

CPA Australian Mining and Energy Conference

Panel Discussion

Sustainable economic policies – viable outcomes for all stakeholders

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Introduction

Thank you for the opportunity to discuss these issues with you today.

This session is intended to “provide an open forum for honest discussion about what works, what needs to be considered and ultimately what fails”.

It can sometimes be forgotten, but we should not forget that Australia has been more successful than most countries in successfully implementing economic reform.

So I would like to start my remarks by briefly recapping the Australian reform story.

Australia’s reform story¹

The market-based reforms of the past thirty years interacted in mutually reinforcing ways, fundamentally transforming Australia’s system of economic governance.

To recap, in the 1970s, Australia had highly regulated labour and product markets. The economy was insular, with high levels of industry protection. Furthermore, the inflexible institutional arrangements, such as the wage-fixing system, propagated external price shocks into generalised inflationary pressures. As a result Australia experienced poor economic performance during the 1970s and 1980s. Moreover, our relative performance had been declining since the 1950s.

By the 1980s it was increasingly recognised that the status quo would result in continued relative decline of Australia’s living standards and that a change in direction was required.

The next three decades were a period of reforms that were significant in both their size and scope.

There were important macroeconomic reforms, particularly the shift in the focus of fiscal policy to medium term framework emphasizing sustainability,² and the shift to monetary policy being set by an independent central bank operating with a medium term inflation target.³

There has also widespread microeconomic reforms to the tax and financial systems, product, labour and financial markets.

While there were debates about the speed and extent of reform, in general the reforms received support across the political spectrum.

The reforms had a number of common elements. First, they reduced transaction costs. Second, the reforms improved the flexibility of the economy. Third, the reforms meant that prices better reflect the true cost of production and relative prices better reflect product transformation costs. As a

¹ For further exposition of these issues, see Banks, G, 2010, *An Economy-wide View: Speeches on Structural Reform*, available at: <http://www.pc.gov.au/speeches/20100329-structural-reform-compendium>; Parker, D, 2007, “The Importance of Open World Markets for Australia’s Development and Prosperity”, *Economic Roundup* http://www.treasury.gov.au/documents/1280/PDF/Lowy_Institute_Conference.pdf; Henry, K, 2001, “Australia’s economic development”, Address to the CEDA 40th anniversary annual general meeting dinner, *Economic Roundup* http://www.treasury.gov.au/documents/108/PDF/3_ceda.pdf

² See, Gruen, D and Sayegh, A, 2005, “The Evolution of Fiscal Policy in Australia”, *Oxford Review of Economic Policy*, 21, Oxford University Press.

³ See, Stevens, G, 1999, ‘Six Years of Inflation Targeting’, Reserve Bank of Australia *Bulletin*, May, pp 46–61. Available at <http://www.rba.gov.au/publications/bulletin/1999/may/pdf/bu-0599-2.pdf>; and Debelle G, 2009, ‘The Australian Experience with Inflation Targeting’, Banco Central do Brasil XI Annual Seminar on Inflation Targeting Rio de Janeiro. Available at <http://www.rba.gov.au/speeches/2009/sp-ag-150509.html>

result, Australian economic agents are more responsive to changes in the economy, because prices are more accurate signals of these changes.

Finally, these reforms have meant that Australian economic agents now have better information about what to expect in the future. This is due to the creation of forward markets, as well as the credible anchoring of expectations by macroeconomic policy frameworks. Overall, the reforms have improved the efficiency of resource allocation in Australia.

Political Economy of Reform

The divergent reform experiences of different developed countries over recent decades highlights the fundamental importance of the issue of the political economy of reform – that is, how to actually make reform happen.

This is an area where the OECD has done extensive work, using its comparative advantage in comparing the experience of member countries.⁴ From this analysis a number of basic principles have underpinned successful implementation of reforms, including:⁵

1. Policy should be underpinned by solid research and analysis;
2. Successful structural reforms take considerable time to implement;
3. Effective communication by governments is important;
4. Government leadership is essential; and
5. Successful reform requires persistence.

This is an imposing list – and reminds us that successfully implementing reform is difficult. But, as noted above, we should not forget that Australia has been more successful than most over recent decades. So it is possible.

