

PART 4

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THE ROLE OF INSTITUTIONS  
AND PROCESSES

Policy-making and, especially, structural reform confront many technical complexities and political obstacles. Successful outcomes depend on a government's capacity to marshal good information and advice, and on the public's understanding of what is at stake in different policy choices. These speeches focus on the issues surrounding 'evidence-based policy making' and the role played by the Productivity Commission.



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# Evidence-based policy making: What is it? How do we get it?\*

The American humorist, P.J. O'Rourke once said, 'the mystery of Government is not how it works, but how to make it stop'. In an earlier century, Otto von Bismarck is famously reported to have said 'Laws are like sausages: it's better not to see them being made'.

Those witty observations have become enduring aphorisms for a reason. They reflect a rather cynical and widespread view of long-standing about the operations of government. Also, let's face it, within government itself, many of us today find ourselves laughing knowingly at the antics of *The Hollow Men*, just as we did with *Yes Minister*; and perhaps also cringing in recognition at how a carefully crafted policy proposal can be so easily subverted, or a dubious policy can triumph with little real evidence or analysis to command it.

The idea for *The Hollow Men* was apparently conceived, and the first few episodes developed, under the previous Government. That said, a change of government did not seem to reduce the program's appeal, nor its ratings. No doubt that is because it contains some universal realities of political life — notwithstanding which party happens to be in power. And, indeed, notwithstanding the greater emphasis placed by the current Government on evidence-based policy making, as reflected in a variety of reviews and in new processes and structures within the Commonwealth and COAG.

Thus we have seen considerable public debate about the basis for a range of recent policy initiatives. These include: the 'alcopops' tax; the change in threshold for the private insurance surcharge; the linkage of indigenous welfare payments to school attendance; fuel watch; grocery watch; and the Green Car Innovation Fund. There was similar public debate under the previous Government about the basis for such initiatives as the Alice-to-Darwin rail link; the Australia-US Free Trade Agreement;

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the Baby Bonus; the banning of filament light bulbs; Work Choices and the National Water Initiative, among others.

Moreover, where public reviews informed such initiatives, they have themselves been subjected to considerable criticism — in relation to their makeup, their processes and the quality of their analysis.

This too is obviously not a new phenomenon, but it illustrates the challenges of properly implementing an evidence-based approach to public policy — and of being *seen* to have done so, which can be crucial to community acceptance of consequent policy decisions.

### *Advancing further reforms will be challenging*

It is as important that we have a rigorous, evidence-based approach to public policy in Australia today as at any time in our history.

Australia faces major long-term challenges; challenges that have only been exacerbated by the economic turbulence that we are struggling to deal with right now. When the present crisis is over, we will still have the ongoing challenges of greenhouse, the ageing of our population and continuing international competitive pressures. We should not underestimate the significance of those challenges, which place a premium on enhancing the efficiency and productivity of our economy.

The good news, as you would also be aware, is that there is plenty of scope for improvement. The bad news is that there are few ‘easy’ reforms left. A lot of low-hanging fruit has now been largely harvested. Even in the competition area, rather than further deregulation, we are confronting the need for regulatory refinements that are quite subtle and complex to assess. In the new agenda to do with enhancing human capital, complexities abound. We do not know all the answers to the policy drivers of better health and educational outcomes, for example, let alone to the pressing goal of reducing indigenous disadvantage.

These are all long-term issues. They also have an interjurisdictional dimension, bringing with it the challenge of finding national solutions to problems that have been dealt with by individual states and territories in the past. This has ‘upped the ante’ on having good analysis and good processes to help avoid making mistakes on a national scale that previously would have been confined to particular jurisdictions.

In an address to senior public servants in April 2008, the Prime Minister observed that, ‘evidence-based policy making is at the heart of being a reformist government’ (Rudd 2008). I want to explore why that is profoundly true; what it means in practice; and some implications for those of us in public administration. In doing so,

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I will draw on the experience of the Productivity Commission — which with its predecessors has been at the heart of evidence-based policy making in Australia for over three decades (Banks and Carmichael 2007; PC 2003c) — to distil some insights into what is needed across government generally if we are to be successful.

### **Why we need an evidence-based approach**

I don't think I should have to convince anyone of the value of an evidence-based approach to public policy. After all, it is not a novel concept. Its absence in practice, however, has been long lamented. Over a century ago, for example, Florence Nightingale admonished the English Parliament in the following terms (Pearson 1924):

You change your laws and your administering of them so fast, and without inquiry after results past or present, that it is all experiment, seesaw, doctrinaire; a shuttlecock between battledores.

The term 'evidence-based policy making' has been most recently popularised by the Blair Government, which was elected on a platform of 'what matters is what works'. Blair spoke of ending ideologically-based decision making and 'questioning inherited ways of doing things' (Modernising Government 1999). The advent of a new government is clearly a good time to initiate an evidence-based approach to public policy, especially after a decade or more of previous one's rule. I think that resonates too with the take-up in Australia of these 'New Labour' ideas from the United Kingdom, commencing with the Bracks Government in Victoria.

But evidence-based policy making is by no means new to this country. Probably the oldest example, or longest-standing one, is tariff-making, which for many years was required under legislation to be informed by a public report produced by the Tariff Board and subsequently the Industries Assistance Commission. The nature of those evidence-based reports changed dramatically over time, however, from merely reporting the impacts on industries under review to also reporting the effects on other industries and the wider economy.

Other key economic policy reforms that have drawn heavily on evidence-based reviews or evaluations include the exchange rate and financial market liberalisation of the 1980s, the National Competition Policy reforms of the 1990s and the shift to inflation targeting in monetary policy in 1993. Examples from the social policy arena include the Higher Education Contribution Scheme in its initial configuration, and the introduction of lifetime community rating provisions in private health insurance regulation.

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The tariff story illustrates the crucial point that the contribution of an evidence-based approach depends on its context, and the objectives to which it is directed. Evidence that is directed at supporting narrow objectives — a particular group or sector, or fostering use of a particular product or technology — will generally look quite different to that which has as its objective the interests of the wider community. Of course, this depends on having the analytical tools to enable such a broad assessment to be undertaken.

Policy decisions will nearly always be influenced by much more than objective evidence, or rational analysis. Values, interests, personalities, timing, circumstance and happenstance — in short, democracy — determine what actually happens. But evidence and analysis can nevertheless play a useful, even decisive, role in informing policy makers' judgements. Importantly, they can also condition the political environment in which those judgements need to be made.

### *Most policies are experiments*

Without evidence, policy makers must fall back on intuition, prejudice, or conventional wisdom — or, at best, theory alone. And many policy decisions have indeed been made in those ways. But the resulting policies can go seriously astray, given the complexities and interdependencies in our society and economy, and the unpredictability of people's reactions to change.

From the many examples that I could give, a few from recent Productivity Commission reviews come readily to mind:

- Our report into road and rail infrastructure pricing showed that the presumption that road use was systematically subsidised relative to rail was not borne out by the facts (facts that were quite difficult to discern) (PC 2006e).
- Our inquiry into state assistance to industry showed that the bidding wars for investment and major events the state governments engaged in generally constituted not only a negative sum game nationally, but in many cases a zero sum game for the winning state (Banks 2002).
- Our recent report on parental leave indicated that binary views in relation to whether childcare was a good or a bad thing were both wrong, depending on which age group you were looking at, and that there were many subtle influences involved (PC 2009c).

To take a separate example from the education field — which is rightly at the centre stage in COAG's National Reform Agenda — the long-term policy goal of reducing class sizes has received very little empirical support. In contrast, the importance of individual teacher performance, and the link to differentiated pecuniary incentives,

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are backed by strong evidence, but have been much neglected. (That illustrates not only a lack of evidence-based policy in education, where social scientists appear to have had little involvement, but also the influence over the years of the teachers' unions.)

Policies that have not been informed by good evidence and analysis fall more easily prey to the 'Law of Unintended Consequences' — in popular parlance, Murphy's Law — which can lead to costly mistakes. For example, the Commission found, in a series of reviews, that the well-intentioned regulatory frameworks devised to protect native flora and fauna, and to conserve historic buildings, were actually undermining conservation goals by creating perverse incentives for those responsible (PC 2004b, 2006a).

Our report for COAG, *Overcoming Indigenous Disadvantage*, is littered with examples (SCRGSP 2007). But, as Noel Pearson and other Indigenous leaders have affirmed, perhaps the most calamitous and tragic example of all was the extension of full 'award wages' to Aboriginal stockmen in the late-1960s. Despite warnings by some at the time, this apparently well-motivated action led to the majority losing their jobs, driving them and their extended families into the townships — ultimately subjecting them to the ravages of passive welfare; with liberalised access to alcohol as the final blow. Good intentions, bad consequences; very, very difficult to remedy.

I am not saying that policy should never proceed without rigorous evidence. Often you can not get sufficiently good evidence, particularly when decisions must be made quickly. And you can never have certainty in public policy. All policy effectively is experimentation. But that does not mean flying blind — we still need a good rationale or a good theory. Rationales and theories themselves can be subjected to scrutiny and debate, and in a sense that constitutes a form of evidence that can give some assurance about the likely outcomes. Importantly though, all policy experiments need to be monitored and evaluated and, over time, corrected or terminated if they turn out to be failures. These are things that governments typically find hard to do — particularly the termination part.

### *Conditioning the political environment*

Complexity and uncertainty would make policy choices hard enough even if they could be made purely on technical grounds. But policies are not made in a vacuum. Rather, they typically emerge from a maelstrom of political energy, vested interests and lobbying. Commonly, those with special interests will try to align their demands with the public interest. The average person rationally does not do the hard

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work necessary to find out whether that is correct or not, but often feels intuitively supportive.

In that *realpolitik*, evidence and analysis that is robust and publicly available can serve as an important counterweight to the influence of sectional interests, enabling the wider community to be better informed about what is at stake in interest groups' proposals, and enfranchising those who would bear the costs of implementing them.

Tariff reform again provides a classic instance of evidence being used to galvanise potential beneficiaries from reform in the policy debate. In Australia, the losers under the tariff regime were the primary exporting industries — the farmers and the miners — who started to appreciate, with help from the Industries Assistance Commission, the extent of the implicit taxes and costs they were bearing; and they soon became a potent force for tariff reform. National Competition Policy has seen a similar political role being discharged through evidentiary processes.

To take a quite different example, the gambling industry got a lot of political support for liberalised regulation that was essentially based on a myth: namely that it would generate many jobs but have only minor adverse social impacts. The Commission's report showed the reverse to be true. Gambling did not (and cannot) generate significant additional jobs in the long term, and has very substantial social impacts (PC 1999a). Establishing that gave community groups a stronger platform to push for reforms to gambling regulation and the development and funding of harm minimisation measures.

## **The essential ingredients**

For evidence to support good public policy, however, it needs to be the right evidence; it needs to occur at the right time and be seen by the right people. That may sound obvious, but it is actually very demanding. I want to talk briefly now about some essential ingredients in achieving it.

### *Methodology matters*

First, methodology. It is important that, whatever analytical approach is chosen, it allows for a proper consideration of the nature of the issue or problem, and of different options for policy action.

Half the battle is understanding the problem. Failure to do this properly is one of the most common causes of policy failure and poor regulation. Sometimes this is an understandable consequence of complex forces, but sometimes it seems to have more to do with a wish for government to take action regardless.

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A contemporary example that has received a bit of airplay as a consequence of the Commission's report on waste management (PC 2006f), is the move to ban the ubiquitous plastic shopping bags from our supermarkets. This initiative drew much support from the alleged problems that these bags pose for the litter stream and for marine health. But closer investigation by the Commission soon exposed gross inaccuracies and overstatements in those claims. Indeed some of what passed for 'evidence' was contrary to common sense, and some outright hilarious. (A Regulation Impact Statement soberly cited media reports from India that a dead cow on the streets of New Delhi had 35 000 plastic bags in its digestive system!)

