stimulus phased out of the budget over time. Other than the lags putting stimulus in place, the chief problem with Keynesian demand management is its asymmetry with respect to the economic cycle. Put simply, it is easy to put in place and hard to remove. Too often, fiscal stimulus simply ends up locked into the spending base, endlessly ratcheting up spending and debt. The Treasurer was determined not to make this mistake. His internal mantra to us and to his officials was that if we were going to be Keynesians in the downturn, we had to be Keynesians in the recovery.

We were careful to design a stimulus that phased down over the same time period we were expecting the recovery to take hold.

It worked. There is a remarkable result in the most recent national accounts. Growth in calendar 2009 was 2.6%. This is just below trend, but by my calculations, fiscal stimulus contributed the lion's share, just over 2%, to this result. Growth in calendar 2010 was 2.7%. Almost exactly the same as 2009, almost at trend growth, and yet fiscal stimulus *detracted* just under 1% from this result. For growth to stay steady between these two years with such extraordinary gyrations in both global growth and the effect of fiscal stimulus is a remarkable endorsement of how stimulus was designed. [51] (And for those who say stimulus should have been withdrawn more quickly, the question must be how much below trend they would have liked the economy to grow in 2010.)

The Treasurer was also insistent that we would not lock in the stimulus and then work out how we did fiscal consolidation later. This meant that on the very same day we announced our major stimulus package, we also announced a very strict fiscal strategy that would return the budget to surplus:

- Allowing the budget automatic stabilisers to work while the downturn proceeded;
- Only allowing additional spending where this administered timely, targeted and temporary stimulus to the economy;
- Offsetting all other new spending with spending cuts elsewhere;
- And when the economy began to grow above trend, banking all upward revisions in revenue, and holding real growth in spending to 2 per cent a year until the budget returned to surplus.

This was our solution to the problem that has bedevilled every economy to have implemented fiscal stimulus during the crisis – how to commence fiscal consolidation without choking off the recovery – but unlike other countries, we mapped out our path back to surplus *at the same time as we entered deficit territory*, not afterwards.

Not only did this provide a clear and consistent stance of fiscal policy for markets (and ratings agencies!) but the strategy has been followed in successive fiscal statements, and the results have surprised on the upside: the initial projection of a return to surplus in 2015-16 is now projected to be beaten by three years.

Also unlike other countries, our rule was set at the outset as a *contingent* rule, in that it designed the fiscal consolidation to be sensitive to the state of growth in the economy. While growth was below trend, the automatic stabilisers and fiscal stimulus would support growth. Once growth was above trend, the automatic stabilisers would be subtracting from growth, and the phase-out of fiscal stimulus would too.

This is how Australia has been able to effect a dramatic fiscal consolidation (currently projected to be a turnaround of 4.5 percentage points of GDP in the underlying cash balance between 2009/10 and 2012/13) without harming the economic recovery.[52]

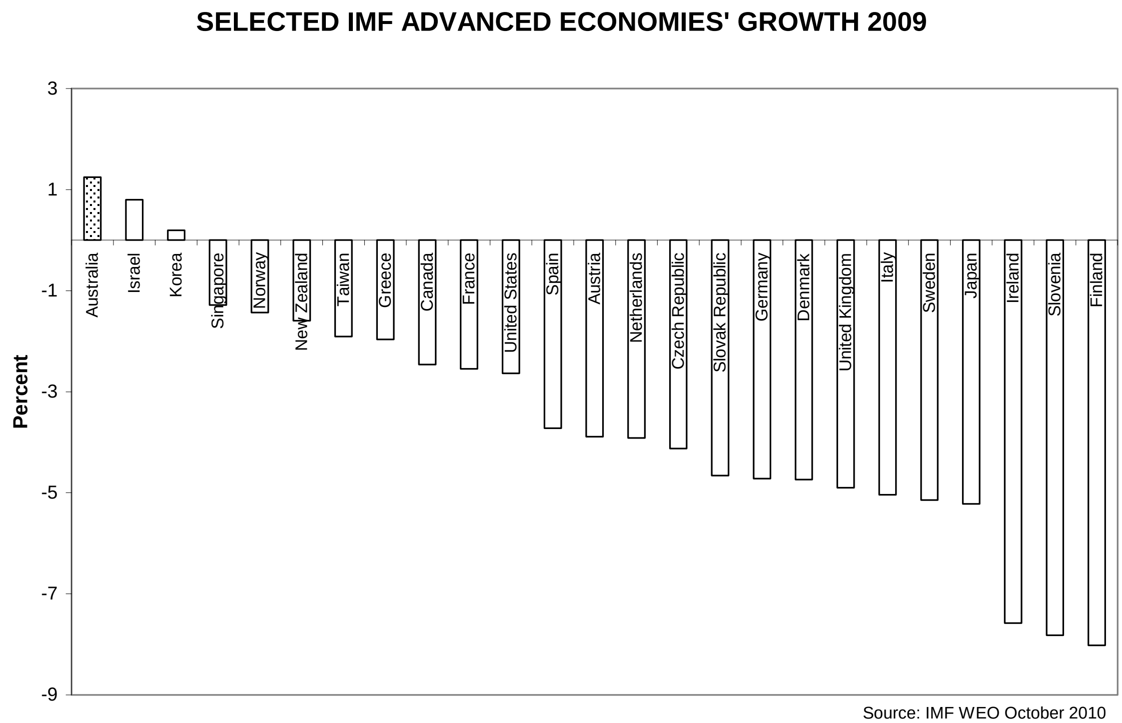
The United Kingdom is an example of a country that has taken the more rigid approach of locking in a fixed fiscal consolidation timetable without regard to the state of growth. Current projections show a slightly smaller fiscal consolidation than Australia's from 2009/10 to 2012/13 (3.1 percentage points of GDP), but a very difficult growth picture, with growth turning sharply negative in the final quarter of 2010.[53]

2.2 The key factors underpinning Australia's success

In this final section, I will offer a view on why Australia's fiscal stimulus was more successful than that of other countries.

Australia outperformed the rest of the developed world during the Global Recession (see **Chart 8** below) this much is uncontested and uncontroversial.

Chart 8:



As I have shown above, fiscal stimulus was a necessary condition for Australia's avoiding recession. The more challenging question to answer is how fiscal stimulus (which after all, was used in many countries) can have prevented an Australian recession, when it apparently failed to prevent one elsewhere. Was it simply a matter of good luck, or were there distinctive features of Australia's response that made it more successful?

