



Effective economic policy: why institutions matter

**New Zealand Government Economics Network
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Why institutions matter (and how to design them)

Institutions matter more than ever

- Falling trust in government and big corporates, rise in populist politics
- Two decades of policy paralysis
- Can better institutions improve policy making and boost trust?

When should policy be outsourced?

Independence and trust are paramount

- Independent Parliamentary Budget Office has improved quality of policy making and public policy debate

Advisory bodies need political buy in

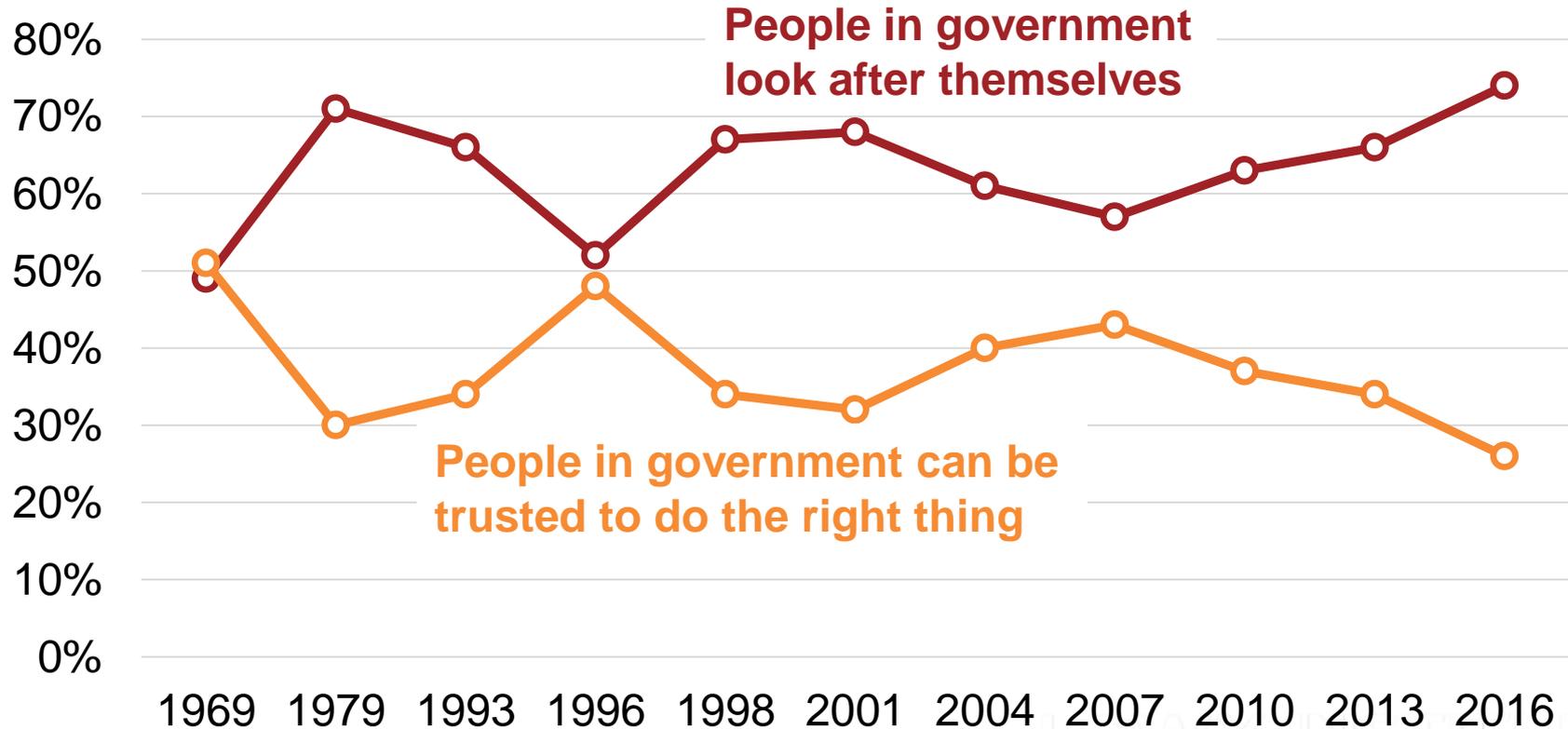
- Infrastructure Australia process largely ignored in favour of political considerations

