

**MAINTAINING A FOCUS ON FISCAL DISCIPLINE
AND BUDGET TRANSPARENCY
THE ROLE OF THE PARLIAMENTARY BUDGET OFFICE**

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by

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We are regularly reminded of the importance of taking measures to ensure the long term sustainability of government finances.

The financial impact of the ageing of the population and increasing costs of health care are key examples of the budgetary pressures facing the Australian Government.

The importance of governments maintaining a buffer against economic shocks has also never been more evident than in the wake of the recent global financial crisis, with many governments still facing a long road to economic and fiscal recovery more than five years after the event.

The spectre of declining terms of trade and slower revenue growth means that fiscal discipline will need to play a prominent role in maintaining the sustainability of the Australian Government's budget.

The ability to hold governments accountable through more transparent and easily understood budget documentation has also long been a challenge; one that has grown with the increasing complexity of accounting treatments and the expanding volume of information presented in a diverse range of budget and budget-related papers.

The Parliamentary Budget Office (PBO) has a significant role to play in focussing policy makers on the fiscal consequences of their decisions and highlighting underlying budget trends that are not always obvious from material presented in annual budgets.

Before discussing how the PBO goes about its business I will give you a brief overview of the PBO and its mandate.

The PBO and its mandate

The PBO commenced operations on 23 July 2012; a little over 16 months ago. The period since then has been a challenging one for the PBO. Not only have we had to build the organisation from the ground up, but at the same time make preparations for and deal with the demands associated with the 2013 general election.

The PBO is a relatively small, reasonably well equipped, independent and non-partisan institution of the Australian Parliament. The PBO currently has 35 staff and is funded for approximately 40 staff. Additional funding is provided every third year for surge capacity to help meet the demands of the work associated with a general election.

The role of the PBO, as defined in the *Parliamentary Service Act 1999*, is to inform the Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals. The PBO undertakes positive analysis. It does not engage in normative analysis and it does not make policy recommendations.

The PBO pursues its mandate through the preparation of policy costings, budget analyses and submissions to Parliamentary committees, as well as through its own self-initiated program of published research on the budget and fiscal policy settings.

In addition, within 30 days after a general election, the PBO is required to prepare a post-election report on the budgetary implications of the election commitments of the major parliamentary parties.

In essence, the PBO's mandate is in two parts: first to support the Parliament in a range of budget-related matters; and second to help inform the public debate on the budget and fiscal policy issues.

The PBO does not have a direct input to the development of the budget or the monitoring of budget outcomes.

Access to information and financial and economic models in a timely fashion is vital for the PBO to be able to prepare high quality responses to requests from parliamentarians within reasonable timeframes and to undertake effective research and analysis of the budget and fiscal policy. To this end we have engaged extensively with government agencies to put in place arrangements for the provision of information to the PBO. By and large these arrangements are working well.

The confidentiality of dealings with the PBO is protected by the PBO's exemption from the provisions of the *Freedom of Information Act 1982*. In addition, all documents relating to PBO requests that are in the hands of other government agencies are also exempt from public disclosure. Protocols are also in place requiring Ministers not to ask, and agency heads not to disclose, details of their specific dealings with the PBO.

The Parliamentary Budget Officer is an independent Officer of the Parliament and is not subject to direction in the performance of his/her functions. The independent and non-partisan character of the PBO is vital for it to be able to interact with parliamentarians on a confidential basis and publish analyses of the budget and fiscal policy settings unconstrained by external influences.

The Parliamentary Budget Officer is required to advise the Presiding Officers of the Parliament (the President of the Senate and the Speaker of the House of Representatives) in matters relating to the operation and administration of the PBO, and assist the Presiding Officers to fulfil their accountability obligations to the Parliament.

