



The article:

Did Labor really save us from the GFC? We ask an expert

By [Richard Holden](#)

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A central issue in the upcoming federal election is the economic credibility of the Labor and Liberal parties. This, in no small measure, rests on the claim that the Labor Party "saved" the Australian economy during the financial crisis that began in 2008.

Did they?

There has been a lot of discussion about this, including some from thoughtful, well-informed commentators such as Warwick McKibbin (an ANU professor and former Reserve Bank board member) and Tony Makin (a professor at Griffith University). But rather than discuss what other folks discussed, let's get straight to the issue.

The Labor Government spent about \$95 billion, in four waves, to try and stimulate the economy. They did so against a backdrop of a worldwide economic meltdown that originated in the United States. We really only know two things for sure: there was stimulus spending of about \$95 billion, and the Australian economy emerged from the crisis relatively unscathed.

Did they get the best bang for the buck? Of course not. Builders were late completing construction projects, States partially substituted federal funds for their own spending, 60 percent of individuals saved the money they received rather than spending it, and pink batts are, well, silly. But that's not the point.

What exactly is stimulus spending meant to do? The crude answer is that, in the face of a financial crisis, government expenditure helps replace falling private spending, thus keeping so-called "aggregate demand" from falling.

But more importantly, it affects people's expectations. The real danger in such a crisis is that I expect you to stop buying what I produce so I don't produce, which leads me not to have the income to buy what you produce, so you don't produce. This quickly leads to a kind of expectations death spiral. My fear reinforces your fear.

Stimulus spending helps break and reverse this downward spiral. But to do so it needs to be big, bold and most of all, credible. You can't change people's beliefs if they don't think that you will follow through. Labor's stimulus involved overwhelming fiscal force: it was very large and very credible.

The Coalition seems to want to discuss the whole issue as if it were a home renovation. "Honey, do we really need granite countertops in the kitchen—those are expensive, you know?" It's exactly that line of thinking that leads people to believe that a stimulus won't be credible.

It is hard to overstate just how scary the economic environment in the US was in 2008

I was on the faculty at the University of Chicago at the time, and I saw it first hand. The world was terrifyingly close to a repeat of the Great Depression. Goldman Sachs stock once dropped nearly 50 percent in a single morning. Goldman Sachs!

And they were on the good side of credit default swaps and subprime mortgages. Around that time I spoke with a friend who was then an economic advisor in the Obama administration, and asked for his



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thoughts. He said, in all seriousness, "Go get cash and bottled water. ATMs might not be working two days from now."

It was that bad.

So, was the Rudd Government brilliant, lucky, or reckless?

My reading is: brilliant. For sure, they had a lot of other factors supporting the economy that many other countries did not have: a central bank with the decisiveness, and room, to slash interest rates; a major trading partner (i.e. China) enacting a massive stimulus of their own; and a very flexible exchange rate.

They also arguably "played it safe" by following advice from Treasury and the International Monetary Fund.

But two things merit the term "brilliant". One: the resolve to use overwhelming fiscal force, particularly in the face of political opposition; and two: the sophistication to understand the importance of shoring-up the banking system through deposit guarantees (announced in October, 2008).

Together these gave Australians confidence that we would weather the crisis. That confidence prevented the kind of expectations death spiral from which the US is still battling to recover.

Franklin Roosevelt was right. In times like 2008 "the only thing we have to fear, is fear itself". Oh, and a government that doesn't realize that stimulus only works if it's big, bold and credible.

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