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This note focuses on the practical issues around the conduct of fiscal policy, particularly the Australian experience.

Although Australia is a small, open, advanced economy, it has a relatively greater share of its exports in primary commodities than would be the case for most other small, advanced economies.[1] Despite a national saving rate that is around the average for OECD economies, a high investment rate means that Australia is traditionally a large net importer of capital.[2]

Taken together, these two facts mean that Australia's economy is highly sensitive to developments in the world economy and in world financial markets. As a result, the global financial crisis and the associated global downturn provided one of the more severe possible tests of Australia's economic resilience.

Explaining fiscal actions

A clearly specified, credible fiscal strategy is important to marshal and maintain public support for fiscal policy actions.

The Australian government is required to produce a fiscal strategy statement at least annually. The statement must show how fiscal policy actions taken for the purposes of moderating fluctuations in economic activity are to be reversed, and it must show that they are consistent with long-term fiscal objectives.[3]

The budget must also contain a statement of risks that includes contingent liabilities and publicly announced government commitments not yet included in the fiscal estimates.[4] This requirement means that off–balance sheet liabilities, such as debt guarantees for other

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[1] ABS Cat No. 5302.0—Balance of Payments and International Investment Position, Australia, June 2009. www.abs.gov.au/ausstats/abs@.nsf/mf/5302.0.

[2] Organisation for Economic Co-operation and Development, 2009, *Economic Outlook*, No. 86 (Paris: November), www.oecd.org/document/18/0,3343,en_2649_34109_20347538_1_1_1_1,00.html; and ABS Cat No. 5206.0—Australian National Accounts: National Income, Expenditure and Product, June 2009. www.abs.gov.au/ausstats/abs@.nsf/mf/5206.0.

[3] Section 9 of the *Charter of Budget Honesty Act 1998.* www.comlaw.gov.au/comlaw/Legislation/ActCompilation1.nsf/framelodgmentattachments/1AF5822889419466CA256F710051FA64.

[4] Sub-subsection 12(1)(e) of the *Charter of Budget Honesty Act 1998.*

entities, must be disclosed at the same time as the balance sheet and other financial statements are updated and released.

Nontraditional fiscal measures should not be excluded from the reporting requirements. If they are excluded, then the public's understanding of the stance of fiscal policy and of the risks that the government is facing is diminished. Contingent liabilities are not costless—financial markets will demand a premium to finance governments that have them, and ratings agencies and the IMF pay particular attention to them.

Medium-term fiscal targets

Economic theory does not give us precise guidance on appropriate fiscal targets, and each country will have different factors that need to be taken into account in formulating its fiscal objectives.[5]

Australia's high reliance on foreign saving and the weighting of its export income toward primary commodities mean that adverse developments in the world economy and financial markets have significant implications for the real economy. In these circumstances, relatively conservative fiscal objectives are appropriate because they allow the government to act to minimize temporary macroeconomic disruption if necessary. Countries not subject to the same level of external exposure as Australia may be able to adopt less conservative fiscal objectives.

Long-term economic considerations are also relevant. In Australia, factors such as growth in Asia and the aging of our population have fundamental implications for the future structure of the economy. Australia's fiscal position needs to be robust to the future demands that will be placed on public services and infrastructure. Long-term budget projections can be very useful in identifying these types of pressures.

The commitment to a fiscal target can be as important as the target itself. Just as different countries can sustain different inflation targets for monetary policy, different objectives can be sustained for fiscal policy. It is the clear statement of those objectives and the maintenance of policies consistent with those objectives that establish the credibility that can be so helpful for the conduct of macroeconomic policy.

[5] Cottarelli and Viñals offer a range of goals for returning to fiscal normalcy after the crisis, from "stabilizing public debt ratios at whatever level has been reached as a result of the crisis," to aiming at "placing the fiscal accounts on a sustainable path, one that is indeed stronger than before the crisis, and that ensures the resilience of the fiscal accounts to the demographic shock." (C. Cottarelli and J. Viñals, 2009, "A Strategy for Renormalizing Fiscal and Monetary Policies in Advanced Economies," IMF Staff Position Note SPN/09/22 (Washington: International Monetary Fund, p. 8). www.imf.org/external/pubs/ft/spn/2009/spn0922.pdf.

Temporary fiscal interventions

It is important to distinguish the use of fiscal policy to boost aggregate demand temporarily from the longer-term objectives of fiscal policy.

Monetary policy is still the first choice for macroeconomic management, but it can be complemented by discretionary fiscal policy in limited circumstances, including where the downturn is likely to be deep, where it is synchronized across a number of countries, and where there is financial sector impairment that limits the potency of monetary policy.

It is important to specify which actions form part of a temporary stimulus, what their objectives are, and how and in what circumstances they will be withdrawn. It is also important to show how they are consistent with the government's longer-term fiscal objectives. This allows the public and financial markets to judge the efficacy of the government's measures and supports the credibility of the fiscal strategy.

Temporary fiscal stimulus needs to be clearly targeted at ameliorating temporary economic disruptions, and the budget's automatic stabilizers must be allowed to operate. The beneficiaries of public guarantees require incentives to return to nonguaranteed financing as market conditions normalize. The timing of the withdrawal of fiscal stimulus also needs to be robust to changing economic circumstances.

Coordination of fiscal actions

In the current situation, advanced economies face the challenge of a simultaneous, large fiscal consolidation. An overly hasty effort to repair balance sheets could harm the global economic recovery.

This danger could argue for greater international coordination in the withdrawal of fiscal stimulus, although it is likely that, once a sustained economic recovery is under way, private sector activity will quickly use any resources freed up by the withdrawal of fiscal stimulus.

An area in which coordination might be a more important challenge is the involvement of different layers of government in the delivery and withdrawal of stimulus. For example, this might be a particular challenge if subnational governments have wide spending powers combined with balanced budget rules.

Conclusion

To sum up, there are some useful guiding principles for fiscal policy:

- Communicating—to the public and the markets—the fiscal strategy and the fiscal position are of utmost importance, including specifying to the fullest extent possible the risks and contingent liabilities that are not shown on the government's balance sheet.

- Long-term fiscal objectives need to be set with a country’s individual circumstances in mind and should provide adequate flexibility to respond to a plausible range of economic stresses.

- Monetary policy is at the front line of demand management, but discretionary fiscal policy can be useful in exceptional circumstances. When this option is exercised, the nature and role of the stimulus and its timetable for implementation and withdrawal should be clearly specified and consistent with the government’s long-term fiscal objectives.