Part of the response must be that while fiscal stimulus may not have prevented recessions elsewhere in the world, it helped to significantly reduce the economic damage and assist in more rapid recovery. Especially in those countries whose financial systems were seriously impaired, the economic shock was simply too great for fiscal stimulus to counteract fully. This should not be seen as a failure of fiscal policy, rather of the poor regulation and other policy errors that led to financial collapses in the first place.

In my view, there are three elements that explain the better outcome for fiscal policy in Australia's case.

1. The first is a better policy response to the crisis itself.
2. The second is a better starting position, courtesy mostly of effective economic policymaking in the decades leading up to the crisis.
3. The third is good fortune, independent of any Australian action.

Let me deal with elements (2) and (3) and move on to a longer examination of element (1).

2.2.1 Better starting position

Australia entered the crisis in a relatively strong economic position. The major problems facing our economy – capacity constraints, overheating and rising inflation – were in fact helped (though not in any way we would have wished) by the onset of global recession.

But as the crisis hit, Australia had a number of advantages, chiefly:

- Good financial regulation that had avoided a run-up in subprime loans and large derivatives exposures for Australian banks;
- A flexible exchange rate that could help absorb a large external shock;
- A flexible labour market that allowed working hours to absorb much of what would otherwise have been job losses;
- A strong fiscal position that allowed a substantial fiscal response; and
- An independent central bank that rapidly cut interest rates and made other policy accommodations.

This is an impressive legacy of more than two decades of economic reform, so could these have been the decisive factors in Australia's avoiding recession? It is important to examine two other economies to find the answer: Canada and New Zealand. Both these countries enjoyed all the advantages listed above and yet both suffered much more significantly than Australia during the crisis. Canada's economy shrank by 3.3% between the December 2008 and June 2009 quarters, and New Zealand's by 3.8% between March 2008 and March 2009.[54]

There are a number of factors underlying each country's performance: Canada was unquestionably harmed by its close economic relationship with the United States, and that country's very deep recession. New Zealand did not benefit to the same extent as Australia from China's fiscal stimulus. Yet both countries' experiences strongly suggest that the quite unusual combination of structural economic advantages Australia enjoyed on the eve of the crisis were not decisive on their own for Australia's outperformance.

It will also be said that both Canada and New Zealand implemented fiscal stimulus packages, so by the same logic, these cannot have worked to prevent a recession in their cases either.

Canada did announce fiscal stimulus in late January of 2009 (and indeed of a similar size to Australia's), but it needs to be noted that this was more than three months after Australia's first package, and crucially, not until halfway through their three-quarter recession. New Zealand is a starkly different case. It essentially sold existing plans to cut taxes as stimulus, and in fact made a virtue of not introducing a fiscal stimulus package in the mould of those in the United States, Australia and elsewhere.[55]

2.2.2 China

David Gruen sums up the influence of China on Australia's growth performance pithily to Taylor and Uren: "Thank goodness the Chinese bought the Keynesian story".[56] The Chinese package, announced on 9 November 2008, was to inject around $US600 billion into the economy (accompanied by a very significant expansion of bank lending). It was not just the size of this package that was beneficial for Australia and the whole region, but the focus: on infrastructure projects, housing and rebuilding after the Sichuan earthquake – in short, on investments very likely to increase the demand for Australian commodities.

If the benefit to Australia was so substantial, then we are faced with an intriguing question: could Australia have benefited by "free-riding" on the Chinese stimulus, and should we have done so, given the Chinese package was announced before our second stimulus package?

This was a question we did grapple with at the time, but which decision-makers ultimately rejected for two specific reasons. Firstly (and it is very easy to forget this from today's vantage point) there was widespread skepticism within government and more generally at just how much real stimulus there was in the Chinese announcement.[57] Secondly, Australia faced some very specific weaknesses in domestic sectors (especially in construction) that would not be assisted by the Chinese stimulus, and would likely add significantly to unemployment.

The analysis of the impact of stimulus detailed in Section 1.1.1 above provides a good sense of where “free-riding” on the Chinese response would have left Australian growth, namely in a recession, albeit a shallower one than would have been the case without China’s stimulus. Regrettably, Chinese stimulus was not sufficient to fill the Australian output gap.

2.2.3 Better crisis response

In this section, I ask what was distinctive about the Australian response that might have contributed to an outcome so significantly better even than other economies with good pre-crisis starting positions?

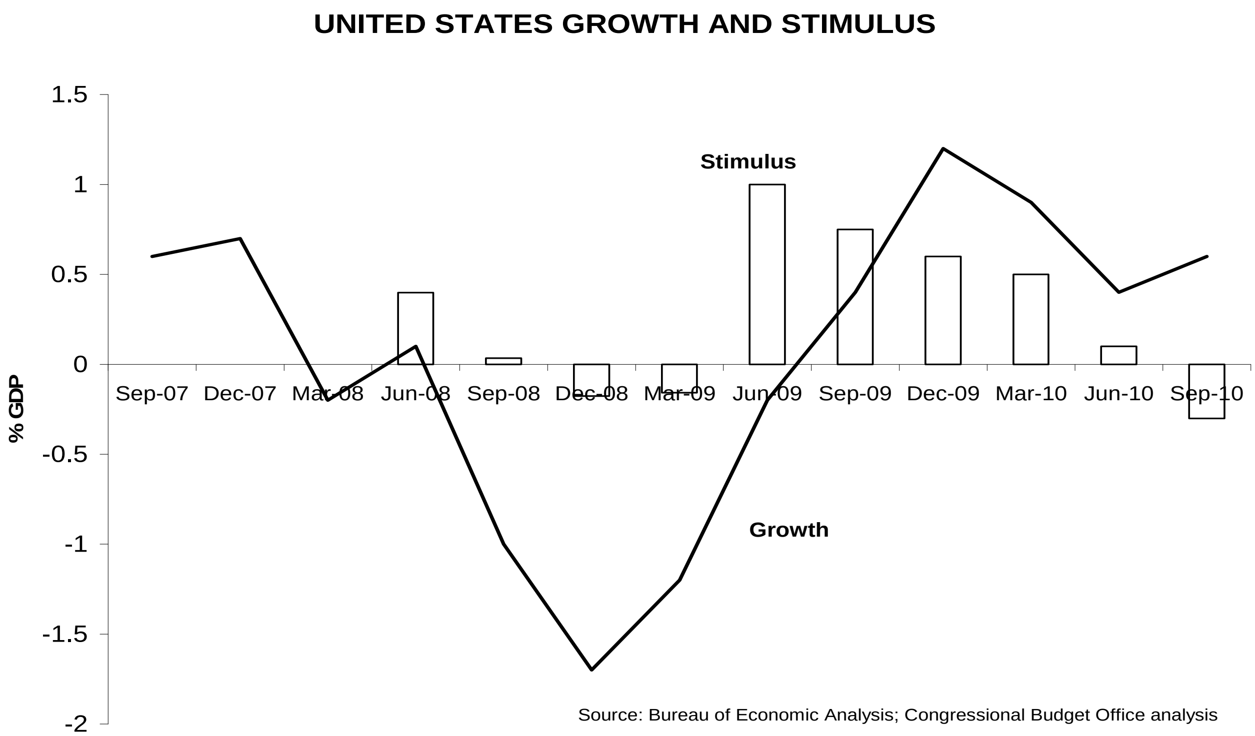
A useful framework for thinking about this is through the standard (and still highly relevant) critique of Keynesian demand management as it relates to the decision-making process. Such critiques focus on three lags in particular:

