

Submission to the review of the operations of the Parliamentary Budget Office



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Summary

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

The PBO is a relatively new institution – it was established just eight years ago to provide independent and non-partisan analysis of the budget cycle, fiscal policy, and financial implications of policy proposals. But it has already established itself as an important part of the Australian policy landscape.

Reviews of the PBO by an independent panel in 2017, by the JCPAA in 2014, and by the Australian National Audit Office in 2014 all found that the PBO was discharging its statutory responsibilities effectively. We agree.

The PBO's policy costings role has been embraced by parliamentarians; it completed almost 3,000 requests last financial year. The credibility of PBO costings has enhanced policy development by the opposition and minor parties, improving the contest of ideas.

Changes to the confidentiality regime could further enhance the PBO's costings process. We recommend that the PBO be required to release a costing once the commissioning politician (or their party) comment on the costing in public. A similar rule could apply to Treasury costings. This would ensure that important

context – including the assumptions and level of reliability – are visible. It would also help protect the PBO against unwarranted political attacks on its costings.

The PBO's research reports have improved the information base for public debate. They have highlighted a number of 'nerdy but important' methodological issues around the fiscal aggregates – weaknesses in the net debt measure, for example – that would not otherwise be well understood.

The major contribution of the PBO's research agenda has been to shine light on the medium-term budget outlook. This contribution could be further improved by the PBO embracing alternative medium-term projection methodologies, to provide a more realistic guide to the likely future state of government finances.

Finally, there is scope for the PBO to take on more functions. Most similar bodies overseas make or assess economic forecasts and monitor their government's compliance with fiscal rules. The PBO should be given these additional responsibilities, along with appropriate additional resourcing.

The PBO should also be given carriage of the Intergenerational Report, given the benefits of a national approach and the real risks of this document being politicised.

1 Costings

The PBO was formed to provide high-quality, independent analysis, including on the financial implications of opposition and cross-bench policy proposals. It was hoped that this would 'level the playing field' in policy development by giving non-governing parties access to credible, accurate costings that incumbents have long benefited from.

This benefit has largely come to pass. Trusted, non-partisan costings have improved policy development and the contest of ideas. But the PBO's ongoing credibility depends on parties refraining from politicising the costings.

The PBO's credibility would be further protected, and the public debate improved, if it was required to make costing information public once the costing was publicly referred to by the party that commissioned it. A similar rule could apply to Treasury costings.

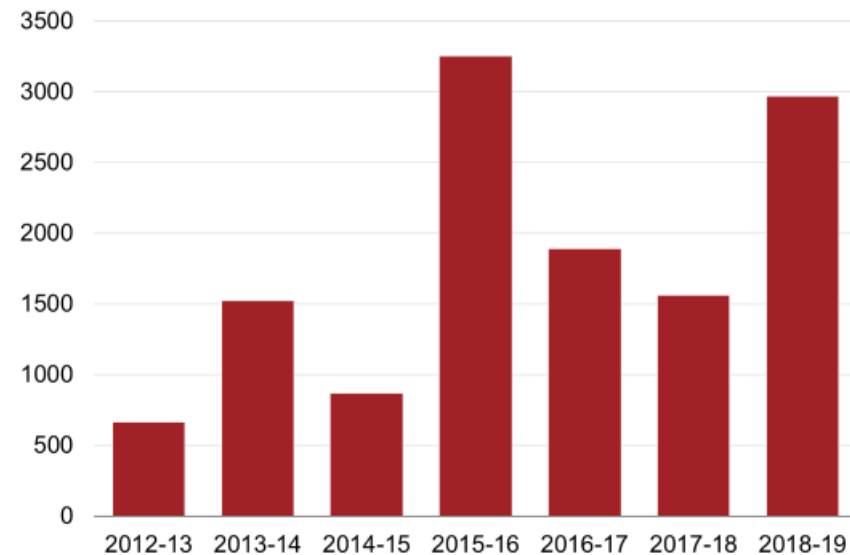
1.1 The PBO has reduced 'costing credibility risk' and improved policy development

The PBO's role in providing policy costings outside election periods assists political parties in policy formation and development. Opposition, minor parties, and independents are not able to request policy costings from the Treasury or Department of Finance except during the caretaker period.¹

The PBO's costing services have been enthusiastically embraced by parliamentarians: the PBO now delivers more than 1,500 costings most years, and double that in election years (Figure 1).

