

Labor



Better Budgeting

Discussion Paper

**Issued by Jim Chalmers MP
Shadow Minister for Finance**

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Better Budgeting

Better, more transparent and more forward-looking budgeting will lead to better, more transparent and forward-looking policy decisions in Australia's best interests.

This Discussion Paper aims to spark and continue deeper conversations about the Budget's guiding principles including Budget transparency. We are seeking input from experts and other stakeholders on improving the way the Commonwealth Budget is put together and presented to Australians.

This will help elevate the national conversation about Australia's Budget into the future – enabling better testing of medium and long-term policy merits, macro settings and the sustainability and mix of tax and spending.

Labor has a proud history of increasing transparency from at least the early-1980s public service reforms. We were the first to introduce the reporting of forward estimates under the Hawke-Keating Government, taking some of the uncertainty out of the annual process and shifting the focus to future consideration of competing priorities.

The Coalition introduced the Charter of Budget Honesty and the Intergenerational Report to further enhance transparency and accountability.

Later, in 2008 and 2009, Labor's Operation Sunlight¹ made significant reforms to the presentation of the Budget papers and the accountability of ministers and government agencies for the spending of taxpayers' money.

At the 2016 election, Labor committed to giving the Parliamentary Budget Office (PBO) an enhanced role in Australia's macroeconomic reporting to promote stronger fiscal discipline and enhance transparency around Commonwealth Budgets. We also pledged to release 10-year (medium-term) costings to show the structural impact of policies over time.

Better budgeting, more transparency and taking a longer-term view make it more likely that Australians get value from the taxes they pay. These principles also help the nation invest in people, their abilities and aspirations, and the future so we can grow our economy in an inclusive way.

Consultation

The Discussion Paper poses a range of questions in relation to budget transparency and related matters. We are inviting written submissions in response to these questions and any other ideas you may wish to provide. Your submissions can be emailed to jim.chalmers.mp@aph.gov.au with the subject title "Budget Discussion Paper Submission".

Your submission may be released publicly. If you do wish to provide a confidential submission, please clearly mark the submission as "confidential".

Labor will be consulting with a range of expert stakeholders and an informal advisory group, as well as hosting a roundtable discussion later in the year.

Should you have any queries about the process, please contact Michael Quinlivan, Adviser, Office of the Shadow Minister for Finance via michael.quinlivan@aph.gov.au or on 02 6277 4880.

Submissions will close on Friday, 31 March 2017.

¹ Operation Sunlight was the then Labor Government's reform agenda to improve the openness and transparency of public sector budgetary and financial management and to promote good governance practices.

Greater focus on medium-term pressures

Australia's combination of significant medium-term fiscal constraints and key policy challenges including productivity, an ageing population and persistent social problems make the medium-term budget estimates of revenue and expenditure critical for public debate on our budget position.

Many policy decisions or measures may have significant medium-term implications, but not have a large budget impact over the forward estimates. For example, Labor's negative gearing changes or pausing indexation of the Medicare Levy Surcharge and Private Health Insurance Rebate income thresholds had only a modest impact over the forward estimates, but grew to a substantial structural saving over the medium term. Not reporting the medium-term impact of these kinds of measures hinders the public's ability to weigh up the merits of policies.

In doing so, we need to recognise the inherent risk and variability of estimates the further we project forward and understand the assumptions driving those projections. Nevertheless, this uncertainty should not be an excuse for not trying to improve forecasting and the estimation of the impacts of policy decisions and non-decisions on future taxpayers.

While there is considerable detail of economic estimates, revenue and expenditure programs over the four-year forward estimates period, the Budget papers do not provide a similar level of detail for the 10-year medium-term period. This reflects the way medium-term projections are currently developed, which is difficult to disaggregate.

Budget Statement 7 (introduced in the 15-16 Budget) was a significant step in informing the debate on the impact of different economic parameters on the Budget. But there are some key assumptions and scenarios that could be regularly tested over the medium-term period, for example the impact of unlegislated measures.

1. What improvements could be made to enhance the public focus on the medium-term pressures and enhance policy decisions?

Greater independence

Labor took to the last election a commitment to give the Parliamentary Budget Office (PBO)² an enhanced role in Australia's macroeconomic reporting to promote stronger fiscal discipline and enhance transparency around Commonwealth Budgets.

This would see the PBO prepare the macroeconomic forecasts that underpin all key Budget statements and updates; prepare and publish the Intergenerational Report every five years; and prepare and publish an annual structural budget balance statement.

Confidence in the reporting and analysis of the Budget is important for a robust debate and will also help strengthen confidence in the work of government institutions like Treasury and Finance. This is consistent with an international push for greater independence in the reporting and analysis of public finances, for example the [UK's Office for Fiscal Responsibility](#).