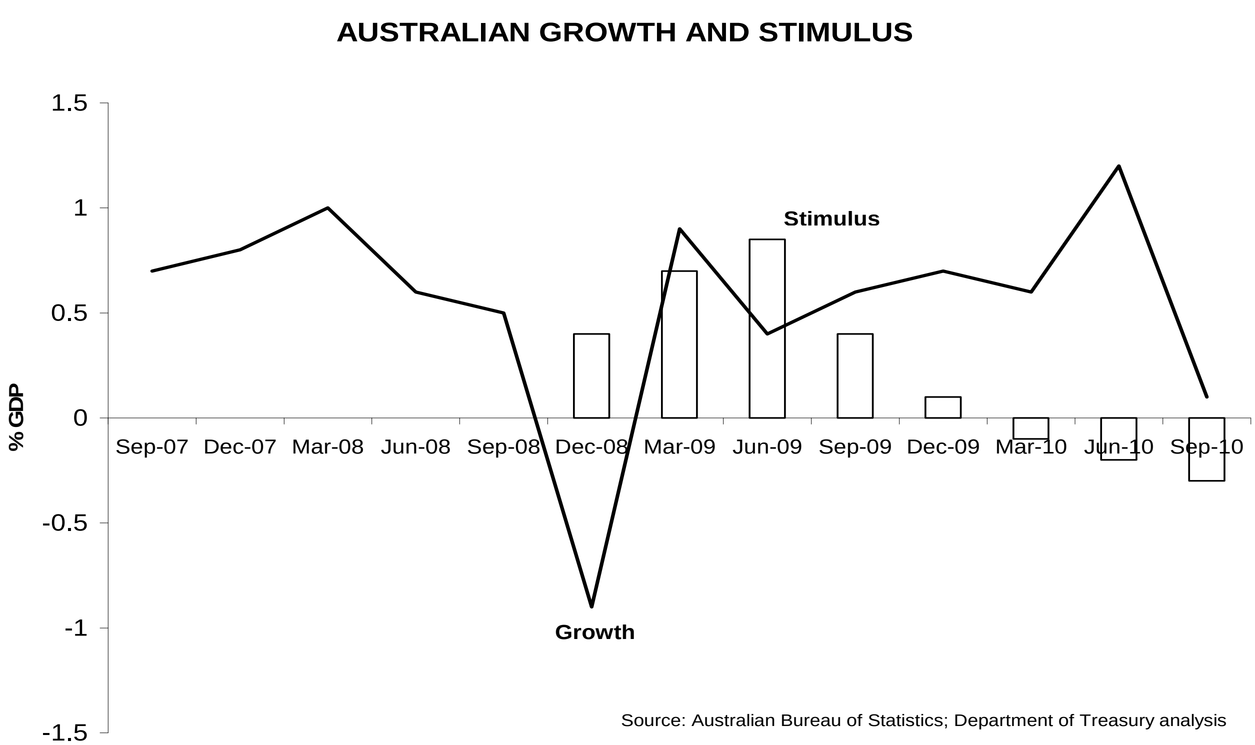
1. The <u>recognition</u> lag, measuring the time it takes for decision-makers to decide a slowdown or recession is in prospect, requiring a fiscal policy response;
2. The <u>decision</u> lag: the time it takes to decide on what the response should be, and to get any associated legislation passed; and
3. The <u>implementation</u> lag: how long the government takes to implement the chosen policies.

As this critique suggests, the main problem with demand management via fiscal policy is one of reaction time, and indeed, I believe it is the most important success factor in the Australian case.

Let me demonstrate the timing issue: I have charted below the growth figures for both the United States and Australia during the global financial crisis (the solid black lines), and then overlaid the estimated impact of stimulus (columns) from the Congressional Budget Office in the US case and from the Treasury Department in the Australian case.[58] I have calculated these as quarter-on-quarter (not annualised) movements, according to the Australian practice.

Charts 9 and 10:





Two things emerge from this simple comparison. Firstly, growth and stimulus appear to rise and fall together. This is unsurprising, given (1) it is the actual intent of the fiscal intervention and (2) the interventions themselves are large (up to 1 percent impacts on quarterly GDP growth).

The second thing that emerges is the very significant lag in fiscal action in the US case. The National Bureau of Economic Research (NBER) – the body tasked with dating recessions in the US – now concludes the recession began in December 2007. [59] And yet the chart makes it clear that a sustained fiscal response sufficient to support economic growth did not take effect until the June quarter of 2009 (having passed the Congress in February 2009). There was certainly a fiscal response in the form of the Bush Administration temporary tax rebate in May of 2008, and this can be seen in the June 2008 quarter blip on the chart. Growth was even mildly positive in this quarter, but the one-off nature of this intervention then naturally detracted from growth in the December quarter of 2008, unwittingly deepening this phase of the recession. All told, there were 14 months between the US economy's entry into recession and the passage of a substantial and sustained fiscal stimulus (which then took another several months to flow through into growth).[60]

The Australian story is very different. The economy never entered recession, but did experience a very sharp downturn in the December quarter of 2008. Initial stimulus (cash payments) was paid out in that same quarter (albeit only at the very end) and a further and more substantial one (the Nation-Building and Jobs Plan or NBJP) was passed in February 2009 and took substantial effect from the June quarter of that same year. As it happens, fiscal stimulus for all intents and purposes arrived at the same time as the downturn, and stayed long enough to see it off.