In situations where government action seems warranted, a single option, no matter how carefully analysed, rarely provides sufficient evidence for a well-informed policy decision. The reality, however, is that much public policy and regulation are made in just that way, with evidence confined to supporting one, already preferred way forward. Hence the subversive expression, 'policy-based evidence'!

Even when the broad policy approach is clear, the particular instruments adopted can make a significant difference. Thus, for example, economists overwhelmingly accept the superiority of a market-based approach to reducing carbon emissions, but they differ as to whether a cap-and-trade mechanism or an explicit tax (or some combination of the two) would yield the best outcomes. Australia's apparent haste to embrace the trading option remains contentious among some prominent economists.

How one measures the impacts of different policies depends on the topic and the task — and whether it is an *ex ante* or *ex post* assessment. There is a range of methodologies available. There is also active debate about their relative merits. Nevertheless, all good methodologies have a number of features in common:

- They test a theory or proposition as to why policy action will be effective — ultimately promoting community wellbeing — with the theory also revealing what impacts should be observed if the policy is succeeding.
- They have a serious treatment of the counterfactual — what would happen in the absence of any action?
- They involve, wherever possible, quantification of impacts — including estimates of how effects vary for different policy 'doses' and for different groups.
- They look at both direct and indirect effects (often it is the *indirect* effects that can be most important).
- They set out the uncertainties and control for other influences that might impact on observed outcomes.

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- They are designed to avoid errors that could occur through self selection or other sources of bias.
  - They provide for sensitivity tests.
  - Importantly, they have the ability to be tested and, ideally, replicated by third parties.

Australia has been at the forefront internationally in the development and use of some methodologies. For example, we have led the world in general equilibrium modelling of the direct and indirect effects of policy changes throughout the economy. But Australia has done relatively little in some other important areas, such as ‘randomised trials’, which can be particularly instructive in developing good social policy.

Most evidence-based methodologies fit broadly within a cost-benefit (or at least cost-effectiveness) framework, designed to determine an estimated (net) payoff to society. It is a robust framework that provides for explicit recognition of all costs and benefits, and requires the policy maker to consider the full range of potential impacts. But it hasn’t been all that commonly or well used, even in relatively straightforward tasks such as infrastructure project evaluation.

The head of Infrastructure Australia’s secretariat recently commented in the following terms about many of the infrastructure proposals submitted to that body: ‘the linkage to goals and problems is weak, the evidence is weak, the quantification of costs and benefits is generally weak’ (Deegan 2008).

It is very welcome, therefore, that Infrastructure Australia has stressed that any project that it recommends for public funding must satisfy rigorous cost-benefit tests. It is particularly important that this includes quantification of the more ‘subjective’ social or environmental impacts; or, where this proves impossible, that there is an explicit treatment of the nature of those impacts and the values imputed to them. In the past, this has proven the ‘Achilles heel’ of cost-benefit assessments for major public investments: financial costs are typically underestimated, non-financial benefits overstated. (Rubbery computations of this kind seem to be endemic to railway investment proposals, particularly ‘greenfield’ ones, which rarely pass muster on the economics alone.)

It is undoubtedly challenging to monetise some of the likely costs and benefits associated with certain areas of public policy. But often we do not try hard enough. There are nevertheless some examples of creative attempts. These include work by the Productivity Commission in areas such as gambling, consumer protection policy and even animal welfare (PC 1998b 1999a, 2008d,).

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### *Good data are a pre-requisite*

A second essential ingredient, of course, is data. Australia has been very well served by the Australian Bureau of Statistics and the integrity of the national databases that it has generated. But in some areas we are struggling. Apart from the challenges of valuing impacts, and disentangling the effects of simultaneous influences, we often face more basic data deficiencies. These are typically in social and environmental rather than economic domains, where we must rely on administrative collections — or indeed there may be no collections at all.

Data problems bedevil the human capital area of CAOG's National Reform Agenda. Preventative health strategies and pathways of causal factors are one example. Indigenous policy provides another striking one, involving a myriad of problems to do with identification, the incidence of different health or other conditions, and their distribution across different parts of the country. In the education area, obtaining performance data has been an epic struggle. In the COAG priority area of early childhood development, a recent survey article from the Australian Institute of Family Studies concludes:

The dearth of evaluation data on interventions generally ... makes it impossible to comment on the usefulness of early childhood interventions as a general strategy to sustain improvements for children in the long-term. (Wise et al. 2005)

Data deficiencies inhibit evidence-based analysis for obvious reasons. They can also lead to reliance on 'quick and dirty' surveys, or the use of focus groups, as lampooned in *The Hollow Men*. The other risk is that overseas studies will be resorted to inappropriately as a substitute for domestic studies. One topical example is the celebrated work by James Heckman in the United States demonstrating the benefits of preschool education based on the Perry Program. That work has become a policy touchstone for advocates of universal intensive preschool education in Australia. While that policy may well prove to be sound, Heckman's work does not provide the necessary evidence. As he himself has clearly acknowledged, the Perry Project was confined to disadvantaged children. And the main gain from the intensive preschool treatment that those kids got came from reduced crime.

A major failing of governments in Australia, and probably world-wide, has been in not generating the data needed to evaluate their own programs. In particular, there has been a lack of effort to develop the baseline data essential for before-and-after comparisons.

Australia could and should have done a lot more to take advantage of its federal system as a natural proving ground for policy learning across jurisdictions. Indeed, in some cases, rather than encouraging data provision to enable comparisons across jurisdictions, the basis for such comparisons has actually been suppressed.

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So I think there is an opportunity, under the New Federalism banner, to fund the evidence base that we need to compare policy performances across our Federation, and thereby to devise better national policies where national approaches are called for.

*Real evidence is open to scrutiny*

Much policy analysis actually occurs behind closed doors. A political need for speed is often behind that. But no evidence is immutable. If it hasn't been tested, or contested, we can not really call it 'evidence'. And it misses the opportunity to educate the community about what is at stake in a policy issue, and thereby for it to become more accepting of the policy initiative itself.

Transparency ideally means 'opening the books' in terms of data, assumptions and methodologies, such that the analysis could be replicated. The wider the impacts of a policy proposal, the wider the consultation should be. Not just with experts, but also with the people who are likely to be *affected* by the policy, whose reactions and feedback provide insights into the likely impacts and help avoid unintended consequences. Such feedback in itself constitutes a useful form of evidence.

The Commission's processes are essentially based on maximising feedback. In a range of areas, we have learned a great deal through our extensive public consultation processes, particularly in response to draft reports. If you compare the drafts with our final reports you will often see changes for the better: sometimes in our recommendations; sometimes in the arguments and evidence that we finally employ.

*Evidence building takes time*

Transparency can have its downsides. In particular, it 'complicates' and slows down the decision-making process — transparency involves time and effort. On a number of occasions in the past decade I have been approached about the possibility of the Commission undertaking an attractive policy task, but in an amount of time that I felt was unreasonable for it to be done well, particularly in view of the time people need to make submissions and give us feedback. When the Commission does something, people rightly expect to be able to have a say. As a consequence, those tasks have more often than not ended up going to consultants. (And in most cases the results have vindicated my position.)

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### *Good evidence requires good people*

The fifth area of importance is capability and expertise. You can not have good evidence, you can not have good research, without good *people*. People skilled in quantitative methods and other analysis are especially valuable. It is therefore ironic that we appear to have experienced a decline in the numbers with such skills within the Public Service at the very time when it has been called upon to provide an evidence-based approach that relies on them. Again, that's been largely a consequence of budgetary measures over a long period of time. Research tends to be seen as a more dispensable function when governments and bureaucracies are cut back.

Several manifestations of the consequential reduction in capability have struck me. One is the lower calibre of some of the departmental project teams that I have observed trying to do review and evaluation work. Secondly, there appears to be increased poaching of research staff within the public sector, or at least pleas for secondments.

We are also seeing major new initiatives to train staff. One significant example is the Treasury's sponsorship of a new program, to be run by Monash University, to teach economics to non-economists.

We have also seen a major increase in the contracting of policy-related research outside the Public Service. A lot of those jobs have gone to business consultants rather than to academics. This contrasts with the experience in the United States, where the academic community seems to be utilised much more by government.

Contracting out is by no means a bad thing. It has been happening progressively for decades. But it does seem to be changing in character more recently. The focus seems to be broadening from provision of *inputs* to policy making, to preparation of *outputs* — the whole package.

There are clear benefits to government from using professional consultants: new ideas, talented people, on-time delivery, attractive presentation and, possibly, cost — although some of the payments have been surprisingly large. But there are also some significant risks. Consultants often cut corners. Their reports can be superficial. And, more fundamentally, they are typically less accountable than Public Service advisers for the policy outcomes.

Whether academics could be drawn on more is a key issue. In an earlier era, the involvement of numerous academics was instrumental in developing the evidentiary and analytical momentum for the first waves of microeconomic reform. Where are the new academic generation's equivalents in support of the 'Third Wave'? Only a

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few names come to mind, for example, of academics making a notable public contribution to policies bearing on human capital development.

Such involvement is of course a two-way street — with both demand and supply sides. The supply side seems to have been diminished over time, partly as promising academic researchers have sought more attractive remuneration elsewhere and partly as their time has been increasingly consumed by their ‘day jobs’. On the demand side, one sometimes hears senior public servants complain that academics can be very hard ‘to do business with’ or that they are too slow, or lack an appreciation of the ‘real world’.

There may be some validity in these perceptions, though I suspect that they may also reflect an unrealistic view of how much time is needed to do good research; and perhaps a lack of planning. Perhaps also a desire for greater predictability in the results than many academics would be willing to countenance.

### *Independence can be crucial*

Evidence is never absolute; never ‘revealed truth’. The choice of methodologies, data, assumptions and so forth, can all influence the outcome, and they do. Given unavoidable need for judgement in evaluation, evidence is more likely to be robust and seen to be so if it is not subjected to influence or barrow-pushing by those involved. What this means is that good research is not just about skilled people, it is also about whether they face incentives to deliver a robust product in the public interest.

Some years ago, following a talk that I gave at a gambling policy conference in Melbourne, an American academic came up to me and said that the Commission’s report was being used extensively in public debate in the United States. I expressed surprise, given the extent of home-grown research there. She said ‘Yes, but we do not know what to *believe*’. That appears to be because research is polarised in that country between that sponsored by community and church groups and that sponsored by the industry. And there is suspicion that ‘he who pays the piper, calls the tune’.

Independence is even more important when dealing with technical research than with *opinions*. People are better able to judge opinions for themselves, but the average person is naturally mystified by technical research. They look for proxies to help them know whether the results of such research are believable. The status of the researcher (or who is paying for the research) is one such proxy.

Economic modelling is replete with these sorts of issues. Any model comprises many assumptions and judgements that can significantly influence the results. For

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example, the Productivity Commission and industry consultants used similar models recently to estimate the economic impacts of reducing tariffs on cars. The Commission found that there would be significant economy-wide gains from maintaining scheduled tariff reductions (PC 2008b). The other modellers, using different (and some less conventional) assumptions, projected net losses — with the current tariff rate coincidentally turning out to be ‘optimal’.

*A ‘receptive’ policy making environment is fundamental*

We come to the final and most important ingredient on my list. Even the best evidence is of little value if it is ignored or not available when it is needed. An evidence-based approach requires a policy making process that is receptive to evidence; a process that begins with a question rather than an answer, and that has institutions to support such inquiry.

We often see the reverse, especially for more significant proposals. The joke about ‘policy-based evidence’ has not been made in abstract — we have long observed such an approach in operation through the lens of regulation making in Australia.

Ideally we need systems that are open to evidence at each stage of the policy-development cycle: from the outset when an issue or problem is identified for policy attention; to the development of the most appropriate response, and subsequent evaluation of its effectiveness. The ongoing struggle to achieve effective use of regulation-assessment processes within governments tells us how challenging that can be to implement.

