Business Council of Australia

SUBMISSION

Response to the Better Budgeting Discussion Paper

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Contents

The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

Executive summary

The Business Council welcomes the opportunity to make a submission in response to the Better Budgeting discussion paper.

The ultimate goal of government spending must be to improve community living standards through the provision of crucial services such as education and health care, public infrastructure, national defence and a social safety net to protect the most vulnerable.

However, the nation's resources are not unlimited, and improving living standards requires scarce resources to be allocated as effectively as possible. Government spending uses up resources that have value in other uses. To get the best outcomes for both our economy and our society, government spending must deliver net social benefits – that is, a value greater than in those other uses.

Resource constraints cannot be addressed by raising taxes to fund additional spending. Higher taxes do not fix inefficient spending and will inevitably impair income growth – and revenues for essential services – over the medium to long term. In the absence of competitive market pressures, ensuring net benefits for the community requires thorough and transparent evaluation of programs and accurate and reliable accounting of where money is spent.

The budget should provide information on both individual policy decisions and the government's overall fiscal strategy. It should explain what the government is trying to achieve with its fiscal strategy and the environment in which it is operating, and provide mechanisms for the government's performance to be evaluated.

There is also a need to understand what money has been committed beyond just the four-year forward estimates period. Major policy reforms, such as the NDIS, can take many years to implement and the budgetary impact of these policies can take more than a decade to manifest fully. It is incumbent on governments to ensure that they are clear about what they will be asking of future governments and future taxpayers.

The budget also communicates policy decisions to the community. Businesses rely on information in the budget to inform their future spending and investment decisions and it is important that taxpayers are able to understand what their money is achieving and hold the government to account.

The Business Council recommends that governments commit to an overarching strategy to strengthen the budget position and deliver higher living standards through:

- slowing the 3 per cent annual real spending growth projected from 2020 onwards
- delivering more effective and better targeted services that give the community better value for the more than $440 billion the government spends each year
- promoting investment and economic growth.

To support this strategy, the Business Council has five key recommendations for better budgeting:

- establishing a budget architecture that includes clear fiscal goals to support a strong affordable budget position, more effective and better targeted services, and investment and economic growth
- adopting and legislating fiscal rules to promote discipline and provide benchmarks for assessing progress
- embedding a culture of independent and transparent program evaluation
- using the Parliamentary Budget Office to improve independent oversight of the government’s performance against its fiscal strategy
- making changes to the way the budget is presented to increase transparency in budget reporting.

1. Strengthening the budget architecture

Clear fiscal goals

It is important to have clear overarching objectives to guide budget policy.

The Business Council has proposed four goals that go to the heart of competent and prudent fiscal management in the interests of the Australian community now and in the future.

1. Ensure the sustainability of priority services, including an adequate safety net, which are integral to community living standards and the functioning of our society.

The prime fiscal objective should be to support the sustainable and effective provision of services that deliver net community benefits and which only governments can provide.

2. Ensure capacity for investments in infrastructure and human capital, vital for innovation and productivity growth and higher incomes.

Investment in human capital and infrastructure and other policies, including taxation reform, can improve productive capacity and economic growth.

Redesigning major spending programs will free up capacity to deliver these essential investments in future growth without undermining fiscal capacity and resilience.

3. Progressively return the budget to surplus to build resilience and flexibility for dealing with economic shocks and volatility, and for underpinning business confidence and investment.

The government budget position has significant implications for macroeconomic stability and resilience.

In 2016-17, Australia will record its ninth consecutive budget deficit. Persistent deficits undermine our ability to respond to economic shocks and volatility. This vulnerability will only worsen the longer deficits continue and debt accumulates.

4. Preserve Australia's AAA credit rating to retain financial capacity and maintain investor confidence.

Maintaining the AAA credit rating is not an end in itself, but losing it would have real consequences across the economy.

Establishing fiscal rules

In its 2017-18 Budget Submission, the Business Council reiterated its call for the government to establish a fiscal strategy to 2025 to achieve sustainable fiscal reform.

While the Charter of Budget Honesty commits the federal government to producing a medium-term fiscal strategy, these strategies are not binding and – consistent with international experience – have often not been fully executed, therefore failing to ensure meaningful fiscal discipline.

The Business Council believes that there is a strong case for the creation of fiscal rules that are subject to independent oversight and potentially legislated. The inclusion of fiscal rules in a fiscal strategy are a means of providing discipline and benchmarks for assessing progress (or identifying backsliding).