In fact, government – in the form of the Strategic Priorities and Budget Committee of Cabinet (SPBC) was in a position to make a decision on the ESS stimulus package over the weekend of 11 and 12 October, just four weeks after the Lehman's collapse. This first stimulus was announced on 14 October, was passed by the Parliament on 24 November, and the first payments were made on 8 December.

Crucially, work started on a further, larger and more sustained stimulus package immediately after the first one was decided in October. This continued through the Australian summer, culminating in the announcement of the $42 billion NBJP on 3 February 2009. This was eventually passed (largely unamended by Parliament) on 13 February, and the first payments were made from mid-March. What this meant was that within about three months of the first stimulus payments being made, the second tranche was hitting recipients' bank accounts. Given the usual assumption that stimulus payments in one quarter continue to support consumer demand in the following *two* quarters, the second stimulus package was already starting to flow before the effects of the initial smaller one had passed.

By contrast, if the critical decision-making meeting in Australia was over the weekend of 11 and 12 October 2008, the American version of this meeting didn't occur until Tuesday December 16 in Chicago. This was the date President-Elect Obama met with his incoming economic team to discuss a memo compiled by Larry Summers providing a comprehensive review of the economic situation and recommending a stimulus package and the elements it should include.[61] The American Recovery and Reinvestment Bill was introduced (first in the Senate) on January 6 of 2009 and the Conference Report was passed by the House and Senate on 13 February. The first funds from the Act began flowing in March of 2009.

There are many reasons for this speedier and more effective Australian response, and many of them have to do with Australia's good luck (or America's bad luck) depending on how one looks at it: Australia did not have the issue of national elections and a change of administration in the middle of our crisis response. Nor were our decision-makers overwhelmed by the difficulties of our financial sector – they had time to focus on the real economy effects.[62]

But Australia's response was not just faster than in the US. It was faster than any number of countries without the US's problems. And it was put in place in the absence of data showing an impact on the real economy. So what are some of the factors that explain Australia's speedier and more effective response?

There were in my view five elements of Australia's response that worked to reduce the lags inherent in fiscal stimulus. Three are specific to the lags themselves and a further two to the response in general:

<table>
<tr><th>Lag</th><th colspan="2">Feature of response</th></tr>
<tr><td>Recognition</td><td>Early warning systems and institutional linkages</td><td rowspan="3">Corporate memory

Policy responsiveness of new administrations</td></tr>
<tr><td>Decision</td><td>Preparatory work</td></tr>
<tr><td>Implementation</td><td>Implementation architecture</td></tr>
</table>

These are not mutually exclusive, of course. A number feed into each other, and I will simply state that at the outset rather than try to disentangle the different influences as I go along. Let me now discuss these in turn:

2.2.3.1 Early warning systems and institutional linkages

As I have noted above, Australia made the decision to implement fiscal stimulus before any real economy indicators had turned negative. This was a decision with huge economic and political consequences. It was hard for us in government at the time to know what the economic consequences would be. But the political consequences were very clearly and explicitly understood at the time, and all knew they would be negative. Even if such a large fiscal intervention were economically successful, the deficits and the debt that would be incurred (small though they were and are by international standards) would cause political pain for an incumbent government, and particularly for a Labor government.

The most interesting question is how decision-makers came to an agreed set of assumptions (in the midst of such fluid circumstances) to justify such a consequential decision. The answer to this question goes right to the core of the effectiveness of discretionary fiscal policy, and the story is one of intensive international engagement and the institutional linkages that underpinned that engagement.

For all of its history, Australia has been a trading nation, and relatively heavily dependent on the trajectory of economic growth in our major trading partners – in the United Kingdom in the 19th and early 20th centuries, in the United States after World War Two, and latterly in East Asia. Without a substantial domestic market to sustain ourselves, we have long been attentive to economic developments beyond our shores. This is an understandable preoccupation of much of our economic and business journalism, but it is also a strong focus of our politicians and our official policymaking family.

It was certainly a strong focus of the Prime Minister's trip to Washington in late March 2008, and the Treasurer's trip two weeks later. Astute observers of politics would have noticed the Treasurer's language on the economy start to shift in the lead-up to his first trip to Washington for the IMF/World Bank spring meetings on the weekend of April 12 to 13, 2008. The phrase he chose was "countervailing forces", and the idea was to describe what had become a complex and increasingly troubling picture of a very strong domestic economy confronting the downdrafts of the

US slowdown and disruptions on global financial markets. The reason he chose it was that the forthcoming trip had re-focused his attention on the international economy from what had been an extraordinarily intense period of work on the 2008/9 budget, principally focused on cutting spending. The Treasurer recognised the Australian people needed a way of understanding the economic inflection point that may be arriving. Too negative an assessment was (a) not yet justified by events and (b) would not have been believed by Australians generally. Too positive an assessment was no longer quite right.

If this was his view before the trip, the view afterwards was even sharper. It seemed everyone he had met in Washington and in New York was telling the same story, and I heard most of them from the Treasurer and colleagues calling home during the trip. They were all summed up by the comment that most lodged in the Treasurer's mind, when Tim Stewart, a former Australian Treasury official and senior manager with Fortress Investment Group told him that Bear Sterns was not the end of the crisis, it wasn't even the beginning of the end, it was just the beginning.[63]

A number of planned budget cuts were shelved as the government took out some insurance against the crisis that it turned out was just five short months away. The best advertisement for the value of international engagement of this sort is the irritation of those like me who stayed home to work on the budget at having some of our savings proposals put on ice. We'd been buried in lever-arch budget files for so long, we'd missed the crisis just around the corner.

But the April trip was just the beginning of a heavy schedule of international meetings. These meetings are a substantial burden on an already very busy Minister's diary, and they are so much worse for a Minister having to travel from Australia to the other end of the world each time. But the trips to the US in April; to France, the UK, China and Japan in June; to the US again in October; to Brazil and the US in November; and again to China in December (just to list the schedule for 2008) turned out to be vital for staying ahead of fast-moving events.

So too were the regular telephone conversations and meetings with Henry Paulson and David McCormick (Treasury Undersecretary for International Affairs). By my count, he met or spoke with these two a total of 13 times during 2008.