Regulatory culture matters

- Australian Securities and Investment Commission under fire for weak enforcement culture

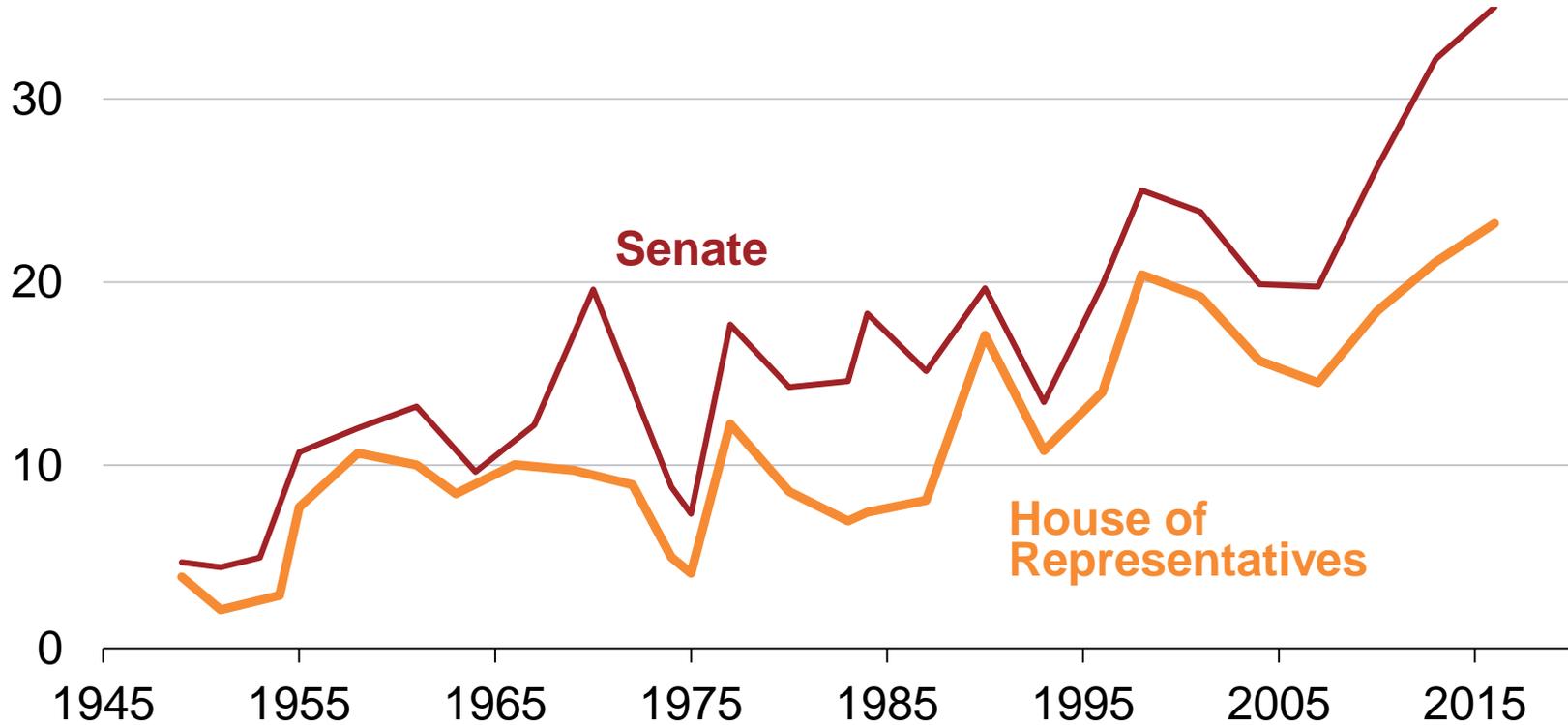
Australians are more cynical about government than ever