Figure 1: The PBO provides a substantial number of costings, particularly in election years

Number of PBO costing requests completed



Sources: PBO annual reports.

¹ During the caretaker period, parties with five or more members in parliament are able to request costings from Treasury or Finance.

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Government critiques of opposition or minor party policies based on ‘black holes’ in the costings are now rare. Free from these distracting and sometimes devastating critiques,² there is greater scope to debate the merits of the policies themselves.

And reducing ‘costing credibility risk’ has improved the contest of ideas by emboldening opposition and minor parties to engage in more policy development.

A related benefit is that the costing process requires the parties to specify a range of details about their policies. Going through the process engenders a level of discipline and helps prevent costly details being overlooked.

1.2 The PBO’s credibility is vulnerable to politicisation

The biggest risk to the PBO is a real or perceived loss of credibility or independence.

The PBO manages these risks appropriately. In our experience, it employs high-calibre staff with a good understanding of policy costing methodologies. Previous reviews have found that the PBO’s costings are regarded as professional, accurate, and rigorous.³

In line with a recommendation from the previous review and international best practice, the PBO periodically conducts ex post reviews of its costings to identify ways to improve its

methodology. As part of this process, the PBO asks individuals outside the organisation to confidentially review particular costings (of PBO costings that are public) and provide feedback on the assumptions and methodology. Grattan Institute has participated in this review process on several occasions.

But there are risks to the PBO’s credibility that are beyond its immediate control. In particular, the PBO faces substantial reputational risks from parties questioning its costings for political purposes.

Governments will sometimes ask Treasury to cost policies that look a lot like opposition policies.⁴ There is no ‘single source of truth’ in a policy costing, and different analysts can produce different numbers because of different methodologies or assumptions. When Treasury numbers look different to the PBO’s, there may be genuine issues raised about appropriate modelling choices. But publicising these as ‘black holes’ in the numbers can call into question the PBO’s credibility.

Governments have largely refrained from undermining the PBO in this way. However, in 2018 the Parliamentary Budget Officer was forced to publicly defend the organisation against claims it had made an error resulting in an overestimate of the revenue from Labor’s proposed change to the refundability of excess franking credits.⁵

² In the lead-up to the 2010 election, the then in opposition Coalition took a big hit to its credibility when Treasury costings identified several significant errors in its policy costings (Martin, 2010). Having an independent PBO to do the costings has substantially reduced the risks of this occurring.

³ Watt and Anderson (2017); ANAO (2014).

⁴ See for example: Harrison (2012); Coorey (2012); Brinsden (2019).

⁵ Prime Minister Scott Morrison indicated that the costing he had received from Treasury suggested that the PBO costing had overestimated the revenue from the policy because it had not factored in behavioural change. He said this meant that Labor’s policy platform was built on a ‘house of cards’: Benson (2018). The PBO reiterated its previous statements that it had taken into account behavioural

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Such political disputes, particularly if they became more common, will harm the credibility of the costing process and its usefulness for parliamentarians.

1.3 PBO costings should be made public when used in public debate

During the caretaker period, parliamentarians can request costings of publicly-announced policies, with all costings publicly released on the PBO website.⁶ But outside the caretaker period, any PBO costing is confidential unless the parliamentarian who commissioned it requests its release.⁷

It is imperative that parliamentarians are able to submit confidential costings to assist them in developing policy. Parties need to be able to 'fly kites' outside the glare of the public spotlight, to assist them in working through potential policy options.

But the story is very different once a party releases the policy and refers publicly to the PBO's costings. The PBO costing minutes contain highly relevant information such as the reliability of the

costing and the assumptions on which it is based. This provides useful context for debating the merits of a policy.