I admit that an evidence-based approach undoubtedly makes life harder for policy makers and for politicians. Lord Keynes, who seems to be well and truly back in vogue, said in the 1930s:

There is nothing a government hates more than to be well-informed; for it makes the process of arriving at decisions much more complicated and difficult. (Moggridge 1982)

I think we can see what he meant. But, against this, are the undoubted political *benefits* that come from avoiding policy failures or unintended ‘collateral damage’ that can rebound on a government, and from enhancing the credibility of reformist initiatives.

### **Some implications for the Public Service**

How can those of us in the Public Service help advance the cause of evidence-based policy making? We begin with the considerable advantage of explicit endorsement

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by the Prime Minister and senior ministers for an evidence-based approach to public policy. In his speech to the Senior Executive Service in 2008, Kevin Rudd declared, ‘we cannot afford a Public Service culture where all you do is tell the Government what it wants to hear’ (Rudd 2008). We have also heard from the head of the Public Service, Terry Moran, that ‘for civil servants, a capacity to analyse problems rationally and empirically and to advance options for action by governments is a basic ethical duty’.

What both are talking about, in old parlance, is ‘frank and fearless’ advice: robust advice that does not second guess the politics or the politicians. So the first suggestion I have for advancing evidence-based policy making is for us to be frank and fearless. That does not mean being a loose cannon, or acting contrary to a government’s broad objectives, but using the opportunity of such political support to strengthen the bureaucracy’s capacity to provide evidence-based advice — and *delivering* that advice, even if it is against the current, or not confined to a minister’s or government’s favoured position (which often are not set in concrete anyway).

#### *Making better use of existing processes*

There exist currently vehicles and frameworks within government that can be used more effectively to this end. Indeed, the recently upgraded regulation-assessment requirements are ready made for that purpose. As noted, these are based on a best-practice ‘policy cycle’, with explicit provision for evidence to be utilised at each step.

In relation to spending programs, there is also likely to be scope to enhance some of the requirements, particularly to strengthen *ex ante* evaluation, and to make explicit provision for *ex post* review.

#### *Effective COAG arrangements*

At the COAG level, we have a new working group structure, which is well placed to advance an evidence-based approach to public policy, given sufficient space and lead time. That said, these arrangements in themselves represent an experiment. Their novel design, in which state department CEOs essentially report to Commonwealth Ministers, faces obvious challenges.

More problematic are the time constraints imposed on COAG processes under the punishing dictates of the quarterly cycle of meetings. The seeming imperative for bureaucrats around the country to be constantly preparing for these meetings appears to be displacing some of the work that should be done to inform decisions.

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It is to be hoped, therefore, that over time we might see a return to a more measured approach, which retains, or even strengthens, the new framework of working groups behind the scenes, but involves more time between meetings of COAG itself.

### *Building greater institutional capacity*

Building capacity — or *rebuilding* it — is also very important. But it can not happen overnight. For one thing, we need to be recruiting into the Public Service more graduates in the social and economic sciences. The United Kingdom saw a doubling in the number of researchers in the Civil Service in one decade under the Blair Government.

Any agency that is serious about encouraging an evidence-based approach needs to develop a ‘research culture’. Establishing dedicated evaluation units, achieving a critical mass of researchers, strengthening links with academic and other research bodies, are all integral to this.

There is also the broader question of institution building to underpin better evaluation generally across government. Some initiatives have developed out of the foreign aid programs and literature that may be instructive. These include ‘evaluation clubs’ or forums that promote cross-fertilisation, peer support and learning about what works — both in relation to methodologies and policy approaches themselves. We could think of developing comparable institutions as centres of excellence to foster greater interjurisdictional learning in Australia — a kind of Cochrane Collaboration in the policy arena. Government/COAG sponsorship for such institution building is worth considering. Indeed, it could be contemplated as a useful extension to the role of ANZSOG, given its ‘ownership’ by all governments in Australia and New Zealand.

### *Better use of external contracting*

When it comes to the (inevitable) use of external contractors, I think we need to give far more attention to defining the task, and to identifying how contractors can best help us to make good public policy. Choosing the contractor — getting the right consultant for the task — is obviously fundamental. I would suggest that in many cases, it is better to go directly to the experts rather than to the big jack-of-all-trades management consulting firms that may be willing to tackle anything, but have an indifferent performance record in policy-related work (to say the least).

Part of the challenge, if consultants are to become contributors to a truly evidence-based approach, is to limit their tendency to second guessing, which can compound bureaucrats’ own tendencies in this direction. As noted previously, this may be less

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of an issue for academics, who typically do not rely on such sources of income, than for business consultants, who do. An evidence-based approach ideally requires contractual arrangements that create neutral incentives for the researcher to make robust findings — for example, by making it clear that his or her work will be peer reviewed.

More generally, monitoring and reviewing the quality of such external work is crucial and, again, academic specialists would seem particularly well placed to help with that, as well as helping agencies choose which consultant to use in the first place.

Peer review can also be very worthwhile for the research that is done within government, but this is not common practice. It is especially valuable where political sensitivities require secrecy during the policy-development phase, but where there may be significant downside risks for the community from getting it wrong.

### *Resourcing evaluations properly*

We need to ensure that all government programs are designed and funded with future evaluation and review in mind. That includes data needs, especially *baseline* data. We should be pushing harder for more and better data generally, particularly in the social and environmental areas. Instead of being seen as an extra or a luxury, data for policy evaluation needs to be recognised as a necessity — and a funding priority right now if we are serious about developing an evidence-based approach.

As already emphasised, we also need to be building in more time, where it is needed to come up with robust evidence that is adequately tested. In a crisis situation such as the present, time is of the essence of course, and some decisions need to be made quickly. That is inevitable. But it is important that we lay the groundwork now to evaluate the consequences of those measures later, so the inevitable problems can be detected and timely adjustments made.

In the current context, this is particularly important for spending initiatives motivated by short-term demand management objectives, which could have an ongoing impact, or create a sense of entitlement and political pressure for their retention. For example, increased assistance to an industry — by strengthening its ability to withstand foreign competitors in a recessionary market — may initially help to shore up that industry's workforce. But this selective support will tend to weaken job retention in other local industries and, if sustained, inhibit overall job creation and productivity growth in the longer term.

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*Bottom line*

The goal of evidence-based policy making is unquestionably important, and it is encouraging that it has received vocal support at the highest political levels. However, measured against the various ingredients for an effective approach, it seems clear that current practice continues to fall short. Addressing this is now largely up to the Public Service. Not only is there a need to improve the capacity of the Public Service to deliver evidence-based policy advice, there is a need for it to improve political understanding of what that entails. If we fail, it will compromise government's capacity to implement the beneficial national reforms that this country needs for the long term.



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## Markets: how free?\*

The invitation to speak at this symposium was an offer I could not refuse. First, the topic, ‘markets: free but not beyond government intervention’, was appealing. It involves recognition that markets have a very important role to play, but also that governments too have a key role — and it is important to get the mix right for the community’s sake in the long term. I’ve spent much of my career puzzling over the tradeoffs in that territory and indeed that is the principle focus of the Productivity Commission itself.

A second reason why I could not refuse, was that this event is hosted by the Whitlam Institute, named in honour of Gough Whitlam. After all, it was Whitlam’s Government that really began the process of opening up Australia’s economy to the global market. He was the first Australian leader, I think, to act on the understanding that a freer, more competitive market would facilitate greater economic efficiency and productivity, which would in turn underpin income growth and pay for social programs needed to address inequality and disadvantage. As I recall a catchcry of the time, ‘a government cannot redistribute what its economy does not produce’.

Whitlam saw clearly that the pursuit of economic efficiency and social progress were complementary. And he acted on this insight. It was he who dealt the first blow against Fortress Australia, with the 25 per cent tariff cut in 1973. While there were multiple rationales, and the reduction was partially reversed in following years, it was a politically brave, indeed unprecedented, gesture that demonstrated what was possible. It contributed greatly to developments in policy thinking that saw the next Labor government, a decade later, pick up where Whitlam had left off and succeed in opening up the Australian economy on a more sustainable basis.

Those further reforms, and the reforms that have occurred since then, were Whitlam’s legacy in another way. Whitlam also understood that policy reforms to promote efficiency and community wellbeing are often stymied by vocal minorities who stand to lose, while not being adequately appreciated by the much larger section of the community who are the ultimate beneficiaries. He created the

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\* Extract from an address to the ‘Governing the Economy Symposium’ convened by the Whitlam Institute, Sydney, 30 November 2009.

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Industries Assistance Commission, out of the old Tariff Board, to expose such claims to careful analysis and public scrutiny, and thereby promote more informed policy decision making in a more neutralised political environment, where the tradeoffs in reform could be better appreciated by the community.

Now at this point I must declare my own interest, because my very first job was with Whitlam's Industries Assistance Commission and, after doing various other things, my current job is with its descendant — the Productivity Commission. The basis of my affinity, I think, is clear!

At one level, the assigned titled of my talk can be interpreted as a simple recognition of reality — a statement of fact. I can not think of any market in Australia which is not subject to intervention of some kind. Indeed some markets could be said to be *creatures* of regulation, depending on it for their very existence. The Carbon Pollution Reduction Scheme is currently the most important, and I guess most contentious, example of that. Some other markets have only emerged through the loosening of tight regulatory constraints. The gambling industries, about which I'm going to say bit in a moment, are a prime example.

In the shadow of the global financial crisis, you can also read into the title the implication that markets can be *too* free — not regulated enough. I think that is a reasonable position for anyone to take, especially in the light of recent experience in financial markets. But it leads to the following big questions for public policy: how free, how much intervention and, very importantly, how should governments go about deciding this in the best interests of the community?

Well, in seeking to address, if not completely answer, those questions I'll first talk about what purpose markets serve, and their contribution to economic progress (and Australia's in particular); secondly, I will explore the limits of markets — what they *can not* do — and, related to that, why they retain an image problem in the midst of the prosperity that they've engendered; and thirdly, I'll draw on two cases studies from the current work program of the Productivity Commission — executive remuneration and gambling — to illustrate some principles that I believe have wider application.

## **What do markets offer?**

The stories that have emerged from the global financial crisis about complex financial derivative markets — as has been said, 'transferring risk from those who did not care about it to those who did not understand it' — together with revelations about numbers of people losing their savings in shonky investment vehicles, the failure of high profile financial intermediaries, and indeed the erratic swings in

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stock markets and currency markets, are all seen by many people as evidence of fundamental problems with markets. That is understandable. But in reality, markets are the solution to a much bigger problem. They yield benefits to society that have greatly outweighed any costs, including those just experienced.

Problems *in* markets should not be conflated with problems *of* markets. It is easy to lose sight of the simple function of markets. They are a means of connecting willing buyers and sellers, to their mutual benefit. That is all they do. Of course, if they do it well, they achieve a lot. But, like the old saying about oils, ‘markets ain’t markets’: some operate a lot better than others. History tells us that those societies with better functioning markets have been the most successful economically, and often the most successful socially as well.

Indeed the economic progress of mankind is broadly coextensive with the evolution of markets: from localised barter, to monetised transactions encompassing large numbers of people over large distances. How rapidly and effectively markets have developed, has depended in turn on the development of institutions and rules to facilitate them and to reduce the costs of transactions in particular. The key ones are how well property rights are defined; how effectively suppliers compete; how well informed are buyers, and the nature and reach of mechanisms for legal redress when things go wrong.

Through the medium of prices, competitive markets ensure that a country's resources get put to use where they can do the most good — taking account of what value people place on different goods and services, and how much those goods and services cost to produce. Competitive markets also ensure that the ‘better mousetrap’ gets appropriately rewarded, in turn providing incentives for innovation and lower-cost production, which underpin the growth process.