Trust in government, percent

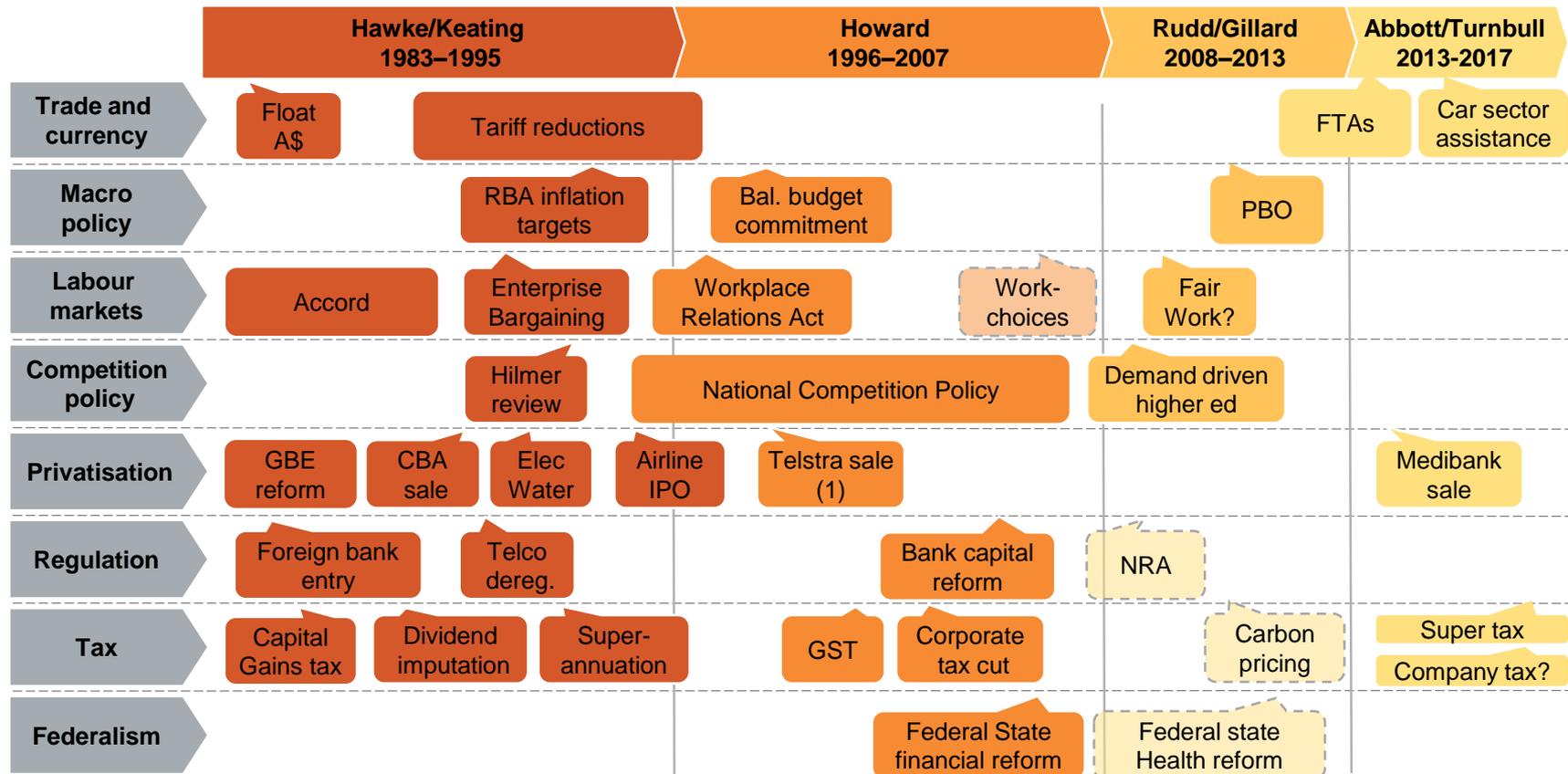


The minor party vote is at an all-time high in Australia

Minor party first preference vote (including Greens), Australian elections



Australia has made fewer tough economic choices this past decade



Note: The NRA is a broad set of microeconomic reforms largely focused on public sector efficiencies

Source: Access Economics; The Reform Dividend; 1983-2004—Calculating the Payout; The Economist, Special report Australia, 28 May 2011; Grattan analysis.

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Frustration with politics has led to many ideas for outsourcing policy

“...given the overwhelming importance of the tax and transfer system and the likely fierce, negative politics against whatever will be proposed, that it would make more sense to consider the establishment of an independent, permanent, **Tax Commission**, an institution designed to be “beyond politics”.