2. What other independent analysis could the PBO publish to inform and promote informed public debate?
3. How can the PBO best leverage external advice?

² http://www.100positivepolicies.org.au/greater_budget_transparency

Reporting Transparency

The Budget papers provide a substantial amount of information on the Commonwealth's Budget. For instance, policy decisions at each update are detailed and explained relatively clearly in Budget Paper No. 2. Budget content and the presentation of budget measures is not prescribed in legislation and governments have significant flexibility in what they choose to report.

Labor in Government instituted a number of reforms to improve the presentation of budget information, and to ensure that key data was incorporated to provide a clear understanding of the impact budget decisions had on Australians.

Yet the Budget papers allow governments to obscure important information that aides commentators and the public in understanding the impact of budget decisions, such as not including distributional information. With inequality at a 75-year high, policymakers need to pay more attention to the impact of policy changes on low and middle-income households.

While the Shadow Treasurer has announced that Labor would task the Productivity Commission with reporting on efforts to improve equality of opportunity and social mobility³, there may be greater scope for the Budget papers to provide information on the distributional impact of key policies. This could include individual cameos at a point in time but also describe the shifting impact of budget decisions on individuals and different cohorts over time.

It has been suggested that in some cases the presentation of measures may not reveal the actual impact of policies, and that there may be little explanation of significant estimates variations or the implementation of past budget measures.

Labor has committed to enhancing the transparency of measures by reporting the 10-year medium-term impact of major measures, and our 2016 election policies were costed over this period to improve the understanding of the impact of policies over that period. There may be other areas that would benefit from greater transparency over a long-term horizon.

4. What improvements could be made to improve reporting in the Budget papers?
5. Are there better ways of reporting the sensitivity of measures and the Budget aggregates over the long-term?

Reporting of investments in capital versus recurrent expenditure

The Budget papers currently split out recurrent and specific capital spending in Statement 6. This reporting is relatively high level, and does not, for instance, reflect grants or loans the Commonwealth has made towards particular infrastructure investments that are delivered through state governments.

Many prominent economic institutions, including the OECD, the IMF and the Reserve Bank of Australia have put the case for developed economies like Australia to increase investment in public infrastructure to boost growth and productivity. Governments may be reluctant to fill any infrastructure gap because the budget presentation does not differentiate between infrastructure spending and recurrent expenditure

To make investments clearer, some commentators have suggested splitting out investments in capital formation and infrastructure from recurrent expenditure in Budget reporting. By splitting out, for example, infrastructure investments, the Government could also provide regular reporting on cash flows for specific projects.

³ The Case for Opportunity, Chris Bowen, 23 November 2016. <http://www.chrisbowen.net/media-centre/speeches.do?newsId=7237>

Furthermore, separating out investments on infrastructure would more clearly demonstrate that this investment in productive capacity improves the medium and long-term fiscal position by increasing future revenues to Government.

Others highlight that many measures currently treated as recurrent expenditure may also deliver long-term payoffs, such as investments in human capital (through better schools or university access for example) and that these types of investments may warrant separate consideration to other components of the recurrent budget.

The dynamic is complicated by Commonwealth-State funding arrangements, and the identification of asset ownership, and which level of government reflects an asset on their balance sheet. As the Commonwealth generally does not own infrastructure assets, this spending shows up as expenditure. States that own the asset may present this as capital or it could be held privately.

Indeed, some present budget information by separating service delivery (expenditure) and capital investments and assets (investment) in different budget papers to clearly differentiate between the recurrent and capital spending priorities.

An area for greater budget reporting clarity could be clearer articulation of the contribution and roles different levels of government play and the returns and benefits each earns (if any) from capital investments. This could include consideration of infrastructure arrangements when the Commonwealth is sole funder; partners with states; or provides untied infrastructure funding.

6. What is the optimal budget presentation for intelligent investment in productivity enhancing infrastructure assets?
7. Could Commonwealth Budget papers better split out spending on productive economic assets such as infrastructure from recurrent expenditure and, if so, how?
8. What is the best way to introduce better processes for capital budgeting and how can these processes better link to state governments and infrastructure providers in the private sector?
9. How should investments in human capital (including education) be treated in such an environment?

Impact on the Commonwealth balance sheet

The Commonwealth's balance sheet has been leveraged to provide support for policy objectives including through programs like the Clean Energy Finance Corporation, Northern Australia Infrastructure Facility, a loan to Alcoa's Portland aluminium smelter and Drought Assistance Concessional Loans. The Higher Education Loan Program (HELP) has also grown substantially in recent years.