If the April meetings were part of the early warning, the Treasurer's presence over the weekend of October 11 and 12, 2008 in Washington could not have been more important for the decisions government was about to make on the crisis response. To read the Treasurer's notes from these meetings is to be struck by the power of collective realisation among the Ministers and senior policymakers he was speaking with. The notes speak of a "psychology of confusion, frustration and fear" and countries' fates "bound together in a way unimaginable a decade ago". One note simply reads "in September it changed its face and in the last three weeks it's become really ugly". His note on implications for Australia is just six words: "the balance of risks has shifted".

It was this schedule of IMF/World Bank fall meetings (and the emergency G20 Finance Ministers' meeting called by the US to take advantage of Ministers' presence) from which the Treasurer called in to the Sunday morning deliberations of SPBC in Canberra on the fiscal stimulus and bank guarantee packages. It was an accident of timing and circumstance, but to have a senior Minister dial in from the epicentre of the crisis to such a decisive meeting was a remarkable example of real-time policy intelligence that served Australia very well during the crisis.

This all underscores a very important point: the early warning signals in Australia were first picked up by the politicians, rather than their advisers and officials. As Steven Kennedy (an adviser to the PM at the time, and long-time Treasury official) puts it:

> *In a period when events are moving rapidly, leaders often hear about developments before they have filtered through their bureaucracies.*[64]

That said, rapid follow-through and deep engagement at the official level were critical. Some history: senior Treasury people have told me of the periodic debates held at Board level about the true value of Treasury's international engagement. There are multiple demands on the resources that maintain Treasury posts overseas, and improved communications technologies and IT mean that keeping in touch with offshore developments is no longer as difficult as it once was. Yet I've been told each time this is looked at, the Board has concluded that the "long game" of economic policymaking demands having a presence in these bodies. When it comes to getting phone calls returned, and getting serious engagement at busy times, the institutional familiarity and personal relationships built through these postings are critical. They were critical during the crisis. Treasury's relationships were very deep indeed. Five of the six members of the Executive Board at the time of the crisis were alumni of an international economic posting, some of more than one. Personal linkages were broad and of long history. As one IMF official put it:

> *Other countries have long tenure with their economic officials, but there's not the same interaction and closeness. Australian Treasury has good people, and they keep good people, and the informal links are also very good.*[65]

From early in 2008, both the Treasurer and the Prime Minister had tasked Treasury and the Prime Minister's Department with gathering as much intelligence on overseas economic developments as was possible from international networks. As it happened, these requests were being made at around the same time the US Administration perceived the need to consult a wider range of countries on crisis response. Senior people in Australian Treasury started participating in conference calls the US Treasury was hosting with other G20 Treasury departments to provide briefings on major developments in financial markets. This is in fact the earliest indication of the role the US was to give the G20 as the key international decision-making forum during the crisis – US officials simply realised a broader degree of policy consultation was required and the G20 was there to fill that gap, albeit initially only at officials level.

Engagement between Australian officials and the IMF in particular during the crisis was significant.[66] Interviewees have described to me a series of interactions, including:[67]

- Pre-Lehman's discussions with Australian officials on potential vulnerabilities to a sudden disruption of capital inflows such as might arise from the growing global financial market turmoil;
- In October 2008, discussion between Australian and IMF officials of a high-level two-page IMF paper on how fiscal responses to the crisis should be designed, with a focus on public investment spending and transfers targeted to low-income households;
- From the Pittsburgh G-20 Summit in September 2009, the engagement between IMF and Australian officials under the auspices of the mutual assessment process announced at the Summit.

But these interactions are about more than just the content of documents passing back and forth. They are also about ongoing real-time engagement between the two institutions: small differences in timing matter a great deal when events are moving quickly. For example, David Gruen related to me some of the background engagement in early October of 2008. He had participated in one of the G20 conference calls on Friday 3 October (this is just a week before the weekend deliberations on the ESS). John Lipsky of the IMF had advised that the Fund that week (Wednesday 8 October) would further downgrade its outlook for global and advanced economy growth (by virtually a full percentage point in both cases). This was the view of the global economy

Secretary Ken Henry was able to present to SPBC in Brisbane on Tuesday 7 October (ahead of the weekend SPBC meetings) and Dr Gruen had the same overview for the RBA Board meeting he attended on the Secretary's behalf the same day.[68]

Of course, Ministers could have waited until 8 October to read the IMF's release separately and at their leisure, but this underestimates the impact of advance warning, provided to Ministers collectively in a cabinet committee meeting and the power of this in focusing the government's attention and resources at a time when policy reaction time was measured in days, not weeks or months.

2.2.3.2 Preparatory work – financial sector

Once Ministers are convinced of the need to act, there is a separate and just as difficult question of what action to take, and whether the government is in a position to do so. This is where some elements need to be added to the Taylor and Uren account to capture three decisions the Treasurer took in the first half of 2008 directed at providing insurance against the crisis more severely affecting Australian markets.

The first was the announcement on 20 May 2008 that the government would increase the amount of Commonwealth Government Securities (CGS) on issue and also broaden the investment powers of the Australian Office of Financial Management (AOFM).[69]

He couldn't say so at the time, but a major factor in the Treasurer's consideration of both these measures was potential future credit and bond market disruptions. Increasing CGS on issue was important to maintain liquidity in the bond and futures markets, especially assisting the pricing (via their benchmark role) of bonds beyond the short end of the yield curve. He made less of an issue publicly of a much more important move, which was to expand the investment powers of the AOFM. What he specifically had in mind was the potential need for government to be able to purchase Residential Mortgage Backed Securities (RMBS) should it become necessary to intervene to re-open that market (which by then had been shut since late 2007). This was subsequently realised when the Treasurer announced just such an intervention on 26 September 2008 – just 11 days after the Lehman's collapse.[70]

Even more important was the Treasurer's decision, announced on 2 June 2008, but in the works for most of that year, to introduce a Financial Claims Scheme (FCS). The recommendation for such a scheme – to provide timely access to depositors' funds in the event of a financial institution's failure and also to strengthen regulators' powers to deal with a failed institution – had been around since 2003, but the recommendation was controversial within the industry, which disliked in particular the ability to impose a levy on the sector to cover any shortfall in recouping depositors' funds from a failed institution.

