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Speech of 03/03/2009
NO.002

FISCAL AND INDUSTRY POLICY IN THE NEW BUSINESS LANDSCAPE

ADDRESS TO THE AIG ANNUAL ECONOMIC FORUM

ZINC, FEDERATION SQUARE, MELBOURNE

3 MARCH 2009

-- Check Against Delivery --

Thanks for the invitation to be with you today.

The topic that AIG asked me to talk on is "Fiscal and Industry Policy in the new business landscape."

In all areas of policy, this a time for boldness. A time for imagination.

A time for governments to seriously consider policy measures that they would normally shy away.

The new US Secretary of the Treasury expressed this well when he said:

"If our policy response is tentative and incrementalist, if we do not demonstrate by our actions a clear and consistent commitment to do what is necessary to solve the problem, we risk greater damage to living standards, to the economy's productive potential and the fabric of our financial system."

I don't think I need to dwell on the seriousness of the situation for you. You have an acute understanding of the depth of the challenge facing the world economy.

When Thomas Friedman was looking for a title for his book celebrating the lowering of trade and political barriers and the exponential technical advances of the digital revolution that have made it possible to do business, instantaneously with billions of other people across the planet he called it "The World is Flat". It is an apt title.

Of course, economies have always been connected, but the increasing flatness of the world economy means that they are more connected than they ever have been.

Just as Australia has benefited from the growth of new economies, especially China over the past decade, so we are acutely affected by the downturn, particularly the slow down of our major trading partners.

With half the world now in recession – more particularly, seven out of our ten top trading partners in recession - we will not escape the waters of economic trouble lapping at our shore.

As anyone who has ever rolled a marble across a wooden floor will know that a flat surface provides no impediment to speed. Thus in our flat world, the reverberations from a collapse in the American housing market spread like a virus, at great speed, first into global financial markets and then with rapidity into the real economy.

The sub prime crisis begot the financial crisis, begot the global recession. And thus, we find ourselves in a place the world has not been for many decades, if ever before.

The world has of course seen plenty of downturns in the last 50 years. It is the syncronisation of this recession that provides one of the great challenges. It is a long time since so many of the world's largest economies have been slowing so much at the same time.

The second point about our interconnected world is the speed at which information reaches people in every corner of our planet.

It has great advantages of course, but the instantaneous spread of communications means that the confidence levels of those in Australia are affected by the confidence levels of those abroad.

Fifteen years ago many Australians may not have known of a recession in Japan or the US nor would they have cared.

Yet today, my constituents, for example, access through the internet and pay TV real-time analyses of world events, and they take a great interest.

This is why it is important that we point out the fundamental strength of the Australian economy and why we differ from the United States, for example.

It is a ludicrous argument to suggest that the Australian Government should somehow not clearly lay before the Australian people the facts of the threat we face.

Those who accuse the Government of talking the economy and confidence down by speaking directly to the Australian people about the troubles that lie ahead clearly have not watched any news broadcasts or logged on to the internet in the last 18 months. If they had, they'd know that the Australian people are more than aware of the depth of the globe's troubles.

Advanced economies are expected to experience the sharpest collective decline in GDP in the post war period. The United States, the United Kingdom and the Euro area – are already in recession. Closer to home, Japan, Hong Kong, Singapore, Taiwan and New Zealand are also in recession.

Our largest export market, Japan, recorded a 3.3 per cent contraction in the December quarter — its worst result since the 1974 oil shock. The Euro area recorded its sharpest ever decline in the December quarter. The world's largest economy, the US, shrank by 1 per cent — its worst performance since the 1982 recession. The IMF expects the US economy to contract by a further 1.6 per cent in 2009, while the Euro area, Japan, and the UK are expected to contract by at least 2 per cent.

The IMF expects the Chinese economy to grow by 6.7 per cent this year, but bear in mind this follows growth of 13 per cent in 2007 and 9 per cent last year.

Against this backdrop, the IMF recently marked down its forecasts for the global economy. It now expects the world economy to grow by just ½ per cent in 2009 — the lowest rate of growth since World War II.

I'm sure you agree that this set of circumstances amounts to an extraordinary situation, which needs an extraordinary response.

All levers of a policy: fiscal, monetary and trade have a role to play.

In trade policy the worst thing the world could do would be to retreat in to economic protectionism once again. We would be turning the economic clock back 40 years. The flat world provided us with unprecedented growth and will do so again. Barriers between nations will only make things worse. Australia has been at the forefront of arguing that now is not the time to close the world off to trade but rather to take a new, vigorous look at kickstarting the failed Doha round.

Of course this crisis started with the world's financial institutions and therefore it will only be fixed once we have restored order to our financial markets.

The first order of business must be to get capital markets flowing again. Then, we must look to the longer term, we must look to a revamp of the world's financial architecture so as mitigate the effects of future financial problems. The G20 meeting of World Leaders to be held in April is a step towards that longer term picture.

As for now, financial markets remain fragile. The ongoing adjustment to tighter credit conditions, presents challenges for policy makers and market participants. Spillovers and contagion effects from further adverse financial market developments are still cause for concern.

The risk of renewed stress and volatility has been mitigated by government intervention, including massive liquidity injections, extended loan facilities, capital injections and banking guarantees.

However, toxic assets still sit on the books of many financial institutions and banks are still reluctant to lend to each other.

This has led the world's monetary authorities to take urgent and unprecedented action to credit flowing again.

In the US, the US Fed Funds rate has been brought down to near zero. In the UK, the official interest rate is now at its lowest level since 1694.