There is international evidence that fiscal rules – which can take the harder form of numerical limits relating to debt, spending and taxes – can be useful to anchor fiscal strategies and budget repair goals. The number of countries with fiscal rules has grown from six in 1985 to 85 in 2014.

Fiscal rules provide signposts for each year's budget in progressing towards longer-term goals. They also provide discipline. Without them, longer-term goals can more easily be deferred or fiscal discipline can be inconsistent.

The adoption of fiscal rules would not prevent government having the flexibility to change course in the event that an extraordinary economic shock, natural disaster or other emergency situation result in a significant and unexpected call on budget resources.

As outlined in its 2017-18 Budget Submission, the Business Council therefore recommends that the government adopt and legislate fiscal rules to:

- **limit the overall level of taxation**: There should be no increase in the overall level of taxation as a proportion of the economy. That is, it should not exceed maximum levels envisaged in the current forward estimates (around 22 per cent of GDP)
- **reduce spending growth**: Real spending growth in any one year should not exceed 2 per cent until budget surplus is achieved. Two per cent should be an outer boundary for real spending growth in any given year. As long as the economy grows in excess of 2 per cent, this would progressively reduce the overall share of government spending.
- as far as possible, in collaboration with the states, develop measures of and benchmarks to **assess government sector productivity performance**
- **contain the overall size of government**: The Parliamentary Budget Office (PBO) should be given responsibility for reporting on the overall size of government and identifying major trends and risks.

Embedding a culture of program evaluation

The introduction of fiscal rules and targets for government spending and taxation is very important, but how those targets are met is equally if not more critical.

The federal government currently spends more than $440 billion of taxpayers' money each year, and it is incumbent on governments to ensure that what they spend delivers net community benefits. Assessing this is not an easy task because often community benefits are hard to measure. But the challenges do not excuse not even trying.

To be successful in highly competitive markets, enterprises must continually seek to improve their productivity performance to ensure that they deliver goods and services that consumers want to buy at the lowest cost. But government services and programs generally do not face these same market and consumer pressures. Other mechanisms and approaches are required to ensure that programs achieve what they set out to achieve and that wasteful spending is not crowding out potentially valuable spending.

The Business Council recommends embedding a strategic approach to designing major programs through regular and disciplined evaluation, underpinned by more effective collection and analysis of performance data. This should be achieved through:

- requiring budget bids for new or continued funding to demonstrate that a thorough whole-of-program evaluation has been undertaken
- requiring program evaluations to assess public and private sector models of innovative service delivery and incorporate these models into the program design where relevant.

Independent program evaluation

The Business Council also recommends that independent government institutions play a larger role in systematic program evaluation.

Various mechanisms are employed for program evaluation. However, few reports that reach the public domain have a specific focus on value for money and rigorous cost-benefit analysis during program design, implementation or evaluation of long-standing programs.

For the budget to effectively promote stronger growth, better services and value from government spending and, ultimately, higher community living standards, each dollar spent must be working as hard as possible. Yet currently, there are significant areas of spending that are not regularly or systematically evaluated.

Most of the program reviews conducted inside government, especially if they relate to areas where potential savings can be realised, are kept confidential.

Many existing review mechanisms, including ANAO audits and many government-commissioned inquiries, are backward looking. Although they can draw out lessons for the future, these lessons are couched mostly in terms of errors to avoid rather than policy changes that can deliver better value for money.

Given these limitations, there is a case for an independent agency like the Productivity Commission to be tasked with responsibility for evaluating major government programs with a view to better assessing value for money. The NDIS provides an example where the Productivity Commission recommended the design and implementation path of a new system. The Commission has also been asked more recently to review progress and implementation risks.

2. Enhancing the role of the Parliamentary Budget Office

Independent institutions – such as the Reserve Bank of Australia, the Productivity Commission and the Australian National Audit Office – contribute to Australia's economic performance through enhanced scrutiny, oversight and advice, both inside and outside government. These institutions contribute to good policy governance at a national level and help contribute to public trust and confidence in government.

The PBO was created in 2012 to provide independent advice on the budget cycle, fiscal policy and spending proposals. The PBO is not currently required to report on the government's fiscal performance, but the Business Council believes there is scope for the PBO to play a larger role as a source of independent government oversight.

Reporting on the government's fiscal strategy

Since the global financial crisis, a number of countries have established an independent, non-partisan fiscal watchdog to report on government performance against fiscal rules and strategies. Over 75 per cent of fiscal councils established since 2004 have an explicit role in monitoring fiscal policy rules. This has been found to be a key role of effective fiscal councils.