The Treasurer had a different take on this. He believed such a scheme was too important to leave in the bottom drawer, and instability on global markets made it prudent to act quickly. The legislation was introduced on October 15, 2008 in the flurry of activity following the bank guarantees announcement, but this obscures a point that those outside government readily underestimate: had the Treasurer not given the go-ahead for this months earlier, the complex legal drafting would not have been completed and refined for introduction of legislation. It would not have been ready when the crisis hit were it not for the Treasurer's decision in early 2008.

There was one other system architecture decision around this time, which was to reaffirm the government's support for the "four pillars" policy preventing mergers between the four biggest banks in Australia.[71] The big banks had long disliked this policy, and there had been effort behind the scenes to make the policy case for its repeal, but more importantly, efforts of which we became aware to challenge it publicly by proposing a merger between two of the four.

This was probably always doomed for a multiplicity of reasons: public sensitivity regarding bank mergers was greater than ever given the travails of the smaller competitors to the big banks and the Westpac/St George merger (which absorbed the 5th largest bank in Australia). But the Treasurer had further reason to be concerned. Reports had been around in the early part of 2008 of unquantified exposures of Australian banks to subprime losses in the United States, and it had proved very hard to get clarity even in private conversations with the banks.

I knew a repeal of four pillars was dead the first time this topic came up in discussions with officials and the Treasurer. If we as government didn't know where the exposures were, did we want two of the four balance sheets merged, or did we want all four separate and hence possibly able to assist in buying a troubled competitor? The question answered itself. As the Treasurer himself said, addressing Parliament on the issue:

> *Quite apart from the need to sustain competition in the banking market, I would not be at all comfortable if the soundness of our banking system depended not on the strength and risk management skills of four banks, but on the strength and risk management skills of a lesser number.*[72]

2.2.3.3 Preparatory work – fiscal policy

A further factor is that the bureaucracy was rapidly able to provide advice to government on precisely which policies to implement. Taylor and Uren mention in their book an intriguing instance of forward planning for potential crisis undertaken by the Treasury in 2004. As Ken Henry tells them:

> *When things are going well it is time to start planning for what happens when things go badly.*[73]

Executive director of fiscal group Nigel Ray also explains:

> *I saw it less as an exercise about having a toolkit, and more about helping people understand what the risks were.*[74]

One consequence of Australia's now two-decade long recession-free run of growth is that many officials are simply too young to remember what a recession feels like. What comes through in these papers is a solid effort to teach officials the history of previous crisis responses and consciously learn the lessons.

The actual papers were not available to Taylor and Uren at the time, but have since been released to me (and others) under Freedom of Information. The papers themselves are inconclusive, in fact, unconcluded. There is a useful primer on the history of discretionary fiscal policy interventions, with a basically sceptical tone (largely justified by the history it is recounting!) as to the utility of attempting to manage the Australian economy in this way.[75]

But there is a more enlightening paper apparently war-gaming a series of possible responses to a slowing economy in the latter half of calendar 2003, written for the Treasury executive board.[76] This paper counsels a three phase policy response to any possible slowdown, commencing with modest cuts in interest rates and a temporary $1-2 billion boost in discretionary spending, then escalating to deeper cash rate cuts of 100 basis points and a discretionary spending boost of half of one percent of GDP. Then if unemployment should reach above 7 percent, a third stage should commence, cutting interest rates by a further 150 basis points and additional stimulus of up to 2 percent of GDP.

This precise "observe over time and respond" counsel was sensible for the circumstances at the time, but of course wholly inappropriate for a scenario developing at the speed of the 2008/9 crisis. That said, the fingerprints of this work show up in a few places in the government's eventual crisis response:

Firstly, the paper is eloquent about the need to move quickly as the economy begins to turn and to be mindful of the slow reaction time in past crises. This was hardly a lesson those in Treasury in the early 1990s had need of learning, and yet it was doubtless very useful for younger officials – which in this case would be anyone under about 45!

Secondly, there is a critical insight about the different speeds at which monetary and fiscal policy can take effect:

> *Changes in monetary policy have an impact on economic growth that is spread roughly evenly over about two years after the change … The impact of fiscal policy can be considerably quicker. Some fiscal policy actions can influence activity from the point of announcement, before they are implemented.*[77]

Compare this very point with the same one made by the Treasurer about the situation the government faced in October 2008:

> *Monetary policy – that is falling interest rates – would provide most of its support for the economy from about the second half of 2009. A falling dollar would do likewise, by supporting exports. Infrastructure spending – even relatively well-scoped projects – would also probably take six months or more to get boots on the ground. So growth would have good support certainly in the second half of 2009. But that left eight long months in between. Eight months in which – if we did nothing – confidence would plunge, jobs would be lost, and businesses would go to the wall. And the question we had to face was how we bridged those eight months? And if the crisis were to last longer – and it turns out it did – how to support growth over a longer timeframe? We also knew that fiscal policy – that is, additional demand through government spending – was the only bridge across those eight long months, and it had to be made to work as much as possible throughout those months.*[78]

It is the essentially counterintuitive logic of this idea that was so influential – the normally very slow-acting fiscal policy instruments can actually provide the fastest stimulus in some situations.

Thirdly, the paper on balance comes down in favour of one-off benefit payments to low income households, and government consumption and investment expenditure, as opposed to tax cuts:

> *Government consumption and investment expenditure have the largest and most immediate impact on the economy with a modest budgetary impact relative to other instruments.*[79]
>
> *Personal income taxes potentially offer the broadest scope to influence economic activity, because they are such a large component of the budget. They have implementation lags that are potentially very short, and their potential for symmetrical application around the economic cycle is greater than some other instruments. However, they have a smaller impact multiplier than spending items as they are an indirect form of stimulus, feeding into disposable income, some proportion of which is saved by taxpayers. As such, they have a smaller 'bang for the buck' in budgetary terms.*[80]
>
> *Benefit payments are likely to have a larger and more timely multiplier effect on economic activity than changes to personal income tax rates of a comparable size, particularly if targeted to low income households.*[81]

It's easy to say much of this was stating the obvious, but that underestimates how contested this view is – witness the academics who still to this day dispute that fiscal policy can be successful. It also underestimates how governments make decisions: given the controversial nature of the advice and the very compressed timeframe in which decisions were being made, it was vital that these policy responses had been thought through and debated within government to make them as robust as possible in the time available. Put simply, had officials not had time to get used to the concept of fiscal stimulus that would be pursued and to probe the best design options, they either would not have been able to advise in favour of stimulus or the eventual design would not have been as effective in economic terms.