The Parliamentary Budget Officer is accountable to the Parliament through the preparation of an annual report, consultation with the Joint Committee of Public Accounts and Audit on the PBO's annual work plan and resourcing, and through regular appearances before the Senate Finance and Public Administration Legislation Committee. The PBO is also currently the subject of a performance audit by the Auditor-General.

The PBO is one of a growing number of independent fiscal institutions that have been established around the world. The mandates and resource bases of these institutions vary widely, reflecting, in part, the differing political systems in which they operate.

However, work by the International Monetary Fund (IMF)¹ and the Organisation for Economic Cooperation and Development (OECD)², shows that independent fiscal institutions share a common goal of enhancing fiscal discipline and promoting greater budget transparency and accountability.

In a recent study, the IMF found that 29 such institutions had been established at a national level as at the end of January 2013. All but four of these institutions have been established since 2005 and many of those have come into existence since the start of the global financial crisis.

I hasten to add that Australia's PBO did not have its genesis in the global financial crisis. Our PBO had been mooted for some time.

Australia has a long history of the cost of election commitments being a focal point of election campaigns. Increasingly it has been recognised that the lack of access to costing resources by non-government parties meant that this debate occurred on an uneven playing field.

In his budget in reply speech in May 2009 the then leader of the Coalition said that "honesty in fiscal policy would be served by the creation of Australia's version of America's Congressional Budget Office".

Subsequently, a commitment to establish a PBO formed part of an agreement negotiated between political parties and independent members of parliament after the 2010 federal election.

A Joint Select Parliamentary Committee was established to inquire into the proposed establishment of a PBO. The Committee reported in March 2011 and unanimously supported the establishment of a PBO³. Later that year legislation was passed to establish the PBO as an independent and non-partisan institution of the Australian Parliament.

In exploring the opportunities for the PBO to contribute to improved fiscal discipline and budget transparency I will focus predominantly on three areas of PBO activity: costing of policy proposals; post-election reporting of election commitments; and the PBO's self-initiated program of published research on the budget and fiscal policy settings.

For comparative purposes, I will then turn briefly to international developments and the roles that other independent fiscal institutions play.

¹ International Monetary Fund, 2013, "The Functions and Impact of Fiscal Councils" IMF Policy Paper, (Washington, DC: International Monetary Fund)

² Koptis, George (2011), "Independent Fiscal Institutions: Developing Good Practices", *OECD Journal on Budgeting*, Vol.11/3

³ Joint Select Committee on the Parliamentary Budget Office, 2011, "Inquiry into the proposed Parliamentary Budget Office"

Costing of policy proposals

Currently the PBO is probably best known for its role in costing policy proposals. To date this has been a very large part of the PBO's work.

The PBO is able to cost policy proposals at the request of parliamentarians (including on behalf of parliamentary parties), on a confidential basis outside the caretaker period for a general election, and on a public basis for requests made by parliamentary parties and independent parliamentarians during the caretaker period for a general election.

Requests for information on or analyses of the budget can be responded to by the PBO on a confidential basis at any time, including during the caretaker period.

The PBO, Treasury and the Department of Finance (Finance) use a common set of principles for undertaking policy costings. These principles are set out in the Charter of Budget Honesty Policy Costing Guidelines. This helps to ensure that a consistent approach to costings is taken by all three organisations.

Since its inception on 23 July 2012, the PBO has received more than 1,000 requests for policy costings, and budget information and analyses. Apart from a small number of requests that lapsed or were withdrawn, the PBO has responded to all requests received to date.

The greater majority of these responses were to requests made outside of the caretaker period and were prepared on a confidential basis.

The large amount of work directed to the PBO reflects the pent-up demand for the PBO's services, in particular from non-government parties in the months leading up to the 2013 election.

The PBO has had a significant impact in helping to level the playing field for non-government parties and independent parliamentarians as they develop their policies. It has done so by helping to redress the asymmetry of access to costing and budget information services that existed prior to the establishment of the PBO.