As previously recommended by the National Commission of Audit, the Business Council recommends that the PBO be given the annual task of publishing an assessment of the government's progress against its fiscal strategy. This could occur after the release of the government's Final Budget Outcome but before the release of MYEFO each year.

Preparing the Intergenerational Report

The Intergenerational Report, currently prepared by the Treasury, fulfils an important long-term forecasting function in an Australian context. It provides long-term projections of key figures such as net debt, underlying cash balance, net worth and program spending expressed as percentages of GDP.

However, the IGR does not publish forecasts of annual revenue, expenditure and budget balance aggregates into the future, and does not publish its underlying data. It has also been noted that recent IGRs have been more political in tone than some of the previous reports, and have been used to promote political agendas.

The community would benefit from the IGR reporting on the long-term aggregate fiscal state of the nation every five years. By publishing federal and national (federal plus all states and territories) fiscal gaps, this would assist all governments and the community to better understand the fiscal path we are currently on and the long-term implications of large structural changes. This would also guard against shifting of costs across jurisdictions.

The Business Council regards the IGR as an important part of creating sound long-term fiscal policy and recommends transferring responsibility for preparing the IGR to the independent PBO. The Joint Committee of Public Accounts and Audit recently released its independent review of the PBO, chaired by Dr Ian Watt AC. The Business Council endorses the review's recommendation that the PBO expand its focus on medium-term fiscal sustainability issues, build its capacity to analyse underlying drivers of the budget over the longer term, and develop its longer-term analytic ability to allow the PBO to take responsibility for the 2020 IGR.

The IGR could be further improved by including:

- an assessment of state budget pressures and intergovernmental transfers
- a projection of the national fiscal gap over the long term
- population and migration scenarios
- the full set of assumptions and data used to aid transparency.

3. Improving budget transparency and reporting

The budget is the primary mechanism through which the government’s spending and taxation decisions are reported to the community. While a better budget architecture can help the community assess the government’s performance against its fiscal goals, effective budget reporting is vital for the community to understand the decisions the government has made.

Although budget reforms like the Charter of Budget Honesty, which includes the five yearly release of the Intergenerational Report, and the establishment of the Parliamentary Budget Office have been welcome mechanisms to improve transparency, there are still a number of ways the budget can be improved.

Better reporting of medium-term projections and better integration of the IGR

The budget currently provides detailed information on the economic and fiscal outlook over the four-year forward estimates period.

However, major policy reforms can take many years to implement and the budgetary impact of these policies can take more than a decade to fully manifest. Long-term spending pressures such as social or demographic trends also fall outside the immediate budget period. Labor took a welcome step towards addressing this issue when it released 10-year costings of its key policies prior to the 2016 election, but this has yet to become embedded into the official budget process.

The exact magnitude of major policy reforms, structural improvements or spending pressures are not easily appreciated because such commitments are largely outside of the forward estimates period in the budget and in some instances also place equal funding obligations on states.

Some longer-term budget pressures are picked up in the IGR, which provides long-term projections of key figures such as net debt, underlying cash balance and net worth expressed as percentages of GDP. However the IGR is not well integrated into the rest of the budget and its significance is not always apparent to readers because it publishes data in a different format than that of the budget papers and other economic documents. For example, projections of future spending on major services like aged care are expressed as percentages of GDP rather than in dollar terms. Unlike similar reports in other countries, it does not publish forecasts of annual revenue and expenditure, and does not publish its underlying data.

Potential reforms to improve the effectiveness of the IGR are discussed above. The Business Council also recommends that the budget process be amended to:

- publish 10-year projections for major revenue and spending items, including assessments of the long-term impacts of new measures such as the NDIS
- better integrate IGR analysis into the medium-term budget strategy.

Better reporting of unenacted or amended legislation

Successive governments have, at times, found it difficult to implement their budget commitments as a result of large legislative programs and challenging Senate compositions.

This has led to a build-up of policies that have been announced and factored into budget estimates but remain unimplemented, even after their designated start dates. The effects of these delays on both the cost of the policy and the overall budget are often unclear.

For the government and the community to have an accurate understanding of the budget position, it is important that the budget accurately reports spending or savings forgone because of changes to previously announced policies.

While the Parliamentary Budget Office estimates the financial impact of unenacted measures, the information is not integrated with other budget information. The Business Council recommends that the budget begin to explicitly report:

- estimates of spending or revenue forgone due to delayed implementation of previous budget measures
- clear statements of the financial implications of policy changes to unlegislated measures from previous budgets.

Improvements to the accessibility of budget data

Major data tables (particularly the historical data) should be made available in Excel to assist a range of organisations outside the government analyse the budget position.

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