2.2.3.4 Implementation architecture

Once decisions were made, smooth and rapid implementation was vital. Australia was fortunate to have an established architecture for rapidly making payments to benefit recipients via the central welfare agencies of Centrelink and Medicare (and the Australian Tax Office for tax bonuses) but no such system existed for infrastructure investments. A big part of the explanation for the speed with which infrastructure stimulus dollars were able to be transferred to the states and local authorities and spent in a timely manner lies in an event just two days after the announcement of the NBJP. On Thursday February 5, 2009, the Prime Minister brought state and territory leaders to Canberra for a Council of Australian Governments (COAG) meeting specifically to agree an implementation architecture for the plan.

This initiative itself arose from the Prime Minister's concern that the large stimulus just announced (a) might be diluted in its impact by process delays at the state and territory level; and (b) might be in part offset by state and territory cutbacks at the same time as the federal government was increasing spending.

As it turns out, experience elsewhere suggests these concerns were well-founded. For example, an NBER Working Paper by Joshua Aizenman and Gurnain Kaur Pasricha suggests the US federal government's fiscal expenditure stimulus was arguably offset in its entirety by declining fiscal expenditure at the state level.[82]

To address the Prime Minister's concern, the Department of Prime Minister and Cabinet devised a management, reporting and monitoring structure to drive the rollout of the key stimulus initiatives, in particular, the school building and social housing programs.[83] Coordinators-General were established for each state and territory, and each of the major stimulus programs. These in turn reported to a federal Coordinator-General. Timelines for delivery and even standard designs were explicitly stipulated, and progress regularly monitored. The payment of stimulus funds was made contingent on timely delivery. Crucially, "maintenance of effort" clauses were inserted into the agreement with the states and territories to prevent them taking their own money out as the commonwealth money was being paid in.

All this architecture was wrapped up in a comprehensive agreement signed by all the state and territory leaders and released publicly. In this way, the Prime Minister ensured state and territory leaders had politically "bought in" to the timely rollout of stimulus. A website was also launched, allowing citizens to monitor progress of projects in their own local area – another source of public pressure to ensure timelines were met.

2.2.3.5 Corporate memory

A further two factors worked to shorten fiscal lags across the board. The first was a strong corporate memory of the last Australian recession among policymakers. Focusing specifically on Treasury, for example, the Department is well known in Canberra for being one that people serve for long periods of their career, frequently in excess of 20 years. The Executive Board, as the chief decision-making body of the Department has an average tenure in excess of 20 years. There would be few if any other Departments in Canberra who could claim this record. Some will see this as an advantage, and others will not, but for the purposes of management during the economic crisis, it had one distinct advantage: most of the senior people advising the Treasurer had been in Treasury (and in one case, the RBA) at the time of the last recession – almost 20 years earlier. One executive director put it to me this way:

> *I was in Treasury during the last recession. Our forecasting group was following the economy down. We never had the right picture of the recession. We were always too late. It was a sobering experience for all involved.*[84]

This was no small matter. It meant that the chief economic advisers to a new government were providing a view through the windscreen of the gathering global recession to policymakers, not a view through the rearview mirror of what we had already hit. The ability to learn from past policy mistakes was a big part of this achievement.

Nor should we discount the memories of the early 1990s recession among the politicians themselves. For example, this is Treasurer Wayne Swan talking about his memories of that recession:

> *… I represent a couple of hundred thousand people in Brisbane where I've lived for most of my adult life. And that adult life includes a terrible recession in the early 1990s. And I still see some of the victims of that recession walking the streets of my community. They haven't recovered. And I haven't forgotten. As you can tell, the impact of recession is quite a*

personal topic for me. But not just for me. It is fundamental to the values of those who form this Labor government.

My generation of economic policy makers learned a lot of our early lessons through the remarkable flowering of economic reform during the period of the Hawke-Keating Labor Governments of the 1980s and 1990s. Then we learned another lesson in the crushing recession that hit this country and so much of the rest of the world in the early 1990s.

In a decade, we learned that a brave government could transform a country for the better, and we also learned that it took years and years to recover from the consequences of recession. When the terrible economic events of late 2008 began gathering pace and closing in on us, we remembered the lessons.[85]

The early 1990s recession was a searing experience for Labor politicians (and many of their staff). We all remembered not only how slow fiscal stimulus was to arrive in the early 1990s (after the recession had passed) but also the very patchy record of labour market programs introduced after the recession to try and reduce unemployment. They were by most experts' agreement expensive, slow to work if they worked at all, and left too many long term unemployed, some of whom never worked again. There was a deep intellectual and policy attraction in getting ahead of the deteriorating economy to see if we could prevent unemployment from soaring in the first place. If there was one constant in all the discussions we had behind the scenes during this period, it was the idea that we must learn the lessons of the early 1990s recession.

2.2.3.6 Policy responsiveness of new administrations

Many of these individual elements may not have been as decisive were it not for a final, and I think critical, factor: we were a new administration.

A new government necessarily assembles facts and questions assumptions differently from an established one. I have no doubt it was much to the frustration of a number of our official advisers, but the Prime Minister and his Ministers were obsessive about getting briefing and analysis on a wide range of economic developments.

A more experienced government would be more concerned about the information overload implicit in a senior Minister wanting to read about the latest gyrations of the Baltic Dry Shipping Index. This is not to say that hypersensitivity to relatively small developments is a good way to run a government, but that it is a quirk of a new administration still trying to sift the important from the unimportant. It just happened to be that the picture that emerged from the small details was alarming – for the good reason that the events just around the corner were themselves alarming.

This went to the critical question of how long the recognition lag was before decision-makers realised something would need to be done. But it also had a powerful effect on the time it took to consider options and make a decision once Ministers concluded action was required.

In my experience of government decision-making, Ministers need some time to reach a set of agreed facts about the circumstances they face before they are collectively in a position to make policy decisions in response. The consequence of so much concentrated senior attention to developments in the economic indicators was that views had aligned sufficiently by that October 2008 weekend for decisions to be made relatively quickly. It wasn't the case that decisions were made without thinking, or that large differences of opinion were glossed over. Rather, long and intensive engagement with the subject matter had brought opinions close enough together for agreement to be reached quickly.