Publicly releasing costing information would also help protect the PBO from unfounded attacks on its methodology, by making its assumptions transparent.

Public release of PBO costings might be seen as reintroducing the uneven playing field if policy costings from Treasury aren't subject to the same scrutiny. While Freedom of Information laws provide some opportunity to shed light on Treasury assumptions, it is becoming increasingly difficult to access information via FOI laws.⁸

One way to overcome this concern would be if Treasury were required to produce standardised costing minutes in the same way as the PBO, to be released publicly once the costing is publicly referred to by the government of the day.

change in its costing of the policy: PBO (2018). The PBO's position was made more difficult because the opposition had not publicly released the costing.

⁶ PBO (2019a).

⁷ Or alternatively, if the parliamentarian initially requests the costing on a non-confidential basis: PBO (2020).

⁸ For example, the Department of Home Affairs recently faced criticism for not responding to the majority of FOI requests for non-personal information within the specified time limit: Hunter (2019). FOI refusals are at record highs: Knaus and Bassano (2019).

2 Research and consultation

The PBO's research has improved the quality of debate on fiscal policy. Its analysis and research on the drivers of the medium-term fiscal position is particularly useful to policy makers and commentators. But it would be more useful still if the PBO were to adopt additional projection scenarios.

2.1 The PBO's research reports provide useful insights

Grattan Institute's Budget Policy and Institutional Reform Program provides analysis and comment on fiscal policy settings and risks. We draw on the PBO's work in our research and find it to be of a high quality. It has been particularly useful in understanding issues around medium-term budget sustainability.

The PBO's regular *Medium-term projections* report provides much more information than the budget papers on projection methodologies, fiscal outcomes, and risks. Examples of valuable contributions in recent publications include analysis of the effect of policy decisions on spending for major programs, and analysis of the distributional effects of the proposed income tax cuts over time.

The PBO's annual *National fiscal outlook* report also makes a unique contribution by consolidating Commonwealth and state and territory budget and debt positions to give an indication of the health of government finances on a national basis.

Similarly, the PBO's ad hoc research reports have also helped improve public understanding of fiscal and budget policy issues.

Some reports have highlighted important accounting and methodological issues in fiscal reporting. For example, the 2019

Net debt and investment funds report highlighted the sensitivity of the net debt measure to investment structures in government investment funds, and suggested net financial worth as a better measure of the sustainability of the government's financial position. These 'nerdy but important' issues would probably otherwise be overlooked in public debate.

The PBO could also make better use of the very large data sets, including tax and welfare data, that are not easily available to other researchers. These rich data sets provide significant scope for further analysis of fiscal drivers.

2.2 The PBO should consider additional scenarios in its medium-term projections

The PBO's medium-term projections often look very similar to Treasury's. This is not surprising given the PBO is required to adopt Treasury's four-year forward estimates and its economic forecasts. The only scope for difference is in its revenue and cost models for years 5 to 10.

The PBO also mirrors Treasury's methodology of calculating 'baseline estimates' – i.e. estimates of revenue and spending assuming no change to policy settings over the decade.

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On the revenue side, this unrealistic assumption is moderated by an overriding assumption that if revenue creeps too high as a share of GDP, some of it will be returned via tax cuts.⁹

But on the spending side there is no such modifying assumption. This can result in an unrealistic picture of the path of spending over time.

The PBO notes that its estimates provide a 'baseline from which future policy decisions can be added or subtracted', rather than 'attempts to predict the future'. But both the Treasury and PBO baseline estimates *are* often considered to be, and used as, predictions.

There is a risk this creates complacency about future budget pressures. It is of particular concern when government policy decisions are based on these projections.

The government announced income tax cuts in the 2019-20 Budget (over and above tax cuts introduced in the previous year's budget) of \$158 billion over the decade. These cuts were said to be affordable because the medium-term projections showed the budget would reach surpluses of 1 per cent of GDP by 2026-27.¹⁰

But any additional spending after 2019-20 would undermine this claim. Less than a year after the 2019-20 Budget, the government has already made several significant new spending commitments.