I would like to focus on the first of these principles – the importance of solid evidence and analysis for successful economic reform.

*The importance of evidence for successful economic reform*⁶

The Australian reform experience since the 1980s shows the importance of evidence-based policy.

Providing evidence of the potential and actual net benefits of reform is crucial in building and maintaining public support for reform.

⁴ See, for example, OECD (2007), “What Shapes the Implementation of Structural Reform?” *Going for Growth*, OECD Paris; OECD (2009) *Political Economy of Reform; Lessons from Pensions, Product Markets and Labour Markets in Ten OECD Countries*, OECD Paris.

⁵ Clearly, this list is not exhaustive. See Tompson, W. and T-T. Dang (2010), “Advancing Structural Reforms in OECD Countries: Lessons from Twenty Case Studies”, *OECD Economics Department Working Papers*, No. 757. Available at: http://www.oecd-ilibrary.org/economics/advancing-structural-reforms-in-oecd-countries_5kmh5gnsb937-en

⁶ This section draws extensively from Grant, A and Wilkie J, “The Importance of Evidence for Successful Economic Reform”, *Economic Roundup*, Issue 1, 2009. Available at: http://www.treasury.gov.au/documents/1496/PDF/04_Evidence_and_reform.pdf

One of the key lessons from Australia's reform experience is the need to remind people of the benefits of reform, so that the focus is not solely on costs of reform. This is particularly important, as the costs of reform tend to occur in the short term and can be concentrated on relatively small groups, while benefits tend to materialise in the medium to long term and be widely spread across the community.

Evidence is also important in highlighting the costs in not undertaking reform, which can help to mobilise broader support for reform.

- For example, the work of the Productivity Commission and its predecessors over many years in highlighting the impact of manufacturing tariff protection on the costs of the mining and agriculture sector was important in spurring these industries to support and lobby for trade liberalisation.⁷

Policy Advice and Treasury's Wellbeing Framework

Treasury's mission statement is to:

improve the wellbeing of the Australian people by providing sound and timely advice to the Government, based on objective and thorough analysis of options, and by assisting Treasury Ministers in the administration of their responsibilities and the implementation of Government decisions.

So, how, then, do these perspectives influence Treasury's policy advice? Nearly a decade ago, this question led to work to develop a "wellbeing framework".⁸ I don't have time to go through it fully this afternoon, but in brief it has five key elements or dimensions:

1. the level of **freedom and opportunity** that people enjoy;
2. the aggregate level of **consumption possibilities**;
3. the **distribution** of consumption possibilities;
4. the level of **risk** that people are required to bear; and
5. the level of **complexity** that people are required to deal with.

The purpose of the wellbeing framework is to provide guidance on the key issues Treasury officers should be thinking about in framing policy advice to Government. It is not a 'checklist' to be applied in every circumstance, and its application differs across different areas reflecting their different responsibilities and tasks. Nevertheless, it serves an important unifying function for Treasury's policy analysis and advice, through providing a broader intellectual context for Treasury's work.

The framework reinforces our view that trade-offs matter deeply. Most policy reforms will involve trade-offs within or between dimensions of wellbeing. These trade-offs can be complex and multidimensional. Decisions regarding policies involving such trade-offs ultimately require judgements to be made about valuing different aspects of social welfare, which can only be done through the political process.

⁷ Banks G, "Structural Reform Australian Style", 2005 <http://www.pc.gov.au/speeches/cs20050601>.

⁸ For more information, see Henry, K, "Policy Advice and Treasury's Wellbeing Framework", *Economic Roundup* 2004 http://www.treasury.gov.au/documents/876/PDF/Policy_advice_Treasury_wellbeing_framework.pdf

Conclusion

There are powerful forces at work in the Australian economy, including the re-emergence of China and India and the surge in Australia's terms of trade; demographic pressures including population ageing and growth; climate change adaptation and mitigation; and the continued evolution of the information and telecommunications revolution of recent decades.

How we respond to these opportunities and challenges – that is, the quality of the policy settings and decisions taken today - will be crucially important to the wellbeing of Australians over coming decades.

