

**Submission to the Joint Committee of Public Accounts and Audit Review of the  
Parliamentary Budget Office**

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## 1. Summary

We welcome the inquiry of the Joint Committee of Public Accounts and Audit into the operations of the Federal Parliamentary Budget Office (PBO).

Since it was created in 2012, the PBO has established itself as an important institution making significant contributions to Australian policy debate and understanding. It is generally fulfilling its aims of providing independent and non-partisan analysis of the budget cycle, fiscal policy and financial implications of proposals. It has been effective and professional in discharging its remit to provide independent advice on fiscal policies to both political parties and the public.

In principle, we support the adoption of a new set of fiscal rules for Commonwealth governments. However, these rules are unlikely to have much impact unless they both allow sufficient flexibility to respond to short term downturns in the economy and materially constrain the budgets of a government within its current term, including the forward estimates. We believe that fiscal rules are only likely to be meaningful if they require a government to chart a return to surplus within a rolling 5 year period. If meaningful rules are adopted, then the PBO is the obvious independent and suitably qualified body to monitor the government's progress against them.

In considering the need for any other legislative change affecting the PBO, we believe that the rules around the PBO's costing of election policies need to be refined. Changes to the *Parliamentary Services Act 1999* would better serve its aims of ensuring that the

Australian public be better informed about the costs of election policy proposals.<sup>1</sup>

Legislative change is required to ensure that costings are released sufficiently early in the campaign that they can be subjected to rigorous public debate. We suggest that legislative changes should provide that:

- Parties should only be able to submit their policies for costing up to two weeks after the issuing of the writs for an election.
- Three weeks after the issuing of writs, the PBO should release any costing it has prepared before the caretaker period where:
  - that policy is being advocated in the election by a party that requested the costing;
  - the costing has not already been released by the party; and
  - the party did not request a costing of that policy after the writs were issued.

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<sup>1</sup> Swan (2011)

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## 2. The role and performance of the PBO

The PBO was established in 2012 in order to provide independent and non-partisan analysis of the budget cycle, fiscal policy and financial implications of proposals.<sup>2</sup> A recent report by the Australian National Audit Office found that the PBO was effective in fulfilling its statutory role and was well regarded as “an authoritative, trusted and independent source of budgetary and fiscal policy analysis”.<sup>3</sup> We agree with this view.

PBO’s role in providing policy costings outside of election periods assists political parties in policy formation and development. This is particularly true for the opposition, minor parties and independents that are not able to request policy costings from Treasury or Finance outside of the caretaker period.<sup>4</sup> Over time, this should improve the ‘contest for ideas’ by improving the capacity of those outside of government to put forward credible alternative policies.

The PBO’s election policy costing work has increased the transparency around election commitments and improved the quality of information available to the electorate.<sup>5</sup> Greater visibility of the costs of policy proposals at election time increases accountability and provides a disincentive for political parties to engage in opportunistic spending.<sup>6</sup> However, the current rules

around the public release of costings allow parties to gain the imprimatur of a PBO costing while limiting public scrutiny of their policies. Legislative change to prevent this is required, as discussed in section 4.

The PBO’s mandate to conduct self-initiated research is also welcome. Its research reports on historical trends in Australian Government spending and receipts provide a valuable resource on longer term trends in fiscal policy.<sup>7</sup> Similarly, the PBO’s work in estimating the structural budget balance in 2013 was a useful contribution to the fiscal policy debate.<sup>8</sup> Similar estimates had not been published by Treasury since 2010. To inform fiscal policy, this exercise should be repeated annually, either by Treasury as part of the Budget papers or by the PBO.

A key measure of success for the PBO will be the extent to which it can influence the public debate on fiscal policy. PBO has demonstrated a willingness to engage constructively with bodies outside of government including the Grattan Institute. These types of engagement ultimately assist in contributing to more informed public debate.

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<sup>2</sup> *Parliamentary Services Act 1999*, s64B

<sup>3</sup> ANAO (2014), p. 18

<sup>4</sup> During the caretaker period, parties with five or more members in parliament are able to request costings from Treasury or Finance.

