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## Dear Treasury, all I want for Christmas

- Henry Ergas
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**IT is a recurrent mistake of economic policy-makers to take credit for outcomes they did little to achieve. A disconcerting example of this is the orgy of self-congratulation that was unleashed by the present recovery.**

Treasury officials have been quick to claim that we faced a fearsome threat; we acted; the threat abated; therefore our actions were the cause of our salvation.

A recent paper by David Gruen, a deputy secretary in the Treasury, is an almost textbook case of this type of reasoning.

Gruen compares Treasury projections with actual outcomes. The inference is that it is thanks to the stimulus that outcomes have been far better than expected. But this reasoning hides two crucial assumptions.

First, it assumes the original Treasury forecasts of what would have happened had the stimulus package not been in place are largely correct. Yet the government has never released the modelling and assumptions behind those forecasts.

Even the most cursory examination of past Treasury forecasts shows large forecast errors and a tendency to underestimate gross domestic product growth during recoveries.

Second, it assumes the stimulus package was the only significant factor at work. One other possible factor, the substantial reduction in real interest rates during the past 12 months, is mentioned but essentially dismissed. No consideration is given to external factors, not least unexpectedly strong demand from China and India for Australian exports.

Gruen goes on to defend the stimulus package, especially the spending on schools, because it was so widely distributed. This is half correct. Although the spending was widely spread, the benefits were largely concentrated on the building trades, a key marginal constituency.

But there were other options, such as a payroll tax holiday, that would have been even more widely distributed, more equitable and less distorting and hence, even if marginally less effective, more efficient.

Adding to his defence of the package, Gruen says the infrastructure spending is justified because it adds to productive capacity.

But this is true only if the benefits from that spending exceed its costs. If they don't (think national broadband network or pink batts), then the community loses twice: from the waste, as scarce capital is diverted from better uses; and from the distortions caused by the higher taxes needed to cover the projects' costs.

As a result, far from expanding productive capacity, projects such as these cause it to shrink. This used to be part of Treasury religion; it is startling that there is no mention of it in Gruen's speech.

Finally, Gruen realises that his defence of the stimulus could open the floodgates to spending outbursts in future. Moreover, he is in the awkward position of having previously criticised discretionary fiscal policy. So he turns to the argument that "this time is different".

Why? Because this time there was a clear signal of impending crisis in the collapse of Lehman Brothers and American International Group in the US. In contrast, Gruen says, there was no single moment in earlier crises that signalled the onset of a global downturn and hence could trigger a prompt, targeted, fiscal response.

But few shocks were more clearly announced than the successive oil price hikes of the 1970s. As for the Asian crisis and the tech wreck, only the unconscious didn't see them burst on the scene. That is how shocks have always been and will be in the future: when they hit, you know it.

History matters because we draw lessons from it. When the lessons we draw are wrong, we repeat our mistakes. Whatever fine distinctions Gruen may claim to draw, the reality is that today's fiscal stimulus will be tomorrow's precedent.

Historian Keith Hancock noted: "The Australians have not grown rich because of their policies." Rather, "being already rich, they have been able to afford them". Ultimately, however, the policies Hancock referred to -- protection, restrictive industrial relations and a White Australia -- undermined that prosperity.

It would be a pity if misinterpreting our good fortune were to prove yet again our undoing. Treasury knows that, or at least it used to. It used to be willing to say it. It would be a terrific Christmas present to the nation were Treasury to relearn.

A final note: This week saw the loss not only of Nobel prize-winning economist Paul Samuelson, but also of an outstanding Australian economist, Warren Hogan. Born in New Zealand, later moving to Sydney University, Hogan contributed to a wide range of areas, always in defence of good economic policy. He will be greatly missed.

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