The logic of markets is that all this happens in a decentralised way, with the actions of many unrelated individuals coordinated spontaneously through the prices they face — Adam Smith’s (unjustly derided) ‘invisible hand’. Importantly, emerging shortages and surpluses, which are inherent to any economic system, can be signalled automatically in a competitive market through price movements, precipitating spontaneous actions by both buyers and sellers that eventually serve to eliminate them. If a queue persists, whether it be for taxis or hospital beds, you can be sure that a well-functioning market does not.

As noted, not all societies have been persuaded by the logic of markets. However experiments around the world with alternative systems have only served to demonstrate their value. And indeed we have seen a progressive shift towards, or back to, markets across the globe in recent decades; a move which has generally

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paid off for the countries concerned. Since 1980, world GDP has risen by two and a half times, or an unprecedented 40 per cent per capita, with millions of people rising out of extreme poverty.

For example, China's performance since the end of the Cultural Revolution, when it tentatively began to open the door to markets, speaks for itself. Since the beginning of the reforms in China in 1978, we have seen real GDP in that country grow by more than 10 per cent a year. That in turn has seen dramatic reductions in poverty, rises in life expectancy, and gains in other indicators of wellbeing and capability, like literacy and health. The OECD has described China's advance to a market economy as among the greatest economic success stories of modern times.

The power of markets to produce prosperity has also been reaffirmed within market economies themselves — wherever impediments to the functioning of particular markets have been reduced, or markets have been introduced to industries or activities where none had previously existed.

Australia itself illustrates how important it is to a country's economic performance to make use of markets in a way that achieves the right balance between freedom and intervention. For much of the previous century, that balance shifted decidedly in favour of intervention. Successive governments imposed policies that impeded competition, distorted prices, constrained business and raised its costs.

For many years, the costs of the inefficiencies that multiplied under that regime were masked by the performance of our broadacre agriculture and mining sectors. But by 1983, when the Hawke Government came to power, Australia was falling off the sheep's back. Productivity and income growth were low, deficits had become relatively high, and our per capita GDP had slipped from fifth to fifteenth in the OECD. The 'banana republic' loomed, in Keating's evocative phrase.

The fact that we were able to reverse our economic decline, unlike those Latin American countries that shared top billing with us on the global GDP ladder at the beginning of last century, was largely due to the structural reforms set in train by the Hawke/Keating Government. Key strands of those reforms were directed at freeing up markets, exposing industry to international competition, and allowing prices to perform their proper allocative role, while undertaking reforms to make government infrastructure services more efficient and labour markets more flexible.

The consequent transformation of Australia's economy, from one that was inward looking, high-cost and inflexible, to an innovative, adaptable and competitive one, brought a resurgence in productivity and income growth. Australia climbed back to eighth in the OECD's per capita GDP rankings by the end of the century.

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These reforms also created a new resilience in Australia's economy, that saw us withstand international disturbances that would have laid us low in earlier decades. These included the Asian financial crisis, despite our greater dependence on Asian export markets. And, no doubt, those earlier reforms have also contributed to our relative success thus far in containing the real impacts of the global financial crisis. One illustration has been the ability, under more accommodating labour market regulation, for businesses to reduce labour inputs and the associated costs without sacking workers.

### **What markets *can't* do**

'If markets are so good, then why do they seem to perform so poorly?', I can hear some people thinking. Why do they have this image problem? Why indeed is the logic of markets resisted?

There are two features of competitive market processes that I think provide much of the explanation or reconciliation.

One is what has become known since Schumpeter as 'creative destruction': survival of the economically fittest. Markets go by results. They pay no respect to good intentions and they punish poor economic performance. If a business can not deliver a product that people want sufficiently, it will fail. That is the *destruction* bit. But the business's resources will not disappear or even remain idle for long, at least in most circumstances. They will eventually be absorbed by other, expanding businesses that are meeting the market test — and that is the *creative* bit.

Creative destruction is inherent to the growth process. With limited resources, economies are dependent on successful businesses and industries being able to attract people and capital from less successful ones. Stop that, and you stop the engine of growth, and the 'banana republic' beckons once more.

But that also means that at any time some firms will contract or even close down; some people will become unemployed, at least for a while; and some towns and regions will stagnate or decline, while others prosper. That seems harsh to most people, especially to those most directly impacted. So we see considerable resistance to the logic of markets, and indeed lobbying by industries for taxpayer support. This can be successful if the industry is influential enough, or regional politics favour it — though governments generally know that it is better to provide people with transitional income support in a dynamic economy, than to try to help them by making the economy itself less dynamic. Australian governments have been liberal in providing such income support to households and this has

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underpinned a relatively stable distribution of income in Australia during what has been an extended period of wide-ranging structural reform.

The second reason why markets have acquired an image problem reflects the reality that what the market values need not accord with what *society* values, or indeed even with the interests of the economy as a whole in the long run. Private and social valuations need not be the same. This can manifest itself in several ways, but four principal ones occur to me:

- Firstly, certain kinds of goods and services may not be produced by the market, because while they are socially valuable, firms cannot make a buck out of them as it would cost too much to stop people ‘free-riding’. These are known in the jargon as ‘public goods’.
- Secondly, certain people within society may not get access to some services that *are* produced, like adequate healthcare or adequate education — once commonly referred to as ‘merit goods’.
- Thirdly, some activities or services may be privately produced, but underdone. This includes production activities like R&D, which give rise to unrewardable spillovers, but also things like safety within the workplace or probity within businesses. Another ‘product’ that will similarly tend to be under-provided is welfare services.
- And fourthly, some production activities may be *overdone*, and I guess pollution is the traditional, yet still topical, example.

These gaps or deficiencies in market provision all involve things that civilized societies care about. They have to do with fairness and quality of life. It could be said that they have to do with the *productivity of societies*, not just the *productivity of economies*. But we shouldn't condemn markets for failing to produce them. Markets make an important contribution, but they cannot satisfy every societal goal or need. They cannot do it all. That is why we have governments and why, realistically, electorates require them to perform a larger role than the minimalist functions advocated by libertarian philosophers.

In addition to establishing institutions to underpin markets, governments need to intervene to influence behaviour by the participants, and they need to provide so-called ‘non-market’ services. While many of the latter interventions have been desirable, some have come at a high cost, and some have been motivated by private interests rather than the public interest. Unwinding such arrangements has been the object of the microeconomic reform process since the early 1980s.

Among the more marked trends in government intervention have been the removing of impediments to competition, as well as a shift from public to private provision

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where it is more efficient or cost effective. And, in financial markets, we have seen a greater emphasis on principle-based regulation focused on outcomes, rather than prescriptive regulation focused on inputs. There has also been more reliance on disclosure and the strengthening of overarching institutional oversight.

While this change has yielded significant benefits for Australia — and our financial markets and institutions have proven relatively robust — the global financial crisis’s origins in regulatory failures overseas, together with Australia’s membership of the G20 and that grouping’s increased role, has meant that we are inevitably facing pressure to introduce more regulation in Australia. That is not necessarily a bad thing. We need to be reviewing all regulation periodically in the light of experience, particularly in areas as important as financial markets. But managing this process so as to ensure that any new regulations we do introduce are appropriate to Australia’s circumstances, and a good fit with the existing regulatory framework, will be quite challenging.

There is much at stake in getting this right. Financial flows are the lifeblood of the economy. Prior to the liberalisation of the 1980s, financial markets in Australia could be said to have been very safe, but credit was costly, hard to get and poorly allocated. The relaxation of credit controls and barriers to competition drove major innovations and cost reductions that boosted economic growth and benefited many people, including low-income people.

Any response in Australia to the recent excesses and poor risk management in the United States and other countries should not overlook these important benefits. They imply the need in intervening in this market, to get a balance between reducing the risks and costs of financial instability, and its contagion effects on the real economy, and the risks and costs of reducing competition, innovation and productivity in this key industry sector, and the adverse economy-wide impacts that these too would have.

### **Achieving regulatory ‘balance’**

Some lessons can be briefly drawn from two inquiries on which I am presiding — executive remuneration and gambling — in terms of the bigger picture in balancing freedom and intervention in markets.

The first lesson is that it is ‘horses for courses’. Unless you are operating in a perfect market with social and private valuations and effects coinciding, and complete information for all, there may be a case for intervention to influence behaviour. But how much and what kind will depend crucially on the particular market.

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Secondly, interventions that can target the source of a problem without unwanted side effects or other collateral damage will generally be superior, and give greater confidence of achieving a net benefit to the community over the longer term.

Thirdly, sometimes markets give rise to social costs, but no intervention can be found that would reduce them without giving rise to greater costs. In other words, in some situations, we will see a problem, but there will be no way for government to solve it without causing greater problems. In those situations, although it can be politically hard to resist, ‘no action’ is the most appropriate course.

Fourthly, knowing whether and how to intervene so as to do good, or at least not to do harm, is rarely straightforward, and getting this right demands good analysis and good evidence, which must include consultation with those likely to be affected. So it also requires good process. The Commission has never had an inquiry where its final recommendations to government have not benefited from the exposure of a draft report to feedback from the community. The law of unintended consequences holds most firmly when consultation is weakest.

Moreover, the risks of unintended consequences are generally highest when making *ad hoc* or piecemeal changes to an *interactive* system — which is the essence of a market.

In sum, markets perform a very valuable role. They are integral to the process of economic development and the reduction of poverty worldwide. But they are rarely entirely free, and indeed depend for their existence and proper functioning on a framework of regulation. Markets also cannot satisfy all policy goals and need to be complemented by government intervention that either ‘fills the gaps’, or influences the behaviour of market participants to align private and public interests. Getting this right is hard. Evidence, analysis and ‘learning by doing’ are all essential to finding the best balance, in the best interests of the community.

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# Domestic transparency and trade liberalisation\*

A successful conclusion to the Doha Round remains elusive despite six years of intensive negotiations. The sense of déjà vu is palpable. As in previous rounds, the key sticking point — divisions between the European Union, United States and developing countries on the adequacy of current ‘concessions’ — reflects perceptions within those countries that their liberalisation only benefits them if it is reciprocated by their trading partners. That in turn is a reflection of a poorly informed policy discussion within WTO member countries, and the lack of domestic processes to promote it.

This, of course, is not a new diagnosis. Two decades ago, two international study groups reporting on ways to overcome the then impasse in progressing multilateral trade negotiations advocated establishing ‘domestic transparency’ mechanisms within member countries to generate better information about the costs and benefits of domestic liberalisation, and thus a more ‘positive’ approach to international trade negotiations (Leutwiler et al. 1985, Long et al. 1989). The proposal was also revived in the early stages of the Uruguay Round in the negotiating group on the functioning of the GATT System (Rattigan, Carmichael and Banks 1989) but consideration was deferred pending establishment of an *external* monitoring process within the WTO, the Trade Policy Review Mechanism (TPRM). That deferral became permanent.

The consequences of this deficiency in national preparations for trade negotiations have become more profound given the expansion of ‘trade’ negotiations beyond tariffs and quotas on manufactures to more difficult areas of domestic policy, and by the expansion in membership of the WTO. These days, negotiations encompass agriculture, services and ‘behind-the-border’ issues such as foreign investment, competition law, product standards, intellectual property, governance and other matters which are widely seen as belonging to domestic policy. The complexities of

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\* Edited extracts from Banks, G. and Carmichael W. B., ‘Domestic transparency in Australia’s economic and trade reforms: The role of “the Commission”’, presented to the Lowy Institute and Tasman Transparency Group conference, ‘Enhancing Transparency in the Multilateral Trading System’, Sydney, 4 July 2007. (Bill Carmichael is a former Chairman of the Industries Assistance Commission.)

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this broadened trade agenda, the fact that it has more to do with domestic than international policy matters, and the lack of mechanisms to examine the consequences of policy change, have compounded the difficulties of achieving liberalisation in international settings.