<sup>5</sup> *Ibid.*

<sup>6</sup> IMF (2013a), p. 7

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<sup>7</sup> PBO (2013a) and PBO (2014)

<sup>8</sup> PBO (2013b)

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### 3. Fiscal rules

Historically constraints on Australian government budgets have primarily been political rather than a consequence of fiscal rules. We do not believe that the revised fiscal rules proposed by the National Commission of Audit would be either effective or appropriate. A better fiscal rule would be a requirement to project a surplus within a five year period. This would also require Treasury to provide longer forward estimates than at present. The PBO would be an appropriate body to monitor a government's progress against this rule.

#### 3.1 Historic practice

Australia does not currently have legislated fiscal rules that specify a numerical budget target. Instead, it takes a principles-based approach that requires the Commonwealth to release an annual 'Fiscal Strategy Statement' specifying the government's long-term fiscal objectives and the measures by which fiscal policy will be set and addressed. The government must report on its performance via the budget papers and related documents.<sup>9</sup>

Since this framework was introduced in 1998, governments on both sides of politics have used the Statement to set medium-term fiscal strategies to achieve a 'balanced budget over the economic cycle'. Both sides have committed to fiscal rectitude outside the Statement, usually by promising to achieve a specified surplus in a defined timeframe, and to constrain growth in taxes or spending.

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<sup>9</sup> Daley *et al.* (2013). A more detailed discussion of the regime can be found in Blondal, *et al.* (2008).

It is arguable that the real constraints on budgets have been political, rather than consistency with the formal aim of 'a balanced budget over the economic cycle'.

This type of principles-based approach has the great advantage of flexibility in the case of a period of below-trend growth or an international fiscal crisis. While flexibility carries risks, in the right circumstances it can have significant advantages.<sup>10</sup> Certainly, the OECD's view is that Australia's current system has served it well.<sup>11</sup> The risk with Australia's approach is that while governments commit to a balanced budget 'over the economic cycle', there is no clear way of defining where the current year sits in the cycle. This allows governments too much wriggle room to continue to run budget deficits by claiming that the economy is not yet in good enough shape to justify a surplus.

#### 3.2 Underlying values to judge fiscal rules

Proposals have been advanced to introduce more explicit rules and targets, consistent with the international trends towards adopting numerical fiscal rules.<sup>12</sup>

We believe that in setting such rules, the appropriate values are:

- the rules should not compel a surplus if economic growth is unusually slow;

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<sup>10</sup> IMF (2013b), p. 41

<sup>11</sup> OECD (2012)

<sup>12</sup> Schaechter *et al.* (2012)

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- the rules should “bind” a government within its current term, so that it cannot comply by simply promising that the next government will fix the problem; and
  - the rules should not specify a particular size for government, which is ultimately a political choice, also influenced by the distribution of Commonwealth – State spending.

### 3.3 National Commission of Audit proposals

The National Commission of Audit recommended the government adopt more explicit fiscal rules centred around the need for budget surpluses, a healthy balance sheet and constraining the size of government.<sup>13</sup> Specifically, it recommended three new fiscal rules be adopted by the Commonwealth Government: a surplus of 1 per cent of GDP by 2023-24; substantially reducing net debt over the next decade; and ensuring tax receipts remain below 24 per cent of GDP.<sup>14</sup>

We do not believe that the rules advanced by the Commission of Audit would improve on current arrangements.

The surplus of 1 per cent of GDP in 2023-24 may be inappropriate in 2023-24 if economic growth in that year is unusually slow. It is manifestly not possible to predict the occurrence or timing of future economic crises. Although the NCoA suggested that its surplus target may require an ‘escape clause’ with adjustments to the size or timing of the surplus target in the event of a rare economic shock, in practice this would represent an escape

clause for politicians seeking to rationalise non-compliance with the target. Furthermore, the 2023-24 target is too far in the future to meaningfully constrain the budgets of the current term of government – and will provide relatively little constraint on the budgets of the government after the next election.

