Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

21 – 22 October 2009

Question: sbt 15

Topic: Economic Stimulus – Fiscal Policy Estimates

Hansard Page: E127-8

Senator BUSHBY asked:

Senator BUSHBY—I am getting through what I have to ask. In the information provided by Treasury to the Senate inquiry into the economic effects of the stimulus the estimates were provided 'by assuming that if discretionary fiscal policy was not taken all other factors would have remained the same'. Does this mean that the estimates assume that, in particular, monetary policy settings would have followed the course that they have?

Dr Gruen—The way we came up with the fiscal policy estimates was to use multipliers. I think we actually quoted the numbers that we used for the multipliers. Those are estimates of the extra GDP you get from fiscal spending. I am giving a long-winded answer to this because it is somewhat complicated. We quoted estimates which the OECD and the IMF have quoted for Australia, to make the point that our estimates are roughly the same as theirs. Their estimates would be based on a range of studies, but some of them would have been empirical estimates. So the point of this excursion is that the empirical estimates would have taken into account the average response of the exchange rate and monetary policy over the period in which these empirical things there done. That is a complicated answer, but that is because, these multipliers are based on studies which assume an average response.

Senator BUSHBY—So they do not necessarily assume all other factors would remain the same; they assume an average response within that?

Dr Gruen—Yes, I think that is the right way to think about them.

Senator BUSHBY—So the statement in your submission is probably technically not quite correct then.

Dr Gruen—Yes, if you can draw my attention to it—

Senator BUSHBY—It is on page 7. I have a reference to it, but I do not actually have the submission here.

Dr Gruen—Okay, I think the way to interpret it is that other factors are as they are on average or something like that.

Senator BUSHBY—Okay. Is it a realistic assumption to make to judge the effects of the stimulus policy against an average response rather than what actually happens?

Dr Gruen—This does traverse some ground we have been over before. Any specific episode will have differences from other ones. One of the crucial differences between this episode and other episodes of fiscal expansion is the one I referred to earlier in an answer to Senator Joyce, which is the fact that expansionary fiscal policy was being used all around the world and that would lead you to expect it to be more potent than we had assumed. Certainly our estimates are on the conservative end of the numbers that the OECD and the IMF have quoted. If anything, a coordinated fiscal expansion undertaken by most countries in the world should be expected to have a bigger impact on GDP than if it is undertaken by one country. So, if anything, you would expect the multipliers to be bigger.

Senator BUSHBY—Do we know how big the average monetary changes are in the studies that you used?

Dr Gruen—They would depend. The IMF and OECD have provided ranges, and I guess we could go back and see which studies they have relied upon. Often they will be multi-country.

Senator BUSHBY—Would you be able to do that?

Dr Gruen—Yes, we can take that on notice.

Senator BUSHBY—That would be good, thank you.

Answer:

In studies analysing the impact of fiscal policy, monetary policy is typically assumed to respond in a manner consistent with its medium term framework[1].

A recent IMF staff position note[2] included a table summarising the results of a number of fiscal multipliers studies with a range of monetary policy assumptions. It found that there is strong evidence that discretionary fiscal policy is much more effective if it coincides with accommodative monetary policy — accommodative monetary conditions could increase the size of fiscal multipliers by a factor of 2 to 3, reflecting less crowding out of domestic investment and consumption.

[1] Hemmings, Kell and Mahfouz, 2002, The Effectiveness of Fiscal Policy in Stimulating Economic Activity – A Review of the Literature, IMF working paper, WP/02/208.

[2] Spilimbergo, Symansky and Schindler, 2009, Fiscal Multipliers, IMF staff position note, SPN/09/11.