The broadened international agenda has heightened the need for more transparent domestic policy-making processes. Australia's experience in this area, reflecting in part our traditional lack of negotiating scope in the GATT as an agricultural exporter, has attracted renewed international attention. The latest WTO Trade Policy Review of Australia makes the following observation:

The high degree of transparency in the formulation and evaluation of Australia's economic policies in relation to their rationale, nature, and economic effects, enhances government accountability and public debate over the merits of these policies. Hence, transparency has contributed greatly to the continued process of reform, which began in the 1980s, and in which trade liberalization, much of it unilateral, has played an integral part. (WTO 2007, p. vii)

The TPRM report emphasised that the transparency function had become institutionalised in Australia, notably through the role of the Productivity Commission (and its predecessor organisations) as an independent review and advisory body on microeconomic policy and regulation.<sup>1</sup>

While other countries have organisations within the public or private sectors that do research or provide advice on trade and related policies, Australia appears to be unique in having fashioned an independent institution within government to pursue this on an ongoing basis, using public processes and an explicit national interest perspective. Even within the Australian tradition of extensive use by governments of public inquiries to investigate all manner of public policy issues (Prasser 2006), the Commission's standing transparency function is distinctive.

Although formed in 1998, the Productivity Commission's institutional roots go much deeper. It is the direct descendent of the Industry Commission (1990–1998) and, before that, the Industries Assistance Commission (1974–1990). In turn, that body was created from the Tariff Board, which was founded in 1921.

The Tariff Board was established to advise the Commonwealth Government on questions of assistance for import-competing industries. It served an essentially protectionist role until the mid-1960s, when, under the combined influence of a new Chairman (Alf Rattigan), a separate high profile public inquiry into Australia's

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<sup>1</sup> Growing interest in the Commission is also evident as part of a wider push within a number of countries to enhance their own capacity for policy formulation and economic decision making. A recent focus for this has been 'institution building' within Asian members of APEC and New Zealand, but interest extends as far afield as Chile, Botswana, Kazakhstan and even France.

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economic policies (the Vernon Committee) and developments in protection analysis fostered by Australian academics (notably Professor Max Corden), the Board began to question the effects on the wider economy of its longstanding, needs-based approach to tariff advice.

In the face of considerable resistance from the then Government, the Board increased its analytical capacity, began estimating and making transparent its measures of the relative protection levels accorded different industries (using the relatively new concept of the ‘effective rate’ of assistance) and published a tariff review program focusing on broad groups of manufacturing industries — rather than narrow product lines — commencing with those most highly assisted.

As a result of the Board’s use of transparent criteria against which to assess claims for assistance, and concern for the wider economic impacts of its recommendations, its advice gained greater respect and authority.

The election of the Whitlam government in December 1972 brought decisive changes to Australian tariff policy. The Industries Assistance Commission (IAC) replaced the Tariff Board in January 1974, with a wider remit, and a clearer focus on national economic performance. The new Commission was seen as providing a counterweight to the sectional and other political pressures resisting trade and industry liberalisation.

The legislation creating the IAC provided it with a charter and independence required to ensure that its advice to governments would be disinterested, open to public scrutiny and formulated with regard for the best interests of the community as a whole, not just those of particular groups.

Three features of the IAC’s structure and operations underpinned the effectiveness of its contribution to public debate and policy formulation: independence, transparency, and an economy-wide mandate. These features have remained fundamental to the role and operations of the two organisations that succeeded the IAC, namely the Industry Commission and today’s Productivity Commission. In combination, these institutional arrangements preserve the autonomy of governments over policy, while ensuring transparency and an economy-wide perspective in the advice provided to them on key issues.

The main differences between the three organisations have been in their coverage, which has been progressively extended beyond industry assistance matters to include structural reform issues across all sectors of the economy, and in social and environmental as well as economic spheres. Around 80 per cent of the IAC’s inquiry reports concerned assistance for manufacturing industries. These days, around 80 per cent of Productivity Commission inquiries relate to cross-sectoral,

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infrastructure, social and environmental policy issues. The breadth of matters addressed by the Commission in recent years is illustrated by its major reports on public support for science and innovation, infrastructure regulation and pricing, waste management, energy efficiency, water markets, paid maternity leave, implications of the ageing of the population, and Australia's gambling industries.

## **The public inquiry process**

The Commission's public inquiries tend to be resource intensive and have a high public profile compared to other research studies and are therefore not designed for trivial or straightforward matters. Rather, they typically concern policy issues that have a significant impact on different groups within society, or are otherwise contentious or complex to assess, but where the potential of a long-term payoff for the nation from better informed policy making is high. These features put a premium on good process and effective engagement with potentially affected sections of the community.

Once the Australian Government agrees on the focus and scope of an inquiry (often in consultation with other governments and community groups), the Treasurer sends a 'reference' to the Commission. The terms of reference outline in writing what the inquiry covers and how long the Commission has to report. Most inquiries specify a duration of 9 to 12 months, sometimes less for urgent matters. Such timeframes need to ensure adequate opportunity for public participation and for feedback on the Commission's preliminary findings before its report is finalised and sent to the Government.

Public inquiries are widely advertised and provide an opportunity for different points of view to be heard and considered. The Commission is active in identifying those potentially interested in the inquiry and all individuals and organisations with an interest can participate. They may do so through the Commission's visit program, through written submissions and attendance at hearings, or at workshops and other forums. Submissions and transcripts of public hearings are posted on the Commission's website and are also available in hard copy.

These transparent processes ensure that the arguments of interest groups are subject to close scrutiny, as is the Commission's own analysis.

Final inquiry reports must be tabled in Parliament within 25 sitting days of the Treasurer receiving the report. But it is up to governments to make the final decisions in response to the Commission's findings and recommendations.

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## **The value of a supporting research function**

Crucial to the Commission's contribution has been its capacity to undertake research on its own initiative. According to Rattigan (1986, p. 21) many of the early difficulties of the Tariff Board could be traced to its incapacity to stand back from day-to-day inquiry work, assess the shortcomings in its overall approach and to develop ways to overcome them.

In its earlier forms, the Annual Report was the main vehicle through which the Commission could publish research findings on the structure of protection, sources of structural change in the economy and related matters, and to explain the rationale for the Commission's general approach to its inquiry work. In comparison, the Productivity Commission has an explicit statutory duty to initiate research that complements its other functions and to promote public understanding of the tradeoffs involved in different policy approaches. In addition, it must report annually on the impact of assistance and regulation on the productivity and performance of the Australian economy as a whole. The Productivity Commission's supporting research program is integral to its work and comprises a significant proportion of its output.

## **Impact on trade policy debates and decisions**

In seeking to gain an understanding of the Commission's role, international visitors often ask for evidence that it has made 'a difference' to policy making in Australia. It is hard to be conclusive. After all, the Commission is only an advisor, not a decision maker; there are many other sources of advice to government, and there can be lags between when the Commission reports and the ultimate policy decision, such that attribution is difficult. And of course, views by different parties on the performance of the Commission can be conditioned by how those interests have been affected by its advice and analysis.

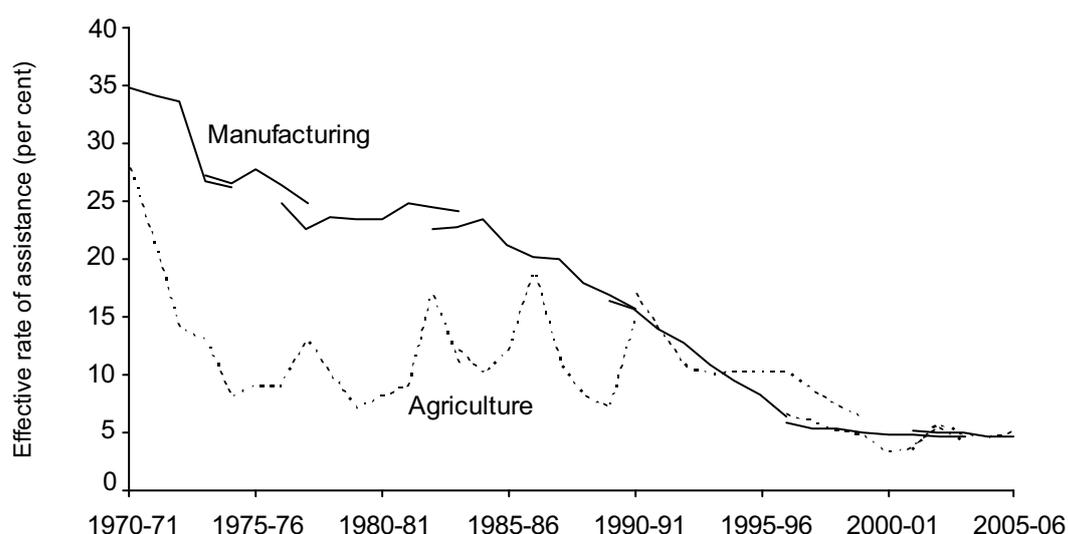
One simple indicator of the Commission's influence is government acceptance of its findings and recommendations. In the case of its inquiries into industry protection or assistance, notwithstanding some high profile rejections (generally in politically charged circumstances), the great bulk of the Commission's recommendations have been implemented either fully or in part.

It has taken more than four decades of policy effort and debate to lower Australia's trade barriers and industry assistance levels, but the protectionist regime has been almost dismantled (figure 1). Nevertheless, tariff reform remains incomplete. In 2000 the Australian Government deferred implementing the Commission's recommendation to reduce the remaining general tariffs of 5 per cent to zero,

preferring to delay removal until a time ‘consistent with trade and fiscal objectives’. Moreover, the legislated reduction in automotive tariffs has the caveat of a further review to be conducted by the Commission in 2008 ‘to determine whether changes are warranted to the legislated tariff reductions in view of conditions in the international trade environment’.

With Australia’s tariff walls falling and competitive pressures on the traded goods sector rising, policy impediments ‘behind the border’ began to attract attention.<sup>2</sup> Initially, the Commission’s reporting helped to widen the microeconomic reform program in the 1990s to improving the performance of economic infrastructure services dominated by government-owned monopoly suppliers in energy generation and distribution, water, rail, ports and postal services.

**Figure 1 Declining industry assistance in Australia**



*Data source:* Productivity Commission estimates.

## Some implications

Australia’s experience demonstrates that institutionalised transparency can help governments undertake beneficial reform and make better policies, but is also suggestive of some general cautions. Expectations need to be tempered:

<sup>2</sup> The Tasman Transparency Group (2007) has pointed out that domestic transparency procedures are needed to bring opaque ‘behind-the-border’ barriers into account in trade negotiations. These barriers are pervasive in the markets for services.

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transparency is unlikely to transform to policy environment overnight. Building a pro-reform constituency in government and the wider community is a gradual process. It took Australia four decades to get tariffs down and more than a decade tackling sources of underperformance in economic infrastructure services. And neither reform program is yet complete.

That said, reforms once made in Australia have tended to stick, having stronger foundations of support or acceptance within the community precisely because the basis for reform *was* transparent. The programs of tariff liberalisation and regulatory reform initiated under one government have generally been maintained by new governments of different political complexions.

The Australian experience with early tariff reform is also instructive of the adverse consequences of avoiding transparency. The 25 per cent tariff cut of 1973 followed a report prepared secretly within government and was implemented without warning. In hindsight, there can be little doubt that it set back public acceptance of protection reform and created uncertainty about how reform would be conducted in future. Reflecting that uncertainty, and in response to pressure from those who stood to lose most from the tariff cuts, the Government subsequently acted to effectively quarantine Australia's most highly protected industries from the general reduction. While the 25 per cent cut lowered the average level of protection, the Government's subsequent selective imposition of quantitative restrictions increased the disparities in protection across industries. This greatly reduced the potential benefits. It is significant that, more than three decades later, the two manufacturing groups quarantined from the across-the-board reduction in tariffs are still the exceptions in Australia's otherwise low protection regime.

