Public Policy Lessons from the Global Financial Crisis

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Introducing the three papers:

1. Fiscal response to the Global Financial Crisis of 2008-09
   Dr Ken Henry
2. Lessons from the Global Financial Crisis: the Department of Prime Minister and Cabinet perspective
   David Tune and Megan Edwards
3. The role of the RBA in Australia's crisis response
   Dr Malcolm Edey

Fiscal response to the Global Financial Crisis of 2008-09 - Dr Ken Henry

"At a time of international economic and financial crisis … it is important that the government of the day have access to an apolitical body of expert advisers whom they can trust to have no motive other than the national interest. The Australian Public Service (APS) uniquely plays this role. Especially in a time of crisis the APS is duty bound to advise the government what course of action it considers to be in the national interest. That advice should in no way be considered tainted by the government's making it public."

Fiscal response to the Global Financial Crisis of 2008-09
- Dr Ken Henry

“Whenever unusual policy measures are taken, the Government will be criticised by its political opponents and their media supporters. … The experience of the GFC demonstrates that academics will join the debate, often with unhelpful propositions. … The line between policy analysis and political posturing is wafer thin, and frequently crossed. Senior Treasury officials can expect to find themselves ambushed by arcane propositions in parliamentary enquiries and other public appearances. The public won’t have confidence in highly unusual economic and financial policy initiatives if Treasury officials aren’t able to deal effectively with critical commentary. ”

Lessons from the Global Financial Crisis: the Department of Prime Minister and Cabinet perspective - David Tune and Megan Edwards

Context: As the GFC was building, PM&C was briefing a new government (following the 24 November 2007 election) for the first time in eleven years, and the new Secretary, Terry Moran, started in March 2008.

Incoming Prime Minister Rudd was keen to get a lot done in a short time.

Lessons:

- Real time information and intelligence has a heightened value in a crisis; invest in relationships during ‘peace time’ to ensure these can be drawn on when needed.
- It’s hard to ‘do the other things’ during a crisis – advice on how to trim the broader policy agenda should be provided.
- If direct investment proposals are in the mix, they must be led by policy and implementation experts.
- It’s the economy, stupid. Pursuing broader policy objectives through crisis measures can have benefits but also increases risk.
- Messaging matters – consider communications strategy early and revisit often.
- COVID-19 Postscript.

The role of the RBA in Australia's crisis response - Dr Malcolm Edey

Australia's prudential oversight framework had been significantly toughened some years prior to the crisis and successfully discouraged banks from emulating various risky practices that were occurring overseas, such as sub-prime lending. This meant that Australian banking institutions entered the crisis period with relatively strong balance sheets, at least on the assets side, compared to many of their international counterparts.

The accumulation of risky behaviour in the lead up to the GFC was largely missed.

Elements of the Australian experience

- Over the six months following the collapse of Lehman Brothers in mid-September, 2008, the RBA cut the cash rate by 400 basis points, the most concentrated series of moves in the period since interest rate changes began to be formally announced in January 1990.
- The average intraday movement of the AUD/USD exchange rate was 3.7 cents in October 2008, compared to a long-run average of 0.7 cents.
- The GFC was largely a banking crisis. But major Australian banks' annual return on equity remained above 10 per cent throughout the crisis.

With policy interest rates near zero, the main options put forward to achieve further stimulus:

- Further measures to expand the central bank balance sheet, including large scale purchases of government securities (‘quantitative easing’), targeted security purchases to relieve stress in credit markets, and direct lending to banks to encourage them to expand credit.
- Forward guidance about the central bank’s policy intentions, designed to lower long-term borrowing costs.
- Policy actions to lower the exchange rate.
- Deeply negative nominal interest rates.
- Raising the inflation target in order to generate higher inflation expectations and thus lower real interest rates.
- Conventional (debt financed) fiscal expansion.
- Direct money-financed fiscal expansion.

Given the unconventional nature of these policies, there is much work still to be done in building a robust framework for calibrating these measures, ensuring that proper governance safeguards remain in place, and thinking ahead about the eventual exit path. But that should not obscure the answer to the more immediate question which was posed earlier: *has monetary policy run out of firepower*? Properly understood, a central bank with responsibility for its own currency, and with the capacity to cooperate with the fiscal authority, never truly runs out of firepower.

The challenge is to make sure it is used responsibly.