Now non-government parties and independent parliamentarians have access to similar costing and budget information services from the PBO that governments have always had available to them from government agencies. This has enabled non-government parties to develop their policies with much greater confidence that their costings, when announced, will stand up to scrutiny.

By working with parliamentary parties and independent parliamentarians on a confidential basis, the PBO is able to engage with them iteratively as they refine their policy options.

Taking place over a number of months in the lead up to the 2013 election, this process enabled policy options to be developed and costed in a considered manner. It faced policy makers up to the cost of individual policy options, many of which were modified during the process to make them more affordable.

The involvement of the PBO in this way can be expected to help improve the robustness and financial rigour of policies that are presented to electors. It can also be expected to help sharpen the focus of public debate on the substance of policy issues rather than on the accuracy of the policy costings as, unfortunately, has so often been the case in the past.

During the recent election period some debates did centre on the content and timing of release of costings. However, it is pleasing that, on this occasion, no 'black holes' were identified in the published costings of parties' election commitments.

This is in stark contrast to the experience of the 2010 election when, after that election, Treasury identified a range of deficiencies in the then Opposition's costings. Similar experiences could be cited from other elections.

The integrity of the costings of election commitments has a direct bearing on the integrity of the election commitments themselves. In the case of flagship commitments, inaccurate costings can even damage the election prospects of the party concerned.

The role of the PBO in helping parties, particularly non-government parties, to cost their policies in a professional manner can go a long way to avoiding such undesirable situations.

There is currently a debate taking place in the United Kingdom on whether the mandate of the UK's Office of Budget Responsibility (OBR), an independent fiscal institution established in 2008, should be expanded to allow it to cost the policies of the Opposition. It will be interesting to see how this debate plays out in the lead up to the next election in the UK.

Post-election reporting

The preparation of a post-election report of election commitments was not originally part of the PBO's mandate. Legislation was passed towards the end of the last Parliament giving the PBO this additional function.

The introduction of the Charter of Budget Honesty in 1998 is widely recognised as providing an improved framework for fiscal responsibility by Australian governments. Under the Charter, governments are required to lay out their fiscal strategy which is to be based on the principles of sound fiscal management.

However, neither under the Charter nor under the legislation governing the operations of the PBO, are political parties required to have their policies costed by Treasury or Finance, or by the PBO. They may volunteer to have their policies costed but they are not required to do so.

In his second reading speech to the Parliament on the initiative to require the PBO to prepare a post-election report of election commitments, the then Treasurer said "The bill will impose discipline on the promises of all political parties and incentivise all political parties to be up front and honest about the cost of their promises." He went on to say "This reform will help to ensure that all political parties are straight with the Australian people before the election because they know that their costings will be revealed by the PBO post the election."

As we have witnessed during the recent election period, the non-government parties did choose to use the PBO very intensively to cost their election commitments prior to the election. Was this because they knew that the PBO would report on the cost of their commitments after the election, whether or not they submitted their policies to the PBO for costing prior to the election? Or was it because it was sensible for them to make good use of the services available to them from the PBO to help them develop their policies with a much higher degree of financial rigour than they otherwise would have been able to?

In a sense the answers to these questions are not important. What is important is that the non-government parties did avail themselves of the services of the PBO over a period of many months in the lead up to the 2013 election. The evidence suggests that the rigour of their policy development and their policy costings benefitted significantly from this engagement with the PBO.

The post-election report that was published on the PBO's website on 18 October 2013 generally confirmed the validity of the parties' costings of their election commitments and their overall impact on the budget.

The PBO's self-initiated work program

The PBO's self-initiated program of research and analysis of the budget and fiscal policy settings focusses on the sustainability of the budget over the medium term. It also seeks to help improve budget transparency and promote a better understanding of the budget and fiscal policy settings.

To date, the PBO has published one report under its self-initiated program. Following the May 2013 Budget the PBO released its report, *Estimates of the structural budget balance of the Australian Government: 2001-02 to 2016-17*. This report is available on the PBO's website.