A second implication is that reform is a *process*, not an event. One set of reforms exposes the need for others. As Australia opened its borders to foreign goods, services and capital, 'upstream' inefficiencies in government utilities and inflexibilities in labour market regulation became more apparent and unacceptable to those facing new competitive pressures. This effectively enlarged the 'constituency for reform' within Australia. As noted, the Commission's work program went increasingly 'behind the border', to cover an array of industry assistance issues and anti-competitive regulation across the economy and, nowadays, the human capital related drivers of productivity growth and living standards.

A point to emphasise, given the context for this international conference, is that the Commission's contribution to Australia's trade policy has generally not been made as part of the trade negotiation process itself. Rather, the Commission's reports have focused on the case for domestic liberalisation. However, this unilateralist focus progressively affected Australia's approach to multilateral trade negotiations. In

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effect, the negotiations largely served to ‘lock in’ our protection reductions, through binding international agreements, rather than driving the reforms themselves (Banks 2003b).

The nature of the Commission’s contribution, which relies not only on solid research but also on providing adequate scope for public input and scrutiny, is not a good fit with the secrecy and rapidity that characterises decision-making in trade negotiations. However there is scope for the Commission to play a more direct role, by providing an assessment of the potential for gains and losses for Australia when prospective trade agreements are contemplated and, subsequently, before agreements are signed, assessing whether the final outcome from negotiations is likely to deliver net benefits for Australia. It could also provide guidance on more general or systemic issues, such as the product coverage of negotiations, the design of rules of origin or identifying the greatest distortions from a domestic welfare perspective.

A caveat is that there needs to be sufficient lead-time for the Commission to consult and test its analysis with other experts and those potentially affected. This applies equally to modelling work, which has previously been performed by consultants under tight timeframes. While the Commission no longer has a monopoly on modelling technology or expertise (to the contrary) it does provide a ‘neutral’ incentives environment for modelling directed at the national interest. In hindsight, the ‘battle of the models’ that occurred during the Australia United States Free Trade Agreement negotiations, arguably did more to confuse than enlighten the community about the likely outcomes for Australia from that agreement.

Finally, the longevity of ‘the Commission’ should not obscure the difficult times it weathered along the way. The institution found itself under threat of closure or emasculation on several occasions. It is the insights gained from the Commission’s survival that are most likely to be of interest to those contemplating how transparency might best be introduced into the policy apparatus in their own countries.

The Commission’s independence has been invaluable in ensuring that its advice is not compromised or swayed by particular sectional or bureaucratic interests. Independence, together with quality analysis directed at community-wide ends, underpin the credibility of the Commission’s advice in contentious areas of public policy.

For a transparency body to be effective, responsibility for it should rest with a minister having economy-wide responsibilities. The Australian experience is that the Commission prospered least when it reported to a minister with responsibility for a particular sector of the economy. A properly functioning domestic

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transparency agency acts as a counterweight to sectional interest groups, whereas industry ministers have industry constituencies to which they naturally feel the need to be responsive.

In practical terms, adequate funding and control over its use determine how well the domestic transparency function can be performed. These were early ‘battle grounds’ as the Tariff Board began to reinterpret its role and saw a need for greater research, and bureaucratic opponents sought to hinder this. Subject to general governmental controls affecting public sector agencies, the Commission has discretion in allocating its budget to meet the needs of its inquiry, supporting research and other functions.

Effective policy formulation in contentious areas of public policy requires effective consultation as well as good analysis. The hallmarks of the Commission’s inquiry procedures are: public notification of new inquiries and their terms of reference; face-to-face visits or roundtable discussions with major interest groups; insistence that all key aspects of submissions and the information and views provided at hearings be made publicly accessible; and exposure of the Commission’s preliminary analysis and conclusions to public scrutiny before its advice to government is finalised.

As a result of the system of open inquiries and public reports that form the basis for Australia’s transparency arrangements, decision making has been better informed about the future consequences of policy initiatives under consideration. This system has helped make it possible for Australian governments to move forward on economic and trade reform, a journey that is not yet over.



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# Why have a Productivity Commission?\*

The Productivity Commission has been given an important job. Its role, expressed most simply, is to help governments make better policies, for the benefit of the Australian community. As its name implies, the Commission's focus is on ways of achieving a more efficient and productive economy — the key to higher living standards.

The Productivity Commission is an independent Commonwealth body, created by Act of Parliament in April 1998, to replace the Industry Commission, the Bureau of Industry Economics (BIE) and the Economic Planning and Advisory Commission (EPAC). It has been launched at a time of almost unprecedented debate about key policy directions for Australia. There has been a backlash against many of the policy reforms of the past decade, particularly those which have exposed Australian workplaces and regions to increased competition. And this reaction has spilled over to the institutions of government associated with that transformation.

As a catalyst for change in policy areas where there are often vested interests in maintaining the status quo, the Commission will often find itself in the firing line. Those who disagree with the Commission's findings will naturally be tempted to shoot the messenger. Recently, there have been three broad areas of criticism. One accusation, carried over from the Industry Commission, is that the new body is ideologically driven. A related criticism is that the Productivity Commission, in combining three separate agencies, now monopolises policy advice. A third approach has been to dismiss the Commission as irrelevant because its predecessor's advice was not followed on some key issues.

## **Which ideology?**

The first and most ingrained of these, that the Commission has an ideological antipathy to all forms of government intervention, probably has its origins in the protection debate under the former Industries Assistance Commission. While it is true that the Commission and its predecessors, including the BIE and EPAC, have

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\* Address to the Committee for Economic Development of Australia, Public Education Forum, Brisbane, 26 August 1998.

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been consistent in advocating reduced industry protection, this has had more to do with removing the costs on the Australian economy and community than with any ideological predisposition against government intervention.

Indeed, in its recent submission to the Mortimer review of business programs, the Commission outlined various circumstances in which governments needed to assist industry (IC 1997c).

The Commission and its predecessors have also emphasised the value of competitive market disciplines to promote greater efficiency and productivity — and thus higher living standards. But this has not involved doctrinaire adherence to unbridled market forces. Each case has been assessed on its merits. For example, in areas such as health and education, the Commission has emphasised the importance of mechanisms to ensure access for those on lower incomes. In a number of reports dealing with environmental issues, the Commission has supported government regulation to achieve better outcomes.

A careful, case-by-case assessment has also informed the Commission's approach to privatisation, which has generally been seen as of secondary importance to removing constraints on competition and advocated only where it would clearly bring additional benefits.

When one goes beyond industry assistance and public utility regulation to consider the other diverse policy areas in which the Productivity Commission now has a role, it becomes even more difficult to button-hole us. Yet the pattern, or lack of it, was already apparent under the Industry Commission. For example, what is the common ideological basis for:

- the Commission's support for public provision of housing?
- its recommendations to maintain the 150 per cent tax concession for business R&D, or its strong support for basic research in universities?
- its advocacy of stronger duty of care enforcement for OH&S?
  - or the extension of the duty of care concept to land management regulation?
- its recommendation that the tax deductibility of donations to community social welfare organisations not only be retained, but extended?
- its rejection of unilateral open skies deregulation of international air services?
- its identification of the role of poor management practices as well as that of unproductive work arrangements in stevedoring?

There is little evidence of an open slather free market ideology in these recommendations. Not only that, I suspect that most of them would not have been

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predicted by the participants in those inquiries — or even by the Commission itself at the outset. The fact is that most of our inquiries are a voyage of discovery. Where we end up depends on what we learn along the way.

Similarly, accusations that the Commission pursues a narrow concept of economics with little regard for adjustment or social issues have missed some important strands of its work. Some of our critics clearly have not read our reports.

There is a long tradition through the Commission's predecessors, of recommending phased or graduated change to allow time for orderly adjustment or to meet equity objectives.

A key instance is the consistent advocacy of gradual, predictable reductions in tariff levels, including in the most recent passenger motor vehicle (PMV) and textiles, clothing and footwear (TCF) reports (IC 1997a, 1997d). But there are many others. For example, while the Industry Commission's report on urban transport found that restrictions on taxi numbers were costing the public on average an extra \$2 a trip, it recommended that the restrictions be eased over a number of years by auctioning additional plates, with the possibility of compensating existing licence holders with the sales proceeds (IC 1994b). In its report on private health insurance, the Commission recommended modifications to community rating based on the age of entry, to help stabilise the system and make it fairer to long-standing members. It also proposed, however, that this change apply only to future entrants and that there be an initial grace period during which anyone could enter under the old rules (IC 1997b).

In these and other inquiries, the Commission has generally given careful consideration to both the adjustment and distributional implications in making its policy recommendations.

For example, although not widely reported at the time, the TCF report identified a need to provide targeted support to improve the employability of workers needing language training and to ensure assistance to depressed regions where there is significant TCF activity (IC 1997d). Emphasising the important role of generally available training and welfare programs in the adjustment process, the Commission recommended that the eligibility of any redundant workers for employment services should not depend on them receiving social security benefits.

Where the Commission has not recommended tailored support to facilitate adjustment by particular groups, this is not through any ideological objection, but because it has seen no additional pay-off from such schemes, which can be difficult to design and generally have a poor track record.

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A concern for the effects of policies and policy changes on different groups of people and regions is embedded in the Productivity Commission's current research and inquiry program. But it was also evident in the work of the Productivity Commission's predecessors. For example, the Industry Commission documented the regressive incidence of import taxes (tariffs and quotas) and how some states benefited at the expense of others (IC 1996c). More recent Commission research has explored the effects of a range of microeconomic reforms on employment in different industries and regions, and on the income levels of different socioeconomic groups (De Laine et al. 1997; Murtough et al. 1998). Such work has demonstrated that policy reforms have been only one among many pressures for change, often being outweighed by developments in technology and on international markets.

The Commission has also attempted to advance understanding of the social dimensions of microeconomic reform through published research, in its annual reports and community workshops — one example being its conference on 'equity, efficiency and welfare' (IC 1996b). We can of course do more in this complex area and that is why it has a central place in our work program and our consultative processes.

I think all of this reveals the hollowness of accusations that the Commission's output is narrow in focus or predictably ideological. If we have one guiding principle, it is the community-wide perspective that we bring to our work. That is the real key to the diversity of the Commission's recommendations.

As already indicated, our findings and recommendations emerge from consultations with a wide variety of industry and community groups. To give a few examples, the Industry Commission inquiry into charitable organisations involved 220 visits to interested parties, 800 written submissions and 284 participants in public hearings; the OH&S inquiry involved 250 visits and over 400 submissions; and the land management inquiry undertook 20 roundtable meetings, involving about 200 people across most regions of Australia. I expect the inquiries into the gambling industry and the effects of competition policy to involve more of the same.

The Commission can draw on a range of skills within the institution itself. Commissioners and staff have diverse backgrounds, qualifications and life experiences. The amalgamation of staff from the BIE, EPAC and Industry Commission enhanced this diversity, as did the appointment of new Commissioners. The *Productivity Commission Act 1998* requires that there be Commissioners with extensive skills and experience in matters to do with the environment, social welfare delivery and the operations of industry.

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This is supplemented by the appointment of Associate Commissioners with skills relevant to particular inquiries. Thus, the Industry Commission was fortunate to have had Sister Margaret McGovern from the Mercy Family Centre as an Associate Commissioner in the charitable organisations inquiry; Michael Easson, with his union background, on the inquiry into OH&S; Professor Mick Common from the Australian National University's Centre for Resource and Environmental Studies on the greenhouse inquiry, and so on.

Such part-time appointees enrich the Commission's understanding of the issues and enhance the credibility of its judgments. They obviously also need to share the requirement on permanent Commissioners that there be no conflicts of interest that could be seen as affecting their judgment. This has been highlighted by the recent designation of the Productivity Commission as Australia's authority for hearing claims for temporary import protection under the safeguards provisions of the WTO. Any doubts about the impartiality of those processes in the current pigmeat case, for example, would put Australia at risk of subsequent challenge in Geneva.