Former
Opposition
leader John
Hewson

Former
Opposition
leader Mark
Latham



“[a body] similar to the Reserve Bank could be established to ...determine the **major features of the federal budget** (such as outlay and revenue targets, appropriate deficit/surplus levels and debt management policies)... the role of executive government would be to develop services and taxation measures compatible with these fiscal parameters.”

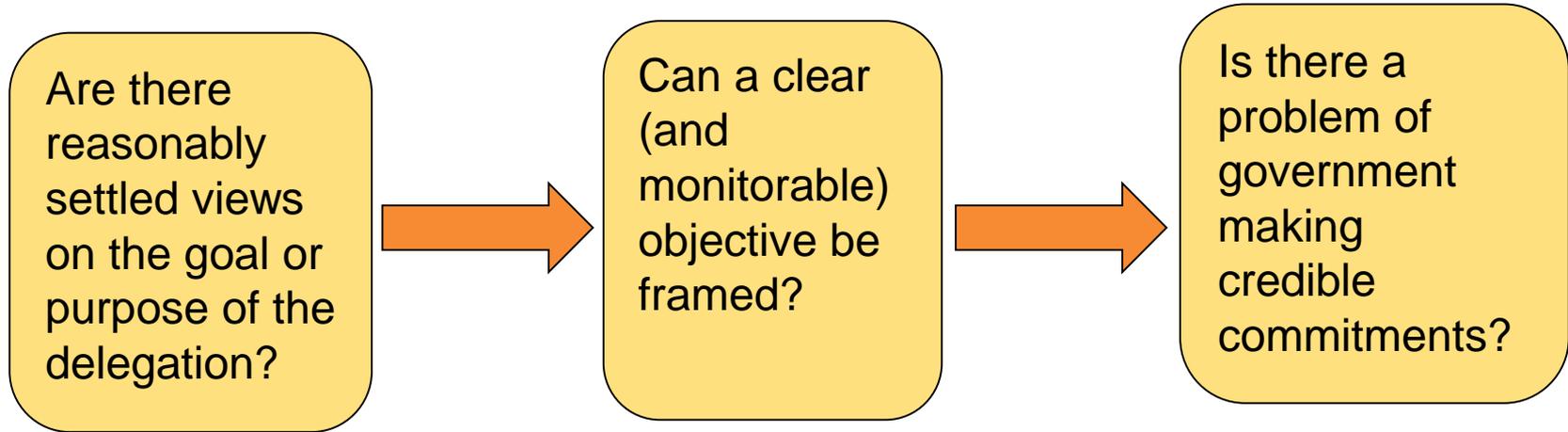
“The Reserve Bank has the power to alter the official cash rate and require minimum deposits on housing loans to counter inflation and threats to fiscal stability. The **Climate Commission** should be able to act on the greatest threat to humanity – climate change – by adjusting the price of carbon.”

Greenpeace New
Zealand Executive
Director, Russel
Norman



But when is it appropriate to delegate power?

Principles of delegation



Just about need for **expertise** – why not an advisory body?

Things that go to **values** – eg. distribution issues – questions for government