The converse point needs to be made. New governments are not burdened by the rhetorical and policy positions of old ones. Let's consider the counterfactual: in my view, the Howard government was so politically invested in the strength of the economy and budget surpluses, it would have found it very difficult to accept that the economy was (a) seriously threatened and (b) that the surpluses needed to be deployed to protect it. We had a different but related problem with (b) but no such problem with (a). Based on their record, one could expect the Howard government might have provided something in the way of cash payments (though not as targeted) and offered a first homeowners' boost. This would likely have been insufficient as a fiscal response.

Conclusion

Australia has been called the "miracle" economy since well before this most recent crisis. While the performance has certainly been remarkable, the label is unhelpful. It suggests our strong economic performance is the product of chance alone; it excludes the important role good economic management has played in the last 20 years of Australian economic success. Former British Prime Minister Gordon Brown used to talk about banishing "boom and bust" economics in Britain. This was and remains the dearest goal of economic policymakers around the world. Brown's emphasis was on monetary and fiscal rules to provide a stable policy framework. This wasn't wrong, but it also wasn't enough. Better regulatory rules was an obvious blindspot, but so was a practical plan for intervening in times of crisis – how to judge your chances of success, and what to do if you decide to act.

This paper has been able to demonstrate that fiscal stimulus was a necessary (though not sufficient) condition for preventing a recession in Australia during the global financial crisis and ensuing "Great Recession":

- It has estimated the size of an Australian recession absent fiscal stimulus, and shown the implausibly low multipliers necessary to believe fiscal stimulus was not decisive.
- It has shown how stimulus showed up in the drivers of growth during the crisis.
- It has examined the criticisms of fiscal stimulus, and found them wanting.
- And it has offered a view of which factors were decisive in making Australia's fiscal stimulus more effective than in other countries.

It is important to conclude with some commentary on the implications for discretionary fiscal policy in economic management more broadly.

The general pre-crisis consensus in macroeconomics was that discretionary fiscal policy was ineffective for managing economic growth. It would always be bedevilled by lags and uncertainties in understanding the path of economic events; responding in sufficient time to make a difference; and designing an intervention that would be effective at anything other than inflating the next boom. It was thought better to leave aggregate demand management to monetary policy, which acted more speedily and (especially with independent central banks) was more able to operate symmetrically through the economic cycle.

I said at the outset of this paper that it was not the account of a disinterested observer. But it is the account of someone who understands more than most about how lags and uncertainty affect economic decision-making.

And my conclusion for discretionary fiscal policy more broadly is one of bounded optimism. On the one hand, we should remember the unusual circumstances of success in this instance of fiscal policymaking. It is rare to have a country with such propitious starting circumstances as Australia; some advance warning of a serious downturn; and an ability to act quickly enough to make a difference.

But as this paper has shown, all of these propitious factors are themselves amenable to policy action. Countries can – and should – choose to build strong economic fundamentals such as sound financial regulation and a strong fiscal position. Countries can build the systems and linkages that give them better advance warning of looming crises. And countries can be prepared to act on the fiscal front when it is justified by the economic circumstances and when the odds of success are sufficiently high, accounting for the risks of intervention.

In particular, governments must have fiscal stimulus packages fully-formed in their top drawers. As I have shown in this paper, the Australian government had elements of such a package ready, but still much of it had to be purpose-built at the time. Immediate cash payments are a simple enough thing to design, assuming countries have the architecture in place to deliver them (as we did). But in a sustained downturn, cash payments have to pass the baton to investment projects. These take time to scope and plan, and time is the one thing policymakers never have when crises hit. There must be a conscious effort to have viable and beneficial projects ready beforehand. In the good times, they can be part of a queue of projects to be steadily worked through as fiscal circumstances allow. But they must be constantly replenished to be ready in case of crisis. Even if they are never built, they sit there as an insurance policy against recession and mass unemployment.

A blanket denial of the potential effectiveness of fiscal policy deprives policymakers of options at the precise times they are most in need of them.

It is important that the story of Australia's fiscal policy success during this crisis is understood for what it can tell us about the conditions under which such interventions can be successful in future – and when they can't – and that policy advisers and policymakers continuously seek to learn the lessons to be ready for future crises.

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[2] All references in this paper to GDP should be taken to mean real GDP, unless stated otherwise.
[3] David Gruen, "The Return of Fiscal Policy", Speech to the Australian Business Economists Annual Forecasting Conference, 8 December 2009.
[4] Derived from Commonwealth Coordinator General's Nation-Building Economic Stimulus Plan Progress Reports of June and December 2009 respectively, http://www.economicstimulusplan.gov.au/pages/theplan.aspx, accessed 29 March 2011. I have assumed investment funds did not flow in any significant way in the March quarter of 2009 (given announcement was only in February) and have allocated 40 percent of 2009's second-half investment spending to the September quarter and 60 percent to the December quarter, on the basis of spending ramping up over this period.
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[6] Budget Paper No 3, 2009/10 Budget, http://www.budget.gov.au/2009-10/content/bp3/html/bp3_payments-04.htm, accessed 22 March 2011.
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[8] Budget Paper No 3, 2009/10 Budget, http://www.budget.gov.au/2010-11/content/bp3/html/bp3_spp-5.htm, accessed 22 March 2011.
[9] Council of Australian Governments Communique, November 28, 2008: 13, http://www.coag.gov.au/coag_meeting_outcomes/2008-11-29/docs/communique_20081129.pdfp13, accessed 22 March 2011. These figures exclude payments for programs where payments are known not to have proceeded in a timely manner – principally in remote indigenous housing.
[10] Gruen, *Return*, 7.
[11] I have also taken account of when the payments were made within the quarter, so for example the December quarter 2008 impact is a very small proportion of the total payments made, because these went out in the last few weeks of the quarter.
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[27] ABS 6202.0 - Labour Force, Australia, Feb 2011; http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6202.0Feb%202011?OpenDocument
[28] Warwick McKibbin, "Testimony before Senate Committee on Finance and Public Administration", 9 February 2009: 32.
[29] James Glynn, "US economy almost certainly in recession: RBA member", *The Australian*, February 7, 2008. http://www.theaustralian.com.au/business/us-basically-in-recession-rba-member/story-e6frg8zx-1111115498611, accessed 29 March 2011.
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[32] "Measures of Consumer Price Inflation – Table G1", The Reserve Bank of Australia, http://www.rba.gov.au/statistics/tables/index.html#prices_inflation, accessed 22 March 2011.
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