The Commission also has the flexibility to draw on the expertise of others in a variety of ways, including through external consultancies and staff secondments. These mechanisms are widely used.

But we can always do better. In the gambling inquiry, for example, we intend to form a consultative panel of eminent people with a range of social and industry perspectives, to generate and test ideas and provide constructive feedback.

### **Monopolisation of advice?**

There has been some criticism that creating the Productivity Commission through the amalgamation of three separate agencies has diminished the competition for ideas and the breadth of views available to government.

It is undeniable that there are now fewer such government organisations than there were before, and this will inevitably have some effect. But this needs to be put in perspective.

For one thing, the key functions of each agency have been preserved in the Productivity Commission. For example, in addition to the public inquiry activity of the Industry Commission, the BIE's international benchmarking of economic infrastructure is continuing — as evidenced by our recent waterfront report (PC 1998c) — and EPAC's concern with social issues is a core feature of the new Commission's program. Moreover, there is now a more widely ranging research

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program than existed under the separate agencies. Much of this work is published as staff papers.

It is also possible to exaggerate the separate contribution of the three agencies. In recent years, there was considerable commonality in their findings and conclusions in those areas where their work overlapped, which it increasingly did.

Governments have available to them many other sources of advice.

The Productivity Commission could scarcely be regarded as having a monopoly within the public sector. The policy departments (including Prime Minister and Cabinet) are all very forthcoming in presenting their views to Ministers, as of course are Ministers' own offices. And most Commonwealth departments have a substantial research capability as well, or could build it (or contract it) if they chose.

It is also misleading to lump the Productivity Commission in with the Treasury as is sometimes done. Although the Commission reports to the Treasurer, it is quite separate from the Treasury Department and has its own independent voice.

The Commission must also compete with the wide-ranging sources of advice from private sector consultancies and think tanks, such as the Centre for Independent Studies, Evatt Foundation, Institute for Public Affairs, Access Economics, Centre for International Economics, ACIL and the many other 'centres' now proliferating at our universities. Then there are the myriad lobbyists and organisations representing particular industries and community interests, as well as individual companies.

If anything, the Productivity Commission's public inquiry processes *facilitate* the competition for ideas among these many parties, whose influence may otherwise be exercised behind closed doors and never be adequately tested.

This also suggests why the Productivity Commission's role could not simply be privatised or contracted out. Its critical distinguishing characteristics of independence, transparency and a community-wide perspective constitute what is fundamentally a public good, which government itself needs to establish.

Governments can and do set up *ad hoc* committees of inquiry or review on key issues. And there has been a variety of them in recent times. Their contribution depends very much on how they are constituted and resourced and whether they can exercise an effective independent role. Some recent ones in the industry policy domain have performed poorly against such criteria; others, like the recent review of the financial system, have performed very well.

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## How influential?

One potential liability for government in sending references to the Commission, especially on issues where the political stakes are high, is that it will not always like the answer. To be true to its charter, the Commission needs to look at issues on their merits, against economy-wide tests, without second-guessing the politics. It can of course provide options for governments to consider, but needs to be clear about the basis for its preferences. This inevitably means that the Commission's advice will not always be accepted.

It would be misreading the Commission's role, however, to interpret any rejection of its advice as indicating that the institution is of no value to the policy-making process.

A government must make policy decisions based on a range of considerations, including its judgment about what will be acceptable to the public and about the appropriateness of the timing. The Commission's advice is but one input among many to the eventual outcome. Because it is independent and directed at the long-term public interest, it nevertheless plays a significant role in helping governments understand the tradeoffs in different policy choices.

The fact that a government may not initially accept key recommendations in a particular report does not mean that that report has no influence. If we take the PMV and TCF reports (IC 1997a, 1997d) as the most relevant recent examples, a number of the findings and recommendations in both reports were in fact accepted by the Government. And, although the Commission's majority positions on the rates of tariff phase-down were rejected, both the Government and industry agreed to further reductions after the current programs are completed in the year 2000. It is reasonable to ask whether this could have been achieved in the absence of those inquiries. I think not. Indeed, the political pressures building at that time were such that we could well have gone in the opposite direction.

It is also not uncommon for recommendations to be acted on some years later. This may be triggered by a change in government or in the economic climate, or just greater public acceptance of new ideas with the passage of time. The general program of phased tariff reductions that commenced in 1988 under the Hawke government, owed much to a 1982 report on approaches to general reductions in protection on which the Fraser government took no action (IAC 1982). A more recent example is the Government's deregulation of the petroleum industry, which was broadly in line with the recommendations of the Industry Commission's 1994 report (IC 1994a).

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A final perspective on the Commission's influence, which has its own irony, is the steady demand for its reports from international agencies and foreign governments. To provide a first-hand illustration, I was recently invited to address a conference on private health insurance in Ireland, where I was astonished to find our report (IC 1997b) being described as a key input to the current review of that country's own health insurance system. Among other examples, the Industry Commission's pioneering work in measuring industry assistance has been picked up by the WTO and APEC and is now adopted in many countries. Our approach to regulation review has been embedded in OECD codes for member governments. And the Commission itself has been advocated as an institutional model for other countries by international agencies concerned with policy reform.

### **In conclusion**

The Productivity Commission is getting on with an extensive program of work, ranging across policy areas of long-term importance to the community. While it has the advantage of well-established processes of transparency and independence, the Commission's output will also be shaped by its new legislation and appointments. These have served to broaden its perspective further and have brought greater emphasis to the adjustment and social dimensions of structural reforms.

Recent political developments demonstrate the importance of dealing effectively with these issues, if generally beneficial policy changes are to proceed. When people are doing it tough and there is mounting pressure for piecemeal policy responses and quick fixes, it is particularly important that we as a society can maintain the basis for a properly informed debate.

I believe that the Productivity Commission's role is integral to this process. While its findings will rarely please everybody, they have the benefit of a robust consultative process in which the interests of the wider community are recognised to be the dominant consideration.

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# Great expectations: management (and other) lessons from the Regulation Taskforce\*

Many of those addressing this conference are leaders of major Public Service departments, with responsibility for large budgets and major policy programs. In contrast, my own organisation, the Productivity Commission, is relatively small and has no executive responsibilities. It also has a special role among public sector entities, with statutory powers to undertake public reviews of government policies and programs and to inform the community about what is at stake in pursuing reforms.

The leadership and management requirements of such a body are therefore likely to differ in a number of respects from those elsewhere in the Public Service. At the same time, the core business of the Productivity Commission — conducting (public) inquiries and reviews — is becoming an increasingly prevalent feature of contemporary policy development, involving the appointment by governments of an array of taskforces and eminent individuals or specialists from the public and private sectors.

Some examples from the last couple of years of such *ad hoc* reviews include Professor Hogan's Aged Care Review, Andrew Podger's Health System Review, the Fisher/Moore-Wilton/Ergas Taskforce on Export Infrastructure, the Biofuels Taskforce, Venture Capital Review Committee, Warburton/Hendy study of Australia's comparative tax burden, Tourism Strategy Consultative Group, Nuclear Energy Review (Switkowski), Agricultural and Food Policy Reference Group, Wheat Export Marketing Committee (Ralph) and, among those in train, the Prime Minister's Task Group on Emissions Trading and the Opposition's Garnaut Review of Climate Change and its Economic Impact.

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\* Address to the L21 Public Sector Leadership Conference, Sydney, 15–16 May 2007. Gary Banks chaired the Regulation Taskforce. (Co-authored with Ian Monday, who had been seconded from the Productivity Commission to the Taskforce secretariat.)

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Some of these dealt with issues for which my own organisation could be said to have had legitimate claims, and some not. The reasons for taking the special-purpose or *ad hoc* review approach, notwithstanding generally higher set-up costs, possibly include a need to achieve an early breakthrough (the Productivity Commission's public processes need time), a wish to specify who is involved, particularly in achieving a blend of private as well as public sector experience (although this can also be achieved through the appointment of Associate Commissioners on particular reviews) and, following the old maxim about Royal Commissions, a desire to avoid 'surprises'.

Regardless of the particular motivating forces, once set in train, *ad hoc* reviews face many of the challenges with which the Productivity Commission has had to grapple over the years, and its experience could provide some useful guidance. However, as I discovered when heading such a review myself, they also present distinct challenges of their own. With this in mind, I have sought in this paper to outline some of the particular lessons that emerged from the Regulation Taskforce, which may be of benefit to other such reviews in the future.

## **The context**

Australia has undergone a major program of microeconomic reform over the past two decades, which has contributed significantly to this country's unprecedented run of economic growth. Much reform has been regulatory in character. It has in many cases been concerned with removing or reforming anticompetitive regulation of various kinds across the economy. The irony is that this era of 'deregulation' has also seen the fastest growth in *new* regulation in the nation's history. For example, at the Commonwealth level, there has been more primary legislation (measured in pages) passed since 1990 than in the nine preceding decades since Federation.

Much of this regulatory inflation has been in response to the heightened social and environmental demands of an increasingly affluent and risk-averse society. For the most part, these demands are legitimate and probably hard for governments to resist. But in many cases they have been addressed through regulatory interventions that have shown more concern for the potential benefits than appreciation of the inevitable costs, and the need to balance the two.

Small business, having least capacity to absorb or pass on regulatory costs, was the first to complain. A Taskforce headed by the late Charlie Bell (CEO of McDonalds) was established in 1997 to address their concerns and, notwithstanding some suggestions to the contrary, many of its recommendations were implemented (Bell 1996). However, the target of cutting red tape by 50 per cent proved elusive

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and small business remained a vocal critic of regulation in subsequent years, particularly after the introduction of the GST.

Big business also became increasingly vocal, with a particular focus on competition regulation and, most recently, the onerous obligations of the Financial Services Reform Act.

On 12 October 2005, the Prime Minister and Treasurer jointly announced the appointment of a ‘Taskforce on Reducing Regulatory Burdens on Business’. Appointees to the Taskforce comprised Richard Humphrey (former CEO of the Stock Exchange), Rod Halstead (corporate lawyer), and Angela MacRae (tax and small business specialist), with me as its Chairman. Our remit was wide-ranging, enabling us to identify reforms to reduce regulatory burdens across all areas of Commonwealth regulation and their intersection with state and territory regulation.

The most obvious challenge faced by the Taskforce was the reporting deadline — with Christmas in the middle it left 3 months for the task. This was compounded by the potentially open-ended scope of the exercise, and the fact that neither the Taskforce nor most of its secretariat had worked together before, and most secondees had had no previous experience working on a project of this nature.

The challenges were made more acute by the high profile nature of the exercise — presented by Government as the means by which it would be able to address business’s concerns (Howard and Costello 2005).

The reception by business itself to the Taskforce announcement was ambivalent. Behind the necessary public support for an initiative that was directed at meeting its needs, was a degree of scepticism about what any such review could achieve in the allotted time. At the same time, business leaders seemed encouraged by the composition of the Taskforce, and the way it proposed to go about its task.

In the event, the outcome of the review has generally been regarded as successful, with Government ‘accepting’ — if not implementing — most of the Taskforce’s recommendations. Actions taken comprise many reforms to the stock of regulations, but also to the processes and institutions responsible for new regulation, which had been a particular concern of business and other groups (Banks 2006a, 2006b).

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## **Making the task manageable**

The scope of the Taskforce's brief was potentially very wide. It was asked to identify problem areas and solutions from across the entire spectrum of Commonwealth regulation in Australia, including areas of overlap with state and territory regulation.

At first blush this seemed to many an impossible task, especially in a few months. After all, taking into account primary and subordinate legislation and quasi-regulation, there are over a thousand new instruments made each year. And, while the sobering reality is that no-one really knows precisely the extent of the stock of regulation, it is undoubtedly many multiples of the annual inflow.