⁹ For example, the government's current target is that taxes will not exceed 23.9 per cent of GDP. And in assessing the medium-term budget impact of Labor's policy proposals, the PBO adopted a 'technical assumption' supplied by Labor of a maximum tax-to-GDP ratio of 24.3 per cent. PBO (2019, p.6).

¹⁰ 'Over \$300 billion of tax cuts set out in the last two budgets have passed the Parliament, enabling Australians to earn more and keep more of what they earn.'

And it is unrealistic to assume governments *wouldn't* make new spending commitments over the medium-term.

There would be value in the PBO producing a second set of projections that factor in additional spending growth or revenue reductions based on historical trends. This more realistic set of estimates would be very helpful for assessing whether policy announcements are consistent with the fiscal strategy of the government of the day.

Within this new structure, Treasury would continue to produce a 'no-change' baseline, while the PBO would produce both its own 'no-change' baseline and a medium-term projection, assuming that governments over the next decade make changes to tax and spending policies at a similar rate on average as past governments.

2.3 Stakeholder relationships and engagement

Grattan Institute has a positive and productive working relationship with the PBO. At the PBO's request, we have provided comment on its forward work program, as well on the approach and content of certain research reports. The PBO has provided its time and expertise to review budget and other economic policy-related Grattan reports, helping ensure we make a well-informed contribution to public debate.

Our AAA credit rating has been maintained and the Budget is coming back to surplus for the first time in more than a decade.' (Frydenberg, 2019). The asserted affordability of the previous year's tax cuts was also linked to an imminent surplus: 'The plan is affordable and funded. The total revenue impact on the Budget and forward estimates is \$13.4 billion. The overwhelming majority of this cost commences in 2019-20, the same year the Budget is forecast to return to balance.' (Morrison 2018). Commonwealth of Australia (2019, pp. 3-11).

3 The PBO should be given additional responsibilities

Unlike most other independent fiscal institutions, the PBO does not have responsibility for making or assessing economic forecasts or monitoring compliance with fiscal rules.

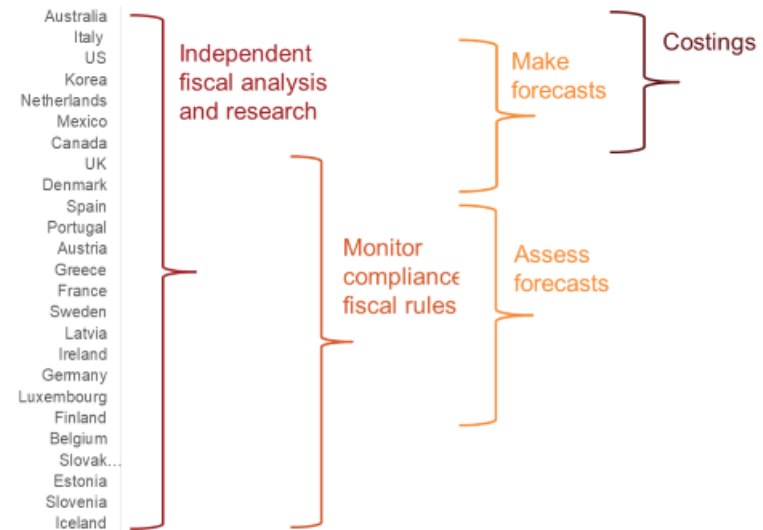
Given its independence and record of transparency, we consider that these functions would be better carried out by the PBO than Treasury, with appropriate resourcing. The PBO should also be given responsibility for the Intergenerational Report.

3.1 Independent fiscal institutions typically have a broader remit

Most OECD countries now have an independent fiscal institution.¹¹ All independent fiscal institutions provide independent fiscal analysis and research, while most monitor compliance with fiscal rules and make or assess forecasts, and only a handful conduct policy costings (Figure 2).

Australia's PBO is in the minority in that it does not have responsibility for making or assessing economic forecasts or monitoring compliance with fiscal rules. We consider there is a good case for the PBO to be given these additional functions.

