

**Senate Economics Legislation Committee**

**ANSWERS TO QUESTIONS ON NOTICE**

**Treasury Portfolio**

Budget Estimates, 1 to 4 June 2004

**Question: Bud 23**

**Topic: IMF Estimates**

**Hansard Page: E84**

Senator Conroy asked:

The International Monetary Fund world economic outlook of April 2004 suggested that Australia's cyclically adjusted balance, again prior to the budget, was also in deficit—a deficit of 0.6 per cent of GDP in 2003 and 0.8 per cent of GDP in 2004. Does Treasury have a technical problem with the IMF estimates?

**Dr Parkinson**—You have me at a disadvantage. I do not have the IMF estimates in front of me and I do not have the IMF methodology. I am aware of the fact that we have looked at that methodology, as we have looked at others, including that by Blanchard and numerous other people, and we do not endorse any methodology.

...

**Senator CONROY**—But you are unaware of what it is at this stage?

**Dr Parkinson**—I would have to have a look at it. Dr Gruen, are you?

**Dr Gruen**—No, I am not aware.

**Dr Parkinson**—We would have to go back and have a look.

Answer:

As Dr Parkinson noted, Treasury does not endorse any particular methodology for estimating the structural balance.

All approaches to estimating the structural balance are imprecise, particularly when estimating the current structural balance or the expected structural balance in the near future. For example, while the OECD and the IMF use the same broad methodology, their estimates of the Australian general government structural balance in 2004 differ, with the OECD estimating a structural surplus of 0.4 per cent of GDP, while the IMF estimate a structural deficit of 0.7 per cent of GDP.

The structural budget balance is the budget balance that would be observed if the level of actual output in a country coincided with potential output. The most difficult step in calculating structural budget balances is in estimating potential output in the economy, and the corresponding difference with actual output – the output gap.

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There are a number of approaches to the calculation of the output gap. The OECD and the IMF use methodologies based on production functions, while Access Economics use a deterministic trend approach.

The estimation of the current (or 'real time') output gaps was studied in a recent Reserve Bank research paper (RDP2002-06, *Output Gaps in Real Time: Are They Reliable Enough to Use for Monetary Policy?* David Gruen, Tim Robinson, Andrew Stone). Using a variety of methods, the paper found that the standard error of estimates of the current output gap when compared with final estimates based on revised data and with the benefit of hindsight was no better than 1.8 per cent of GDP. With an average degree of uncertainty about current output gaps of this magnitude, assessments of the current structural budget balance also have a high degree of uncertainty.