The PBO chose to undertake a study of the structural budget balance to help better inform the public debate on the underlying structure of the budget and its implications for the future direction of fiscal policy.

The structural budget balance is a partial measure of the sustainability of the budget. It shows the underlying position of the budget after adjusting for the impacts of major cyclical and temporary factors. The structural budget balance reflects the impacts of underlying budgetary trends and discretionary fiscal policy decisions.

The PBO's report showed that the budget has been in structural deficit for some years and, on the basis of projections as at the 2013-14 Budget, is likely to remain so until at least 2016-17.

The report generated a considerable amount of public discussion. While a number of commentators drew their own conclusions about the causes of the underlying deficit, none disputed the finding that we have a significant structural deficit that will need to be addressed over the coming years.

Previous studies of this nature have been undertaken by Treasury. An analysis of the structural budget balance was included in the 2009-10 Budget papers and in 2010 Treasury published a follow-up report in the Economic Roundup.

Treasury also released a working paper on this subject, shortly after the PBO released its report, with similar findings. Subsequently, the secretaries of Treasury and Finance included an analysis of the structural budget balance in their recent Pre-election Economic and Fiscal Outlook 2013 report. In doing so Treasury took the analysis out to 2021-22.

As we indicated in our structural budget balance report, there is value in this analysis being undertaken on a regular basis to monitor the movements in the structural budget balance over time. The regular inclusion of analyses of the structural budget balance in future budgets, and economic and fiscal outlook reports, would help to continue to focus policy makers on the appropriate fiscal policy responses to major cyclical and one-off impacts on the budget.

The PBO's next report will examine historic and projected trends in Australian Government spending. It will provide an insight into the key drivers of government spending over the past decade and their expected impact over the medium term.

A key challenge in preparing this report is that the Australian Government does not publish a time series of actual expenditure by function. So before analysing the expenditure data, we first needed to construct a data set of actual expenditure that adjusted for classification changes over time.

This report will be published in two parts. The first part will examine historical expenditure trends over the period 2002-03 to 2012-13. This part will be published in the very near future. The second part will examine forecast and projected expenditure trends over the 2013-14 Budget forward estimates period. This part of the report will be finalised after the Government releases its Mid-year Economic and Fiscal Outlook report.

It will come as no surprise that the major pressure points on the expenditure side of the Australian Government's budget are in the areas of social security and welfare, and health. These two areas account for approximately 35 per cent and 16 per cent respectively of total expenditure and, together, contributed more than half of the real growth in Australian Government expenditure over the past decade.

Over this period both of these large areas of expenditure grew faster in real terms than real GDP. In real terms, social security and welfare expenditure grew by 3.7 per cent a year and health expenditure by 4.7 per cent a year, compared with real GDP growth of 3.0 per cent a year.

Major programs such as the Age Pension, the Disability Support Pension, assistance to families with children and Medicare all experienced strong growth and are forecast to contribute significantly to growth in spending in the future.

Other key drivers of Government spending growth in recent years have been education and the payment of GST to the States which has been growing only modestly but, as the largest single item of spending, contributes significantly to overall growth in government spending.

Real growth in the main drivers of budget baseline expenditures can be expected to continue beyond the forward estimates period. The mature National Disability Insurance Scheme, increased funding for schools, and increased funding to the States for public hospitals will add to these pressures.

Now that the 2013 federal election is behind us, we expect to be able to devote more resources to our self-initiated work program.

The program over the next few years will include work on trends in Australian Government revenue, the sensitivity of the fiscal position over the medium term to key assumptions and economic parameters, best practice budget reporting, distributional impacts of policies, fiscal responsibility frameworks, capital budgeting, and Commonwealth/State fiscal issues.

We intend, whenever possible, to make publicly available the data sets and models that underlie our published work. We will do this for two reasons: first, to be transparent about how we go about our work; and second, to provide a basis for others to undertake their own analyses.