Figure 1: Many independent fiscal institutions make or assess economic forecasts and monitor compliance with fiscal rules
Functions of independent fiscal institutions, various countries



Source: OECD (2017).

¹¹ OECD (2019): 28 out of 36 countries, as at September 2019.

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3.2 Give the PBO responsibility for budget forecasts

The Commonwealth Government should give Australia's PBO responsibility to produce and publish macroeconomic forecasts that would feed into the government's budget estimates.

Australia's forecasts and projections were systematically optimistic when the economy stagnated, and overly pessimistic when it was going well.¹² The excessive optimism of the past decade allowed successive governments to engage in forecast-led denial about the need for budget repair: when the budget is projected to float back to near surplus over the next four years, then it seems less urgent to make politically difficult decisions to improve the bottom line.

Forecasts that are independent of government won't necessarily be more accurate. Private-sector forecasters demonstrated the same systematic forecast errors as the Treasury over the past decade.¹³ But moving forecasting to the independent PBO would at least remove the question of whether the government of the day is 'cooking the books' to improve its electoral fortunes.

Handing responsibility to the PBO would also make macroeconomic forecasts more transparent. Independent fiscal institutions are more likely to publish the assumptions underpinning the forecasts, and engage more freely in discussions about significant economic uncertainties – for example, whether current wage stagnation is a structural change or simply cyclical.

Another potential benefit is creating a more orderly budget process. The Office of Budget Responsibility in the UK has noted that since it has taken responsibility for macroeconomic forecasts and monitoring fiscal rules, budget policy measures need to be locked in at least a week before (rather than the day before) the budget is released.¹⁴

Concerns that losing responsibility for macroeconomic forecasts would undermine Treasury capability are misplaced. Treasury would retain full responsibility for macroeconomic and fiscal policy advice. Arguably, removing forecasting – a distinct skill set – would free up resources so Treasury could concentrate on its core remit.

3.3 The PBO should monitor government performance against fiscal targets

The Commonwealth Government should require the PBO to report on the government's progress on its fiscal targets.

Under the *Charter of Budget Honesty Act 1998*, every government must release a fiscal strategy statement alongside the Budget.¹⁵ The statement is a list of the government's budget targets.

But the current targets are far from best practice: there are too many of them, they are hard to measure and evaluate, some are contradictory, they are often added or dropped without explanation or acknowledgement, and the government does not explicitly report on its progress against the targets.¹⁶

¹² Daley and Wood (2017).

¹³ Daley (2017), slide 18.

¹⁴ Hughes (2019), slide 6.

¹⁵ The charter allows for government to 'publicly release and table a new fiscal strategy at any time', but in practice changes are made in the budget or MYEFO.

¹⁶ Daley et al. (2019, Chapter 11).

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Requiring the PBO to monitor performance against the targets would make the government more accountable. It should also encourage the government to more clearly specify its targets and focus on ones that are objectively measurable.

The additional responsibilities we propose would require some additional resourcing for the PBO.

3.4 The PBO should deliver the Intergenerational Report

The Commonwealth Government produces an Intergenerational Report (IGR) every five years, to assess the long-term sustainability of Commonwealth policies.

The IGR is an important counterbalance to short-termism in politics. It provides insights into the long-term (40-year) fiscal implications of the ageing population, and highlights the effects of changes in population size, age profile, participation rates, and productivity growth on Australia's future standard of living and public finances.¹⁷

The IGR would be better delivered by the PBO, to remove the risk of the report becoming politicised – a criticism (fairly) levelled at past IGRs.¹⁸

There are also strong arguments for the IGR being expanded to a national report, incorporating the long-term budget position of the state and territory governments.¹⁹ This would further strengthen the case for the PBO taking responsibility for the report.

The PBO already has experience in producing national budget aggregates through its *National fiscal outlook* report. As an independent agency, it has no difficulty collaborating with state and territory governments of different political stripes.

¹⁷ Treasury (2015).

¹⁸ Lyon and Amidharmo (2016); Kirchner (2012).

¹⁹ Daley et al (2019, Chapter 11).

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