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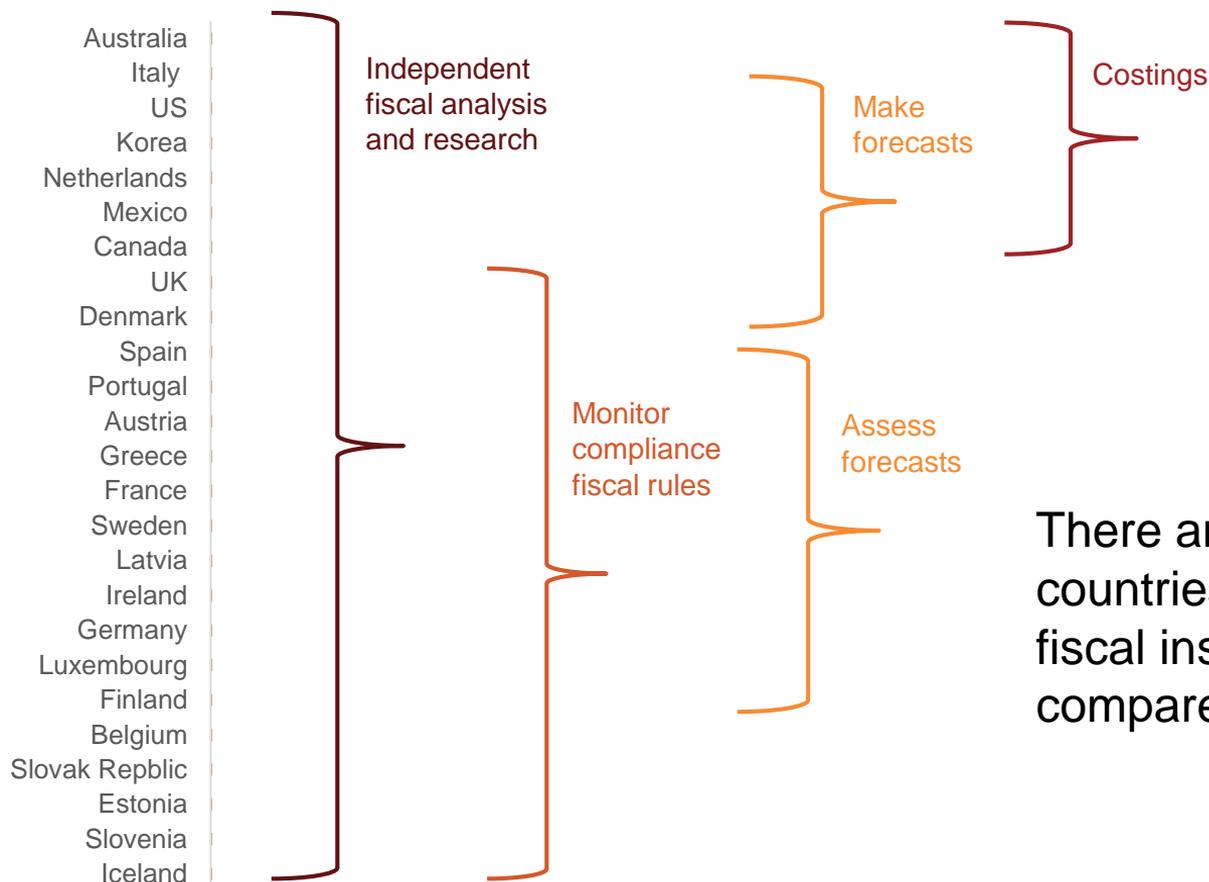
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Independent fiscal institutions are growing in popularity (although mandates differ)



There are now around **40** countries with independent fiscal institutions – compared to **6** in 1990

Independence and trust matters

Parliamentary Budget Office

- Independent policy costings for all parliamentarians
- Publishes a post-election report showing financial impacts of each party's election commitments
- Provides transparency around fiscal and budget policy issues

“The PBO quickly gained the confidence of parliamentarians as an independent non-partisan source of expertise on the budget cycle, fiscal policy and policy costings.”

“The PBO is an important addition to our democratic arrangements and has already made a significant contribution to transparency and accountability in the country's finances.”

PBO improved quality and substance of policy debate

- Levelling playing field for parliamentarians – encouraged opposition and minor parties to be more **bold on policy formation** not just during election campaigns
 - In 2017/18 (non-election year) received over 2000 costing requests
 - Some opposition policies – ring fencing losses investment properties, changes to dividend imputation – may not be on table without PBO
- Much **better informed debate** around fiscal policy
 - Structural budget estimates and greater appreciation structural pressures
 - More sensitivity analysis around budget forecasts
 - Medium term (ten year) projections of revenue and spending

PBO fiercely defends its independence (and its costings)“



Former Treasurer
(now PM), Scott
Morrison

“A detailed Treasury costing of Labor’s retiree tax proposal has revealed a \$10 billion black hole in Labor’s expected budget revenue from denying tax refunds for dividend imputation credits over the medium term...This latest **Labor black hole** is another chapter in Labor’s sorry history of overstating revenue measures.”



Parliamentary
Budget Officer,
Jenny Wilkinson

“The PBO brings our best professional judgement to the independent policy costing advice we provide. We have access to the same data and economic parameters as The Treasury and draw upon similar information in forming our judgements. **We stand behind the PBO estimates**...noting that all policy costings, no matter who they are prepared by, are subject to uncertainty.”