While Australia's Budget is becoming more and more constrained, persistent social and economic challenges – like homelessness, inequality and indigenous disadvantage – remain. Thinking laterally to find ways to fund solutions to these challenges is critical. One suggestion from stakeholders is impact investing, where the Commonwealth could use its balance sheet to leverage private capital into social programs.

These approaches are not without risk to the balance sheet. But currently the Statement of Risks provides only a summary of the nature of risks to the Commonwealth Budget from balance sheet transactions.

10. What improvements could be made to reporting of policies which affect the balance sheet?

Funds and special accounts

Funds have been established for various purposes over the past decade, the most notable of these being the Future Fund. Special accounts are also used to allocate appropriations for particular programs. A key difference between these two concepts is that the cash balance of a fund is held by the fund and managed by the fund manager. A special account is a mechanism to appropriate funds but is a ledger and does not hold any cash itself.

Special accounts and funds have been used as a device to argue for redirecting funding from other programs such as the NDIS Savings Fund Special Account and the Asset Recycling Fund.

11. What circumstances might it be more appropriate to use a fund or a special account?

Second-round effects

The Treasury and Department of Finance have published policy costing guidelines under the Charter of Budget Honesty that states that:

“Second-round effects are generally not included in costings for a range of reasons, including uncertainty in estimating the magnitude and timing of the effects and because second-round effects are likely to be small relative to the direct financial impact of a measure. Second-round effects are also likely to take longer to arise than the immediate costs of a new policy proposal, and often may not occur within the forward estimates’ timeline.”

Second-round effects are attractive when considering a policy. They may mitigate the direct effect of the policy on the Budget. Of course, there may be downsides to including these effects as well, including the uncertainty and complexity involved. For instance, there could be a lack of rigour in developing estimates and the trade-offs and opportunity cost of one policy over another may not be considered. There may also be pressure on those costing the effect to stretch assumptions to the limit.

12. Are there circumstances when second-round effects should and shouldn't be incorporated and reported in the Budget and what are the risks of including them?

Tax expenditure statement

The Tax Expenditure Statement (TES) estimates the revenue foregone from tax expenditures – policies where the actual tax treatment of an activity or class of taxpayer differs from the benchmark tax treatment. Consistent with Australian National Audit Office recommendations, the TES includes estimates of the potential revenue gain from abolishing 10 tax expenditures.

Tax expenditures are difficult to compare to other government policy decisions such as a program due to the complexity of estimating forgone revenue, and the resulting impact on the economy. As these are reported separately it is also hard to understand the total government contribution to interventions.

13. What improvements could be made to the presentation and reporting of tax expenditures including by linking them to other areas of like activity in the Budget papers and evaluating their effectiveness and efficiency more regularly?

Accountability of programs

Significant reforms were made during Operation Sunlight to tighten the outcomes and outputs framework to increase accountability for appropriated funds. Even so, it is still difficult to assess the success of initiatives. There is limited after-the-fact measurement and assessment of outcomes against benchmarks set in advance to determine whether a program is successful.

14. Are there reporting improvements that can be implemented that will increase the accountability of agencies against program objectives and outcomes?
15. How could the evaluation of programs be improved?

Publishing Budget data

As government systems have improved the publishing of tables, charts and the underlying data in the Budget papers has improved. For example, charts and data for the 2016-17 Budget are embedded in the Budget statements at www.budget.gov.au.

16. What other information and formats would enhance public debate and assist non-Government stakeholders in their analysis and understanding?

Budget papers

Operation Sunlight made significant reforms to improve the readability of the Budget papers and make them more transparent, but we should aim for continued improvements to help the community understand how taxpayer funds are being spent and the impact of this on families and businesses.

The Budget is a considerable product including four Budget Papers, a number of glossy overviews, Portfolio Budget Statements and Ministerial Statements. This is a significant amount of information spread across a number of products, which may not be easily digestible. Others have called for the restoration of specific regular Ministerial Statements, which were recently scaled back.

17. What other improvements could be made to make the Budget papers clearer, simpler and more transparent about their impact?
18. Are there examples of other material that may not be currently disclosed that should be?
19. Are there any ways of existing Budget papers which are no longer useful or a priority and where could information be rationalised without decreasing transparency?

Other issues

20. Are there any other budget reporting issues which should be addressed?

Appendix A: List of Consultation Questions

1. What improvements could be made to enhance the public focus on the medium-term pressures and enhance policy decisions?
2. What other independent analysis could the PBO publish to inform and promote informed public debate?
3. How can the PBO best leverage external advice?
4. What improvements could be made to improve reporting in the Budget papers?
5. Are there better ways of reporting the sensitivity of measures and the Budget aggregates over the long-term?
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