A fiscal rule that tax receipts remain below 24 per cent of GDP is also inappropriate. The size of the federal government is a fundamental political choice, which depends on the balance between the various public benefits that government can provide, and the value of private spending. It also depends on the scope of Commonwealth Government taxation relative to State Government taxation. There is no a priori reason to believe that a country with federal taxation at 23.5 per cent of GDP will be better governed than a country with federal taxation at 24.5 per cent of GDP. There is only limited correlation between government expenditure and budgetary surpluses.<sup>15</sup>

### 3.4 Alternative proposals

The *Balancing Budgets* report published by Grattan Institute noted that a rule along the lines of the UK’s ‘fiscal mandate’ – requiring the forecast structural current budget to be in balance or in surplus by the end of the rolling, five-year forecast horizon – would sharpen the government’s incentive to balance the budget in the medium term.<sup>16</sup> The benefit of such a rule would be to maintain the flexibility to provide short-term stimulus in periods when the economy is underperforming while still maintaining the impetus for decision makers to return the budget to balance within

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<sup>13</sup> NCoA (2014), p. 55

<sup>14</sup> NCoA (2014), p. 58

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<sup>15</sup> Daley *et al.* (2013a), p. 47

<sup>16</sup> Daley *et al.* (2013b), p. 81

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a reasonable timeframe.<sup>17</sup> In particular, it would require a government to show how it expected to bring the budget back into surplus within the forward estimates announced during its current term. It would not be enough to simply promise that the next government would balance the budget.

For fiscal rules to be effective, there needs to be some mechanism for reporting the government's progress against the rules. Grattan Institute supports the recommendation in the NCoA report that the PBO be required to report on the government's progress against the fiscal rules following the release of the Final Budget Outcome each year. This would be consistent with the approach adopted in many other countries where the independent fiscal authority is tasked with monitoring government's compliance with fiscal rules. The IMF reports that more than 75% of the 'new generation' fiscal councils (established post 2004) have an explicit role in monitoring fiscal policy rules.<sup>18</sup> Indeed, the IMF nominates such a role in monitoring fiscal policy rules as one of the features of effective fiscal councils.<sup>19</sup>

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<sup>17</sup> Emmerson, *et al.* (2013)

<sup>18</sup> IMF (2013a), p. 15

<sup>19</sup> IMF (2013a), p. 1.

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## 4. Timing of election costings

The PBO is required to publicly release any costing of election policies received during the caretaker period as soon as practicable after the request has been made and before polling day.<sup>20</sup> The same disclosure requirements are imposed on Treasury and Finance under the *Charter of Budget Honesty Act 1998*.<sup>21</sup> Parties are not required to have their election policies costed by the PBO or the Departments. However, in practice submitting policies for costing is rapidly becoming the only way that parties can establish in public debate the legitimacy of their fiscal claims.

The disclosure requirements seek to ensure that the public can be informed of the costs of election policy proposals prior to casting their vote at the election.<sup>22</sup> These processes saw more complete costing of policy proposals prior to the 2013 election than any previous election.<sup>23</sup> Nonetheless, the way in which the Coalition was able to delay the release of its policy costings until two days prior to polling day (and after the commencement of the election advertising blackout) suggests that the current processes allow parties to reduce the transparency of their costings and public debate about them.

In order to ensure sufficient time for the electorate to consider the details of each party's costings prior to an election campaign, parties should only be able to submit their policies for costing up

to two weeks after the issuing of the writs. This would ensure that policies would be costed and released well before the end of the campaign. The PBO demonstrated in the 2013 election campaign that it is capable of quickly undertaking a large number of costings, with the 85 requests it received during the caretaker period dealt with in an average response time of 2.2 business days.<sup>24</sup> Parties would be free to continue to release policies after this point but not with the benefit of a costing undertaken by the PBO or Treasury and Finance.

Changes are also required to prevent parties publishing costings late in the campaign that were requested before the caretaker period. The PBO is required to keep such costings confidential. To prevent such "gaming", we suggest that the *Parliamentary Service Act 1999* should be amended to require that three weeks after the issuing of writs, the PBO should release any costing it has prepared before the caretaker period where:

- that policy, or a similar policy, is being advocated in the election by a party that requested the costing;
- the costing has not already been released by the party; and
- the party did not request a costing of that policy, or a similar policy, after the writs were issued.

The PBO should be empowered to consult with political parties to understand whether a policy that was costed before the caretaker period is similar to a policy being advocated in an election. Mirror

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<sup>20</sup> *Parliamentary Services Act 1999*, s64L(2)

<sup>21</sup> *Charter of Budget Honesty Act 1998*, s31(2)

<sup>22</sup> Swan (2011)

<sup>23</sup> ANAO (2014), p. 90

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<sup>24</sup> ANAO (2014), p. 86

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changes to the *Charter of Budget Honesty Act 1998* applying to Treasury and Finance costings should also be introduced.



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