For its part, the Reserve Bank of Australia has cut the cash rate by 400 basis points to 3.25 per cent, following the February RBA Board meeting.

It is in this environment that the Government has been making decisions it would not normally contemplate.

Decisions such as the bank deposit and wholesale borrowing guarantee.

Australia is almost alone in the nations that we normally compare ourselves to in not having had a failed deposit taking institutions.

There are several reasons for this. Our banks are well run and well regulated. But also the decisive and clear action we took in the bringing in the unlimited guarantee was very important in boosting confidence in our financial institutions at the most troubling time.

The guarantee has also been vitally important in assisting our banks in raising funds off shore.

Likewise, it has been necessary for the Government to go down the road of our special purpose vehicle in car financing and the Australian Business Investment Partnership to ensure that the contraction of credit around the world does not impact on the economy in perverse ways which would have crippling impacts on employment.

And of course we have had to make decisions in relation to fiscal policy that were not contemplated when we were sworn-in in December 2007.

As the managing director of the International Monetary Fund, Dominique Strauss-Kahn, has said: "If there has ever been a time in modern economic history when fiscal policy and fiscal stimulus should be used, it's now."

The Government's top policy priority in the short term is to support economic growth and jobs.

We have of course, already announced two sizeable stimulus packages in addition to several other initiatives aimed at building economic capacity and supporting growth.

The Economic Security Strategy, announced last October, was a stimulus package of $10.4 billion representing around 1 per cent of GDP. It included initiatives to assist lower income households and individuals, and funding for training in order to support jobs.

The Economic Security Strategy and the $300 million program to build local community infrastructure are already providing support for growth in the short term.

For instance, ABS data shows that Retail trade rose 3.8% December 2008. December 2008 was the largest monthly percentage increase since August 2000 and the forth largest increase since that statistical series has been collected. All industries had increased sales in December 2008. Figures from Westfield released in January show that spending in the month of December 2008 was up 2.5% from the previous year. This is in contrast to their overseas sales which was down by 14% in the US and down 7% in New Zealand. Further, Woolworths reported increased sales on essentials in December 2008, as compared with December 2007.

The Nation Building and Jobs Plan, a stimulus package of $42 billion announced in February, is not only a stimulus package for the the short term but very much an investment for the future. For every dollar of direct payments there is two dollars of investment in the future. It includes initiatives to improve education and local community infrastructure, initiatives to increase the stock of public housing, tax breaks for small business, and one-off payments to a wide range of individuals.

Working from the assumption that the global downturn will mean higher unemployment in Australia as private sector spending slows, the Nation Building and Jobs Plan is designed to support jobs by boosting household consumption, supporting private sector investment and by providing additional public investment spending.

The Plan contains $14.7 billion to provide schools with new facilities and to allow them to undertake refurbishment projects. Every single school in Australia will benefit from the immediate funding for much needed projects. In many cases these projects that have lain dormant for years. Just as importantly these projects are ready to go now.

One of the disappointing features of the debate on the Jobs and Nation Building plan has been some people claiming that the investment in schools is investing in social infrastructure and therefore won't build wealth into the future. I couldn't disagree more. Investment in libraries, science and language labs and rebuilding class rooms will pay benefits, not only via a short term stimulus but also by return in educational outcomes over the longer term.

The Government is also providing direct assistance to small business through a $2.7 billion Small Business and General Business Tax Break.

Small business will have access to an additional 30 per cent tax deduction for eligible assets costing $1000 or more purchased between 13 December 2008 and 30 June 2009 and installed before 30 June 2010.

Maintaining cash flow is critical to the viability of small businesses. To help boost cash flow, the Government introduced a 20 per cent discount for small business on pay-as-you-go income tax instalment payable due before today, 3 March. The tax payable at the end of the financial year will be determined by final taxable income, but this initiative will boost small business cash flow in the first part of 2009.

Of course, the Government has not hidden from the fact that with an increase need for aggressive fiscal policy we will face a temporary budget deficit. We will incur debt.

And just as responsible debt holds no fear for responsible business so too in tough economic times responsible debt should hold no fear for Government.

One of the unique features of fiscal policy is the operation of automatic stabilisers. This means that as an economy slows, tax revenues fall and government expenditures go up. Often, trying to counteract these stabilisers is counterproductive and irresponsible.

When economic growth around the world, and in Australia, is under strain, the worst thing the Federal Government could do is to work against the intended effect of the automatic stabilisers. Monetary and fiscal policy need to work in tandem to give relief to families and strengthen the economy in tough times.

We have reaffirmed our commitment to achieve budget surpluses, on average, over the economic cycle. Australia's future economy will be strengthened by the investments being made now; investments that will support future tax revenues and increase the economy's capacity to withstand future shocks.

As the economy recovers, and grows above trend, the Government will take action to return the budget to surplus by allowing the level of tax receipts to recover naturally as the economy improves and by reining in spending growth.

There are some who argue that the Government has done too much, that the stimulus package is too big, that we have gone into too much debt.

My response is simple. If we don't act boldly enough now, our deficits and debt will be larger, not smaller over the medium term.

If we adopt the "wait and see approach" we will leave it too late. Not only will more Australians be avoidably out of work, more good businesses will fail. Economic growth will fall and the budget deficit will rise.

As I said when opening, incrementalism and half measures are particularly dangerous in the current environment, or, as Larry Summers has said, the cost of doing too little is potentially much greater than the cost of doing too much.

The challenge for the Federal Government is to respond to the most challenging set of economic circumstances in many generations with every policy lever at our disposal.

That is exactly what we have done, and exactly what we'll continue to do.