Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

29 May – 31 May 2012

Question: BET 362-368

Topic: Budget

Hansard Page: Written

Senator WATERS asked:

362. What would be the implication of attempting to always run a balanced budget and rely on monetary policy to moderate the economic cycle? Would there be disadvantages in relying on the Reserve Bank pushing interest rates very low?

363. At the time of last year's budget, the Government thought a marginal surplus was appropriate for 2012-13 in the context of real GDP being forecast to grow by 4 per cent in 2011-12 and 3¾ per cent in 2012-13. Real GDP is now forecast to grow by only 3 per cent in 2011-12 and 3¼ per cent in 2012-13. That is, the forecast level of GDP in 2012-13 is now around 1½ per cent less than had been forecast this time last year. So if the optimal fiscal policy last year was to target a marginal surplus, does this imply optimal fiscal policy should be to accept a deficit for 2012-13 and defer regaining a surplus until the following year?

364. The OECD's latest *Economic Outlook* estimated that there is an 'output gap' of around 2 per cent of GDP in Australia; that GDP is below trend. Why then is there an economic need for a contractionary fiscal policy?

365. What is your view of the estimates of the structural budget balance in the OECD's latest *Economic Outlook*? These show the budget moving from a structural or underlying deficit of 3½ per cent of GDP to a surplus of 1 per cent in 2013. That is a turnaround of 4½ per cent of GDP in two years. Generally we only see such sharp changes in countries with serious problems with their debt, such as Greece. Why does Australia need to move back to structural surplus so quickly and what are the risks to activity involved?

366. Can you provide your own estimates of the structural budget balance over the past decade under two alternative assumptions: (a) that the terms of trade are now around a new long-term level, and (b) that they will return to their previous long-term average level?

367. In the longer term, what are the main drivers of productivity? How important is education?

368. How important will adjusting to a carbon-constrained world be in Australia's long-term productivity performance? (At the hearing Dr Gruen may have misheard and referred to adjustment to Australia's carbon price rather than the impact of the world seeking less carbon-intensive production techniques.)

Answer:

362. These issues have been addressed in the Secretary's Annual post-Budget Address to the Australian Business Economists on 15 May 2012.

363. These issues have been addressed in the Secretary's Annual post-Budget Address to the Australian Business Economists on 15 May 2012 and 2012-13 Budget Paper No. 1, Statement No. 4.

364. In its latest Economic Outlook, the OECD forecasts economic growth in Australia to 'be around potential in 2012 and 2013'. While the OECD acknowledges that 'fiscal consolidation will also weigh somewhat on demand' it also notes that 'restoring fiscal leeway while macroeconomic conditions are still favourable, and the terms of trade high, is welcome.'

365. The OECD is a well-respected and reputable economic organisation and its estimates of Australia's structural budget balance are credible. Like the OECD, Treasury's forecast of around trend economic growth incorporates the effects of fiscal consolidation. The reasons for moving back to surplus have been addressed in the Secretary's Annual post-Budget Address to the Australian Business Economists on 15 May 2012.

366. Treasury's most recent estimates of the structural budget balance were published in the October 2010 Treasury Economic Roundup.

367. The main long-term drivers of productivity and the importance of education are discussed in Treasury's submission of August 2009 to the House of Representatives Standing Committee on Economics Inquiry into Raising the Level of Productivity Growth in the Australian Economy.

368. The Strong growth, low pollution (SGLP) report projects that carbon pricing will have an impact on the productivity growth rate of about -0.1 of a percentage point per year. The report also shows that early global action is cheaper than delayed action. Every year of delay adds to the eventual cost of action as it locks in more emission-intensive industry and infrastructure, and defers new investment in low-emission technology, industry and jobs.