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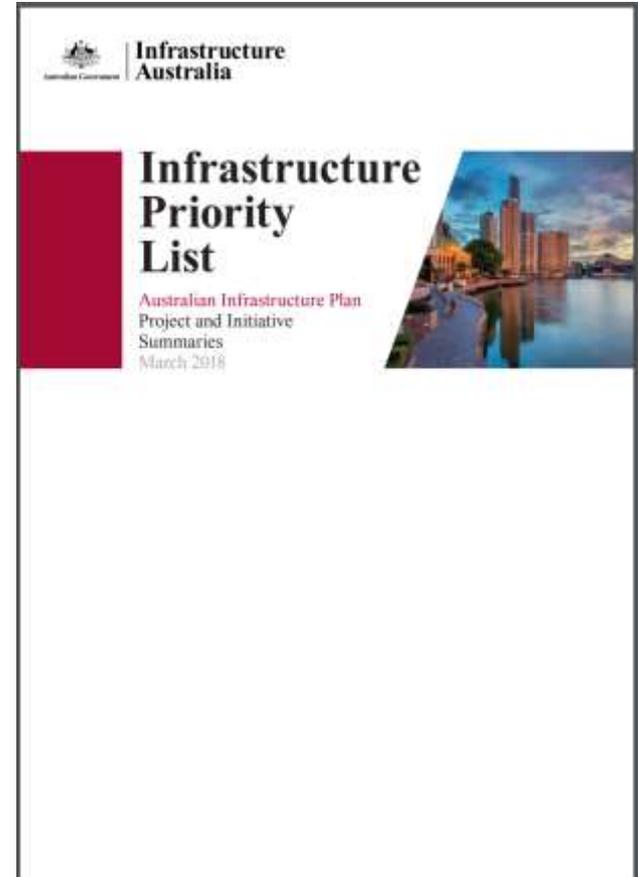
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Advisory bodies have little effect without political buy in: Infrastructure Australia

Infrastructure Australia is an independent statutory body with a mandate to prioritise and progress nationally significant infrastructure.

Infrastructure Australia is responsible for strategically auditing Australia's nationally significant infrastructure, and developing 15-year rolling Infrastructure Plans that specify national and state level priorities.



But does the government listen?

Most big ticket infrastructure underway are not on the Infrastructure Australia high priority list

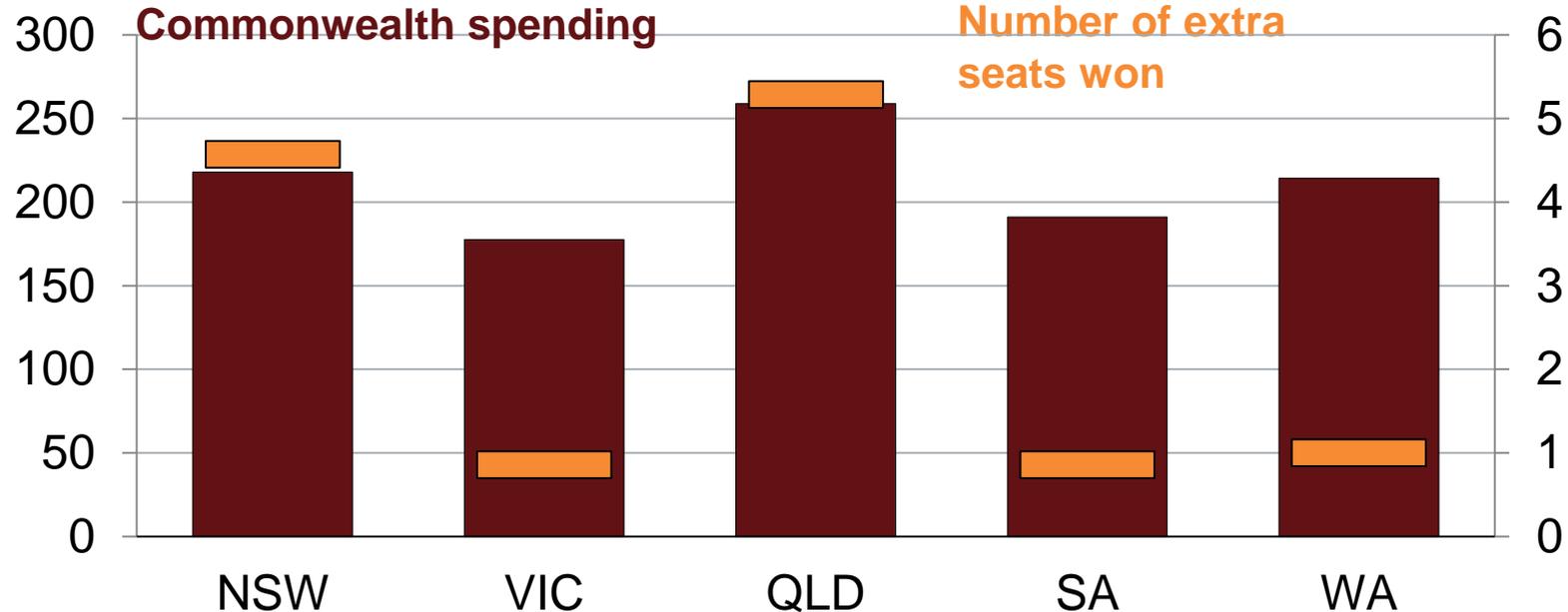
| Project | Cost | Status |
|-----------------------------------|----------------|----------------------------------|
| National Broadband Network | \$49 billion | Not assessed by IA |
| Snowy hydro expansion | \$4 billion+ | Not assessed by IA |
| Melbourne to Brisbane Inland Rail | \$9.3 billion | Assessed but not a high priority |
| Melbourne airport rail link | \$10 billion + | No detailed planning |
| Western Sydney Airport | \$5.3 billion | IA High Priority Project |

