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Two bangs for every stimulus buck

Craig Emerson | March 19, 2009

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AS the advanced countries of the world descend deeper into the economic mire, book publishers are rushing out new textbooks on recession economics. Old Keynesian texts, written against the backdrop of the Depression 80 years ago, are being dusted off and re-covered.

Even conservative US presidents have embraced Keynesianism. George W. Bush released a pump-priming stimulus package early last year. And in 1971 Richard Nixon declared: "We're all Keynesians now." As a 17-year-old high school student then, bracing for the prospect of being conscripted into the Vietnam War by the McMahon Liberal government, I didn't feel a lot of empathy with Nixon or the Liberal Party. I still don't.

US economists such as Nobel laureate Paul Krugman and Robert Shiller argue that when it comes to fiscal stimulus in the US, it's better to err on the side of doing too much than too little. They assert that since official US interest rates are almost zero, there's no more room to move on monetary policy, so it's up to fiscal policy to get the economy moving.

At the other end of the ideological spectrum are the disciples of Milton Friedman such as John Taylor, who astonishingly claims government intervention caused the financial crisis in the US and intervention through fiscal stimulus will make matters worse.

How does Australia find a policy path through these competing schools of thought? Recognising the value of stimulus packages but also their limitations, Australia, as a trading nation, should have such packages but they should be limited in size and duration.

The Opposition is campaigning against the Government's \$200 billion debt limit, most of which is to deal with the revenue losses associated with a collapse in commodity prices.

It says it would support a stimulus package half the size of the Government's. That's a difference of about \$20 billion. In effect, the Opposition is saying debt of \$180 billion is fine but \$200 billion is disastrous.

That's one of the Opposition's positions on the fiscal stimulus package. The other is to wait and see, like Dusty Springfield, wishin' and hopin' and thinkin' and prayin' the global recession will just go away.

Latest estimates of the potential losses of US-originated credit assets are up to \$5.5 trillion. These gargantuan sums are a sobering reminder of the limitations of further fiscal stimulus packages in Australia.

Our economic prospects in the next couple of years will be determined by whether global financial markets begin to provide adequate credit to lever the world out of a deep recession. Across the world, bankers are refusing to lend to other bankers for fear that the lender will collapse if the borrower can't repay.

In what should be dubbed a top-end recession, business executives have become pessimistic and inordinately risk-averse. In a rising share market these business executives designed for themselves remuneration packages top-heavy in shares in their employing companies, making the value of their remuneration heavily dependent on future share prices.

Many borrowed heavily against their inflated incomes and assets to take advantage of a bull market and a booming property market. And many executives lent to their children to help them buy expensive first homes.

Most executive salaries in Australia were slashed by the collapse in the stock market, which is more than 50 per cent down on its peak in 2007. Creditors made margin calls, obliging executives to offload shareholdings at heavy losses and to sell investment properties to raise cash. Property prices began

falling in exclusive suburbs, while expensive cars and yachts were put on the market.

The effect on the psychology of company executives of this top-end recession is profound. It is one trickle-down effect Australia's wage earners don't want. But it is trickling down. Top-end pessimism, born out of personal wealth destruction, is causing job losses across the world and in Australia as businesses close and investment projects are cancelled or deferred.

And the gloom of battered financial market players is trickling down through daily news bulletins as it affects the psychology of everyday working people. The more pessimistic the public becomes, the less is spent, the more jobs are lost.

Recessions are not just temporary events for those affected by them. Young people who can't get their first job and older workers who are made redundant can be scarred for life. Family breakdown and suicide are not just temporary setbacks in an otherwise happy life.

Practical limitations on the size of any further fiscal stimulus packages in Australia dictate that any extra dollars spent should produce two bangs for every buck, a stimulus bang and a reform bang.

All recessions come to an end. When the recovery begins, it is imperative that Australian businesses be well positioned to compete in tough international markets and against imports. Foreign survivors will be lean and mean.

The Rudd Government is already embarking on an ambitious microeconomic reform program that includes investment in human capital through the education revolution, tax reform, investment in innovation and infrastructure, and creating a seamless national market through the reform of business regulation.

The problem with big infrastructure projects to date has been that they have not been shovel-ready. While offering a reform bang, they did not offer an immediate stimulus bang. Cash payments have provided a vital bridge between the immediate need for stimulus and the time taken to get infrastructure projects under way.

A program of numerous small infrastructure projects, through schools, roadworks and local council works, provides the second bridge to enable key long-term infrastructure projects to be readied for investment.

Applying the two-bangs test will lift productivity growth while boosting business and consumer confidence.

Australia needs a productivity revolution. As Thunderclap Newman sang while I was sweating on being conscripted, "the revolution's here, and you know it's right".

A productivity revolution may not seem very exciting to a 17-year-old boy in 2009, but it is vital to his future job prospects. And it sure beats the hell out of conscription.

Craig Emerson is the federal Minister for Small Business.

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