# ACT Legislative Assembly Select Committee on Estimates2009-10 Budget - Further Analysis

## The potential impact on the ACT Budget of the IMF's projected growth rate for Australia versus the Commonwealth's.

The forecasts and projections in the ACT Budget for Gross State Product and GDP for 2009-10 were:

| | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
|---|---|---|---|---|---|
| ACT: GSP % | ½ | 3 | 3 | 3 | 3 |
| Australia: GDP % | 1 | ¾ | 3 | 3 | 3 |

Since the ACT Budget was developed, there has been a further deterioration in the national economy. We have seen from the earlier briefing that changes in forecasts between those published in the Updated Economic and Fiscal Outlook (the forecasts reflected in the ACT Budget) and those published in the Commonwealth budget significantly reduced ACT revenue.

Commonwealth Budget for 2009-10, May 2009:

| | 2008-09e | 2009-10f | 2010-11f | 2011-12p | 2012-13p |
|---|---|---|---|---|---|
| Australia: GDP % | 0 | - ½ | 2 ¼ | 4 ½ | 4 ½ |

Interestingly, for each of the two sets of the Commonwealth's estimates for Australia's GDP growth, the final GDP figure is about the same. Nevertheless, we know from the Commonwealth budget that the revenue outcome for the ACT is not the same. The change in the GDP estimates shaved $200 million from the ACT's budget.

Then we compare the Commonwealth Budget estimates with the IMF estimates (1):

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|
| Real GDP change % | 2.1 | -1.4 | 0.6 | 1.9 | 2.8 | 2.9 | 3.0 |

If these IMF figures were recast to reflect financial years, the result would roughly be:

| | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
|---|---|---|---|---|---|
| Real GDP change % | -0.3 | -0.1 | 1.3 | 2.4 | 2.8 |

(1) International Monetary Fund: World Economic Outlook: Database: April 2009

Under the IMF's estimates, the final GDP for Australia is materially smaller than it would be had the Commonwealth's budget time estimates prevailed. This suggests, prima facie, that the IMF estimates impact on the ACT budget would be substantially larger than a further $200 million loss.

Unfortunately, no sure estimate is available because we do not know the model used by the IMF or its assumptions about the composition of the growth/decline in GDP which it predicts. Thus if the IMF assumes greater growth than the Commonwealth does in exports – which escape GST – then one would predict a disproportionate fall in GST than might occur under the Commonwealth's forecasts. And the converse also holds.

We can assert that a lower GDP trajectory as predicted by the IMF will cause reduced employment, reduced investment and reduced consumption. But we do not know the break-up of these elements, and that is important to determine the impact on ACT revenue from Commonwealth sources.

Having said that, it is a reasonable assumption that if the IMF estimates prevail, the ACT budget will suffer a further fall in revenue which could approach – even exceed – the $200 million reduction in GST occasioned by the more modest changes seen in Commonwealth forecasts.

Other Implications

There are other likely impacts. In a climate of reduced growth as suggested by the IMF, the Reserve Bank would more likely reduce interest rates further. The ACT Treasury has indicated that where there are accommodating interest rates, the ACT benefits more than other jurisdictions. Another possible consequence is that the Commonwealth might take further action to reduce its continuing budget deficits. This would likely lead to reduced employment in the ACT, reduced property prices and reduced economic activity. All of this would adversely affect ACT revenues. These impacts were seen when the early budgets of the Fraser government acted to reduce Commonwealth spending.

If the IMF estimates for GDP growth prevail, that would likely have an additional impact on the ACT economy. It is possible but unlikely that the ACT would be unaffected by such a large reduction in GDP growth as would occur if the IMF estimates were correct. Just as national employment, investment and consumption would be reduced, so would ACT employment, investment and consumption. Again, without an understanding of the model used by the ACT Treasury, the changes associated with accepting the IMF estimates would be difficult to quantify. Because 53% of the total ACT revenue derives from the ACT itself, there would be local consequences from a slower growth in GDP. These might exceed a further reduction of $100 million over four years.

Implications of IMF Estimates

The IMF is a competent and professional international organisation. But the resources it applies to understanding the Australian economy is slight compared to those applied by the Australian Treasury. Moreover, the Treasury has a good, though imperfect, forecasting record, especially compared to commercial/financial staff who are involved in economic forecasts.

This suggests that it would not be prudent to adopt IMF figures, unless there are persuasive reasons for so doing, such as evident bias in Treasury projections.

It is clear that Treasury has assumed strong growth in the out-years. But it points out that the average growth in its projections for GDP is less than that which occurred following recent recessions. It is also true that the IMF forecasts – which show a shallow but consistent growth – seemingly underestimate the ability of an economy to emerge strongly from a recession.

None of this means that the ACT's earlier estimates for GSP and GDP growth should prevail. The more recent estimates from the Commonwealth will have more effects than a reduction in the Commonwealth's revenue sharing with the ACT. Treasury could be asked to quantify the other implications of the changed Commonwealth forecast.

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20 May 2009