

**Malaysian Institute of Economic Research  
National Economic Outlook Conference**

**Session IV: Fiscal Response  
'Pump Priming'**

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## **'Pump priming'**

- measures to stimulate an economy during a recession
- public expenditure and tax cuts are required to fill the income and demand void that is created during an economic downturn so that it will draw forth private spending.
- notion of transience. occasional action needed to ensure the proper functioning of an economy.
- ensure that emergency public spending does not become a permanent feature of the economic landscape

## **Outline**

- Less or more pump priming ?
- No clear cut answers. Early withdrawal - remove current growth momentum; over-stimulating economies also costly.
- Three general conclusions are drawn about the effectiveness of pump priming.
- Economies cannot rely overly on stimulus measures
- Must undertake reforms that will ensure high rates of productivity and income growth.

## **Two views:**

- Economists do not agree whether fiscal policy really works. Franklin D. Roosevelt's 'New Deal' policies ended the Great Depression? Depression lasted more than a decade, resisted multiple pump priming attempts
- Fiscal conservatives - conclusive proof government spending does not work
- Keynesians (Paul Krugman) - governments spent too little rather than too much
- Post-war dominance of Keynesianism
- Conservative backlash in the 1980s - low economic growth, large budget deficits, high inflation, negligible productivity and bloated government bureaucracies
- Supply-side economics that re-introduced the centrality of markets and rational expectations. Prime Minister Margaret Thatcher in the UK and President Ronald Reagan in the US
- 1980s and '90s - Washington Consensus
- 1985 recession
- 1997/98 Asian Financial Crisis
- Return of external demand impetus and strong capital flows meant that there were still substantial incentives to continue a pro-private sector and market stance

## Present Status, 2009

Output (% change)				
-5.0%>	-1.0%~-<5.0%	-1.0%~<1.0%	+1.0%~+<5.0%	+5.0%>
DEU, ITA, JPN, MEX, RUS	AUT, CAN, CHE, ESP, FRA, GBR, MYS, NLD, SGP, SWE, TWN, THA, USA	KOR, AUS, BRA,	IDN, PHL, VNM	CHN, IND
Inflation (% change)				
-1.0%~-<3.0%	0%~-<1.0%	0%~+<1.0%	+1.0%~+<3.0%	+3.0%>
JPN	CHE, CHN, ESP, MYS, SGP, THA TWN, USA	AUS, AUT, CAN, DEU, FRA, ITA, NLD	GBR, KOR, PHL, SWE	BRA, IDN, IND, MEX, RUS, VNM
Unemployment (% labour force)				
10.0%>	7.5%~<10%	5.0%~<7.5%	2.5%~<5.0%	<2.5%
ESP, <u>USA</u>	BRA, CAN, <u>DEU</u> , <u>FRA</u> , <u>GBR</u> , IDN, ITA, PHL, RUS, SWE	AUS, AUT, IND, <u>JPN</u> , MEX, TWN	CHE, <u>CHN</u> , KOR, MYS, NLD, SGP, VNM	THA
Fiscal deficit (% GDP)				
-10%>	-10.0%~-<-5%	-5%~<0%	0%~+<5%	+5%~+10%
GBR, ESP, USA	FRA, IND, ITA, JPN, MYS, RUS, THA, VNM	AUS, AUT, BRA, CAN, CHE, CHN, DEU, IDN, KOR, MEX, NLD, PHL, SGP, SWE, TWN		
Public Debt (% GDP)*				
0%~25%	25%~50%	50%~75%	75%~100%	100%>
AUS, CHN, KOR, RUS,	CHE, ESP, IDN, MEX, SWE, THA, TWN, VNM	AUT, BRA, GBR, IND, MYS, NLD, PHL	CAN, DEU, FRA, SGP USA,	ITA, JPN

**American Recovery & Reinvestment  
Act of 2009**

	US\$ (bn.)	% Total
Total	787	100
Tax cuts	288	37
State & local fiscal relief	144	18
Infrastructure & science	111	14
Protecting the vulnerable	81	10
Health care	59	7
Education & training	53	7
Energy	43	5
Other	8	2

**Fiscal Stimulus Packages of Asian  
Countries, 2008-09**

Countries	US\$ (bn.)	% GDP
China	585	13
Japan	568	12
S. Korea	84	9
Malaysia	18	8
Singapore	14	8
Thailand	3	1
Indonesia	6	1
Philippines	7	4
Vietnam	1	1

## Policy issues

- Asia Pacific Economic Cooperation Summit in Singapore - maintain their pump priming until 'a durable economic recovery
- G20 Summit , Pittsburgh - co-ordination of exit policies
- EU finance ministers - withdrawing pump priming measures by 2011 (maybe)
- Two things apparent – (1) leaders do not think that a durable recovery is already in place; (2) acute awareness about the costs
- All East Asian economies are expected to post fiscal deficits in 2009 - most around 5 per cent of GDP
- Deficit numbers notoriously dependent on assumptions about revenue and growth
- Public debt levels - world's largest economies carry large amounts of public debt and forecast to rise further
- European Union (EU) - collective fiscal deficits twice the permitted figure; 13/27 members given between 2011 and 2015 to slash public spending
- IMF studies - higher the level of public debt, lower effectiveness of fiscal policy in stimulating growth

## Conclusions

- Keynes observed during Great Depression – (1) wealthy individuals hold more liquid assets in times of great uncertainty (2) even if wages fall, employment demand may still not pick-up. Proposed deficit government spending as a solution.
- Fiscal policy has a role to play in the economic recovery process nevertheless not panacea in each and every case
- (1) Economies differ greatly in terms of their structure and attributes and stimulus packages designed differently
- (2) Pump priming can even become part of the problem if steps are not taken to ensure fiscal responsibility and good governance (A) credible policy framework and respected institutions, (B) preparedness of governments to exit fiscal policies
- (3) Pump priming only re-starts economic growth, does not substitute it. Must be accompanied by policies to incentivise private investment and spur productivity. Recognise there is 'expiry date' on pump priming measures