International developments

As I mentioned earlier in this address, the mandates of independent fiscal institutions around the world vary widely. The IMF has found from international experience that fiscal institutions influence the conduct of fiscal policy mostly through public debate and only rarely through direct action in the budget process.

The IMF's recent analysis points to a number of key features of effective fiscal institutions: a strict operational independence from politics; provision of budgetary forecasts or their public assessment; a strong presence in the public debate; and an explicit role in monitoring fiscal policy rules.

According to the IMF, the majority of new generation fiscal institutions monitor compliance with explicit fiscal rules. This is not surprising, particularly given the imperative of most European Union member states to take all necessary steps to recover from the global financial crisis.

Both the Canadian PBO (CPBO) and the United Kingdom's Office of Budget responsibility (OBR) have responsibility for monitoring compliance with fiscal targets.

Others, such as the Netherlands Bureau for Economic Policy Analysis and the OBR in the UK, prepare independent macroeconomic and fiscal forecasts that the government is obliged to use in its budget preparation.

The Canadian PBO, the UK's OBR and the Congressional Budget Office (CBO) in the United States all prepare regular medium (10 years) or longer term fiscal projections.

The CBO's annual long-term Budget Outlook Report includes projections that typically span 25 years but can extend as far as 75 years into the future. Its projections show the impact of long-term demographic trends on government spending, revenues and deficits. The CBO also projects the long-term economic impacts of alternative fiscal policies.

The CPBO and the UK's OBR both prepare an annual fiscal sustainability report. The Canadian report covers a 75 year time horizon while the OBR report covers 50 years, as does Australia's intergenerational report which is prepared by Treasury at least every five years.

The Australian PBO is explicitly precluded from preparing economic forecasts and budget estimates. The Parliamentary Budget Officer is required to use the economic forecasts and parameters, and fiscal estimates contained in the most recent relevant economic and fiscal report released under the *Charter of Budget Honesty Act 1998*.

The costing roles of the independent fiscal institutions also vary. I have already explained that the Australian PBO costs policy proposals at the request of individual parliamentarians and parliamentary parties. It also costs the electoral platforms of the major political parties in its post-election report of election commitments.

The OBR certifies costings of measures as part of the Budget process, the CBO and the National Assembly Budget Office of Korea (NABO) cost all legislative proposals, and the CPBO costs some policies at the request of parliamentarians.

In addition, the CBO "re-estimates" the budgetary impact of the government's proposals using its own assumptions and economic forecasts, and conducts analysis of the costs that legislation would impose on other levels of government and the private sector.

Some fiscal institutions, such as NABO, are mandated to analyse the efficiency and effectiveness of public expenditure. This is more usually the function of independent audit institutions whereas independent fiscal institutions, in the main, are forward looking.

The recently established National Commission of Audit has been asked to identify options for strengthening Commonwealth budgeting arrangements by, amongst other things, examining the role of the PBO. I expect that the Commission will consider international experience when addressing this part of its terms of reference

End note

We must not forget that the PBO is still a relatively new institution that still faces significant challenges.

The PBO must continue to carve out its role as a trusted, effective, independent and non-partisan institution of the Parliament. The PBO must also develop further as a source of relevant, high quality, objective and publicly available budgetary and fiscal policy analysis.

To address these challenges the PBO is continuing to build its capabilities, forge close links with parliamentary and external stakeholders, and maintain a clear focus on its mandate.

I trust that my address today has given you a better appreciation of the various aspects of the work of the PBO, including its policy costing role, post-election reporting of election commitments, and publication of its own research and analysis on the budget and fiscal policy settings.

I trust, in particular, that I have been able to demonstrate the value that the PBO is adding by helping to level the playing field for non-government parties and independent parliamentarians, and sharpen the focus of policy makers on fiscal discipline and budget transparency.

References

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