Project selection remains highly politicised

Commonwealth spending on transport infrastructure and average number of seats contributing to swing

Average annual per capita investment (\$)

Number of seats

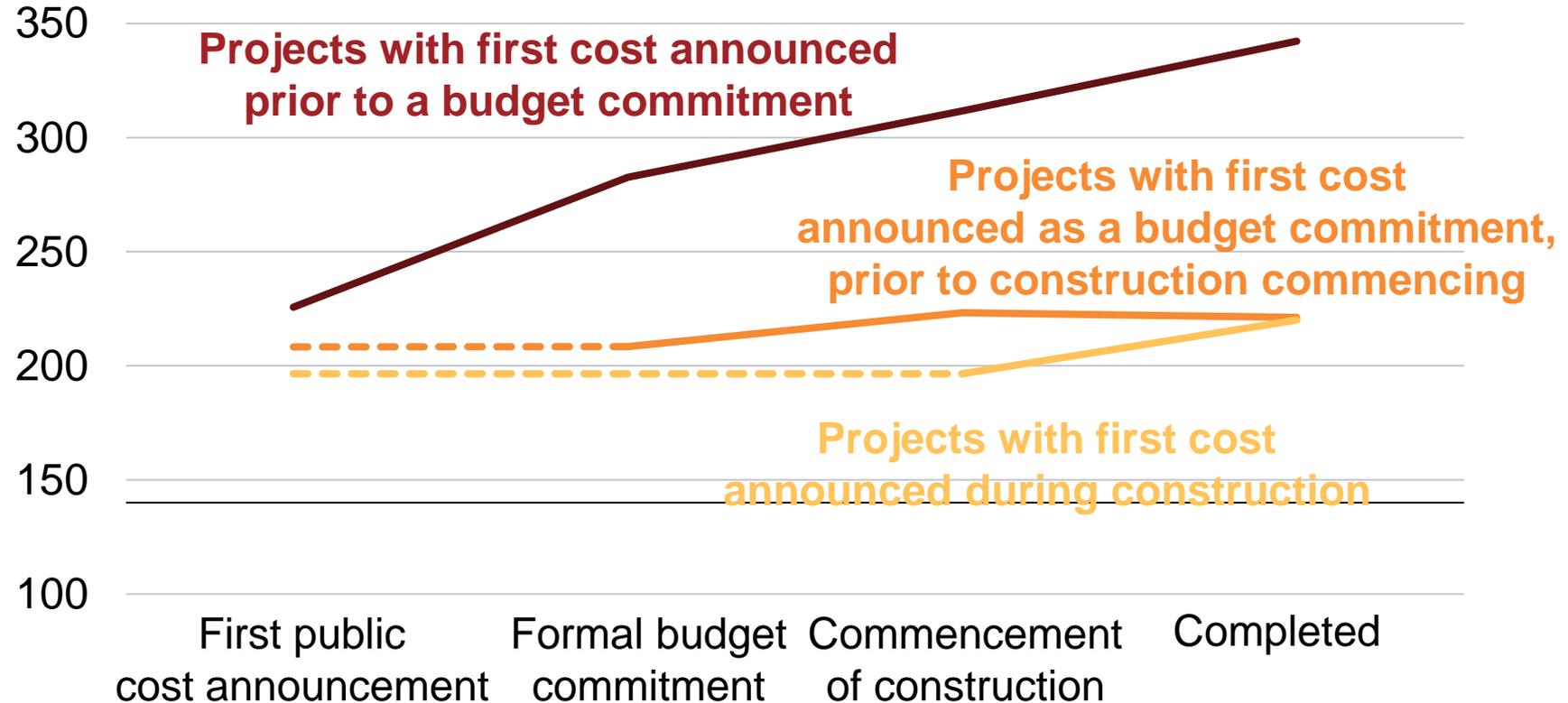


Notes: Spending includes amounts paid directly to local government. The seats measure is the number of extra seats won in each state, by the party that made an overall gain at the election i.e. Coalition in 1996, 2001, 2004, 2010, 2013; Labor in 1998, 2007.

Source: Grattan analysis of Commonwealth Budget Papers 2005-06 to 2014-15; AEC (2015); Grattan analysis.

Projects announced prematurely have larger cost overruns

Average project size, by project stage, \$2016 millions



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Regulatory culture matters: banking regulator under spotlight

Australian Securities and Investment Commission's (ASIC) culture comes under heavy criticism in Australia's Banking Royal Commission

ASIC places too much reliance on negotiated outcomes

"[ASIC] has a deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of and punishment for wrongdoing"

"Civil penalty proceedings have seldom been brought."

70% of ASIC's enforcement actions have been against small business

"Complex litigation against large entities is necessary."

"[T]here seems no recognition of the fact that the amount outlaid to remedy a default may be much less than the advantage ...gained from the default."

"Banks could not find a word of criticism for ASIC"

ASIC sustained substantial reputational harm

Banking royal commission: How ASIC went missing in action with the banks

Regulator ASIC has a 'culture of subservience to the big banks', says former employee

Scrap ASIC and give us a real regulator

Abbott suggests sacking bank regulators as ASIC feels the heat

Why we should abolish ASIC



Risks to enforcement culture: regulatory capture



One argument in favour of leaving consumer protection with the ACCC was that it wouldn't be captured ...It doesn't have time to become close to the industries it polices.

The argument against a specialist regulator is that it will succumb to the 'Stockholm Syndrome', that the regulator and the industry will hire from each other and go to the same conferences and so on.

With the benefit of hindsight and what's been coming out at the royal commission, the weaknesses of the specialist approach we took to regulation are also evident.

Risks to enforcement culture: revolving door?

ASIC identified 70 inbound secondments between 2005-2015 from banks and consulting firms

- Only provided information in response to a Senate Question on Notice, despite pressure prior
- Did not provide information on the roles they performed

A NAB employee on secondment to ASIC helped ASIC prepare its response to a relief application from the bank lobby that he had helped prepare

“ASIC has a deeply ingrained culture of subservience towards the major financial institutions.”

“I saw ASIC literally changing the law, amending the Corporations Act to benefit the banks and the lobby groups for the banks”



James Wheeldon, former ASIC employee

Risks to enforcement culture: fear of court losses

How concerned should regulators be about losing cases?

- ASIC witnesses expressed concern about the cost and uncertainty of litigation
- ASIC's success rate for litigation has averaged above 90% since 2011–2012. In 2015–2016 it reached 96%.

“That seeming accomplishment has concerning implications, for it suggests that ASIC has a preference for easily won cases...and does not do enough to resolve grey areas in the application of the law.”

Royal Commission interim report suggests shift in onus:

*When contravening conduct comes to its attention, the regulator must always ask whether it can make a case that there has been a breach and, if it can, then ask why it would **not** be in the public interest to bring proceedings to penalise the breach.*

A regulator of the regulators?

Draft report of the Royal Commission into misconduct in the financial services sector suggests new statutory body to ensure regulators are subject to critical review and held to account for their performance



OR



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