Clearly, it was not going to be possible for the Taskforce to comb through the entire regulatory morass in any comprehensive way. A more selective or targeted approach was called for. Achieving this, while meeting the expectations of government and business, was going to be crucial to the success of the exercise.

That the Taskforce was asked to identify areas where regulatory reform could provide 'significant immediate gains to business' proved an important escape clause. Rather than scan the body of regulation itself, the Taskforce initially called on business groups to identify priorities from their perspective. The focus in the terms of reference on addressing regulations that were 'unnecessarily' burdensome, provided a second important avenue for narrowing the scope of the task. The Taskforce took from this that its job was not to examine or analyse policies as such, but rather to focus on undue (avoidable) costs associated with their implementation through regulation. It was a critical distinction.

Nevertheless, it was anticipated that, in some cases, the compliance costs would be intimately connected with the nature of the policy approach itself. The Taskforce took the view that, where justified, such areas should not be ignored, but recommended for more detailed follow-up reviews. Similarly, it was clear that in the time available the Taskforce would not be able to confidently make recommendations in all the areas that it considered significant. So an approach that involved early actions where the appropriate course was clear, together with an agenda of follow-up reviews, was an important way of credibly managing the potentially wide range of regulatory problems that business was likely to put forward. The Taskforce further limited the dimensions of its work by excluding from consideration regulations that were still 'in play' or those already subject to effective review processes.

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## Forging a cohesive project team

Having a team of good people who work well together and are committed to a common objective is crucially important to the success of any such enterprise, particularly one facing severe time constraints.

The mixed record of achievement of *ad hoc* reviews can on occasion be explained by the origins and make-up of their secretariats. The biggest problems typically arise where an appointed review is fitted up with a secretariat drawn from the department responsible for the policy area under review. The dominance of the department's own interests and views can be hard to shake.

Our review started with the considerable advantage of an appointed taskforce comprising four people of an independent cast of mind, whose experiences, skills and inclinations proved highly complementary. We also got on well together, which was a further advantage.

The secretariat was drawn from across government. It included officials nominated by the three 'stakeholder' departments (Prime Minister and Cabinet, Treasury and Industry, Tourism and Resources) as well as one each from the Departments of Health and Ageing and Employment and Workplace Relations. The person appointed to head the secretariat was head of the Office of Small Business within the Department of Industry, Tourism and Resources. In addition, I was permitted to appoint several researchers from the Productivity Commission, including an SES Band I officer to act as the deputy project manager.

The advantage of such a 'whole-of-government' secretariat is that it was able to bring relevant skills and experience, as well as providing conduits for communication with relevant areas of government, without the problems that can arise with a concentration of people from an interested portfolio.

Nevertheless, most members of the secretariat had never worked together, and most had had no experience working in such a setting. It was important to establish quickly a sense of belonging and of commitment to the exercise, over and above the particular interests of home departments. In this I believe we were successful.

A number of deliberate initiatives contributed to the team's effectiveness. A key early decision was to bring the team together in one location, at the Productivity Commission's Canberra office. The Commission's Function Room was commandeered for the departmental appointees and also served as a meeting place for the whole secretariat. This soon created a hothouse atmosphere for discussion and team bonding. In my view, the proximity of team members is absolutely essential for a 'short, sharp review'.

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A guiding principle behind a number of operational practices within the Productivity Commission is that ideas must be able to withstand robust internal scrutiny and debate if they are to have any prospect of prevailing externally. Through the course of a project there are regular team meetings at which all members are encouraged to have a say, as well as various other mechanisms to test ideas with the rest of the organisation. This culture of scrutiny was fostered within the Taskforce as well. Debate and discussion within the project team was promoted through daily planning meetings, as well as *ad hoc* meetings on key issues as they emerged. These were in addition to several meetings involving all members of the Taskforce, which served to make higher level judgements and establish directions for the secretariat's efforts.

### **'Optimising' community participation and consultation**

Lack of consultation with those affected by a proposed regulation is often the main cause of poor regulatory design and excessive burdens on business. Government agencies have generally been poor at consultation and this was one of the main complaints of business.

As noted previously, we deliberately chose to rely heavily on the views and information from business in order to do our job. It was essential, therefore, that we got extensive business participation in the review and that we extracted quality information from business. How to achieve this in a tight timeframe was perhaps the biggest challenge of the whole review.

The main elements of the strategy, more or less in sequence, were as follows:

- immediate contact with heads of the largest business associations, to encourage their support and active participation
- immediate advertising of the review and call for submissions in the national press, plus some media interviews to raise the review's profile
- release of an Issues Paper (Regulation Taskforce 2005) and meetings with key individual stakeholders, to obtain views and solicit (substantive) submissions
- a series of roundtables and forums to enable better interaction with some stakeholder groups (for example, small business and the aged-care industry) and more focussed discussion in key areas (for example, social/environmental regulation and economic/financial regulation)
- follow-up interaction on an *ad hoc* basis in response to particular submissions.

The Issues Paper and early meetings helped encourage participation by demonstrating the potential payoff, as well as by providing guidance on the sort of

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input that was needed. The Taskforce received 150 submissions, most of which were of high quality.

In the Commission's experience, visits to stakeholders during a review and the relatively informal discussions that they entail, can be just as valuable as formal submissions and public hearings (more so, in some cases). The Taskforce visited some 60 organisations within a six week period. As a practical matter, this required some specialisation among Taskforce members, based on pragmatic considerations of geography, area of expertise or interest, and availability. This is not ideal, as much learning occurs through such visits. And some stakeholders will expect to see the whole Taskforce, particularly its Chair. We handled this by reserving certain meetings for all or most members to attend. In all cases, meeting notes were made and disseminated to all members of the Taskforce and its secretariat.

The roundtables and other forums proved to be a valuable part of the consultation process. The Productivity Commission's experience was useful — particularly in reinforcing the need to be strategic and selective. The lesson from some Commission projects is that there needs to be a well-defined target group and set of issues. It is also important to have a clear agenda, which participants see in advance and can prepare for. That way, there is more prospect of an informed discussion that focuses on issues important to the review, and from which useful information and insights can be gained.

### *Consulting with government*

In addition to consultations with business and community organisations, there was also extensive interaction with the Public Service itself. Much of this was through correspondence related to preliminary proposals for reform, but there were also opportunities to speak to senior officials from various departments. The terms of reference specifically asked the Taskforce to consult closely with the Secretaries of Prime Minister and Cabinet, Treasury and Industry, Tourism and Resources. This was discharged through meetings with individual Secretaries in the early stages of the review, and a subsequent meeting with all three Secretaries at the 'early bottom lines' stage, where attention was also given to the proposals bearing on systemic reform.

### **Producing an accessible document**

Contrary to the Government's expectations when commissioning the review, it became increasingly apparent that, to do justice to the response from business, the report would need to include a large number of recommendations. That posed

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obvious presentational challenges for the report itself. The Government's desire for a 'short sharp report' was shared by the Taskforce, but how short and sharp can a report be when it contains 178 recommendations?

The different character of most of the Taskforce's recommendations meant that it could credibly opt for breadth without depth. Moreover, as noted, in most cases the recommendations had the advantage of business support and departmental acceptance. Where both agreed (and third parties were not affected) the burden of proof was considerably lightened. So we adopted the 80:20 rule, providing the minimum explanation necessary to indicate why a particular reform was advocated. The result was a report of eight chapters and 184 pages.

Given the large number of recommendations, rather than listing them word for word at the front of the report (which would have amounted to some 30 pages), we captured each as a one-line summary, together with its identification number and the page of the report where it could be located. This proved very effective as a quick entry-point to the report, as well as conveying the entirety of the report's bottom lines in a dozen pages. Its utility was affirmed by the Government's adoption of the same format in summarising its response to the report.

### **Attention to implementation priorities**

While these presentational devices helped make an extensive report more accessible and reader-friendly, the more important or substantive means by which the Taskforce accommodated the Government's wish for a manageable agenda, notwithstanding the breadth and scope of our report, was through the clear identification of priorities.

In identifying the priorities, the Taskforce considered the prospective gains, the likely ease of implementation and logistical issues, such as the need to avoid overloading COAG or particular portfolio areas. Its priorities encompassed both specific reforms and proposed reviews, and were listed under thematic headings in the report's final chapter. Ten of each of the most important stock reforms and proposed reviews were then highlighted in the Overview.

### **'Selling' the report**

The attention given to the report's structure and readability no doubt contributed to its success. Effectively engaging readers can usefully begin with the choice of a report's title. Determined that this Taskforce would not squander the opportunity to have a meaningful and useable title for its report, a competition was set in train to

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see which team member could come up with the best one. In the end, ‘Rethinking Regulation’ got my vote (and the assent of the Taskforce) for being not only catchy, but also for capturing the central message in the report about the need to address the underlying causes of bad regulation. The attention given to the title has been partly vindicated by its frequent use in official references to the report, and as the title for a number of subsequent conferences and seminars on regulatory reform.

A second presentational feature relevant to our selling of the report was the inclusion of a foreword, signed by the Taskforce members. This again enabled the key messages of the report to be relayed at the outset in simple and direct language. Perhaps more importantly, it also signalled that all four members of the Taskforce had ownership of the report’s recommendations.

### *Briefings and other direct interaction*

Beyond the appeal of the report’s contents, the scope to influence the take-up of its recommendations within government was limited in some respects, but enhanced in others.

On the debit side, the lack of a public draft meant that there was no opportunity to enlist support for specific recommendations. However, given that many recommendations were based on business submissions anyhow, this was not much of a liability. Moreover, the staged nature of the Government’s response meant that, with the release of the report at stage one, there remained scope for business to provide support for the balance of the recommendations ahead of the final response (Costello 2006, Howard and Costello 2006). The release of the report in advance of the Government’s final response also enabled members of the Taskforce to talk freely about its contents at various business forums and conferences (Banks 2006a, 2006b).

Perhaps the most effective avenues for selling the report have been directly with government itself. I have already noted the ongoing testing of proposals with departments as the review proceeded, which laid the groundwork for a number of the final recommendations to be supported. This was reinforced and extended through briefings to heads of the three sponsoring agencies (Prime Minister and Cabinet, Treasury and Department of Industry, Tourism and Resources) and other briefings to officials across affected portfolios. In addition, the Taskforce had the opportunity, shortly after submitting its report, to present and discuss its findings with the Prime Minister and Treasurer.

The return of officials seconded to the secretariat back to their home departments provided a direct opportunity to influence the responses of those agencies to the

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report's recommendations. Indeed, a senior member of the secretariat was able to assist the work of the Interdepartmental Committee responsible for preparing a whole-of-government response for Cabinet consideration.

These experiences have served to impress on me the vulnerability of such reports to the processes and individuals charged with their implementation. It is all too easy for carefully considered proposals to be subverted at the implementation stage by misinterpretation, even if not intentional. This argues for ongoing communication between review and advisory bodies and those responsible for developing government responses or for detailed implementation. I do not underestimate the contribution of those ongoing communication channels in this case to the generally positive outcomes. That said, it is also crucial to the integrity of an independent process, where independence is called for, that the reviewing body not cross the line into policy implementation. The right balance is needed.

## **Summing up**

We are seeing a rising trend in the use by governments of special-purpose 'taskforces' and 'review groups' to assess and make recommendations about contentious or complex policy issues. This is a positive development, in terms of its potential to facilitate greater public involvement and the generation of objective, expert advice — and thus better informed policy decisions.

Whether that potential is realised in practice, however, is not a foregone conclusion. It depends on the ability of the reviewer to get on top of the issues and effectively engage stakeholders in the time allotted to the review. Moreover, to pave the way politically for policy actions flowing from the review, it needs to be seen to be relatively independent, especially where exercising judgement is crucial to its findings and recommendations.

Experience thus far is mixed. Some reviews have been influential in the short term as well as having an enduring impact; others have achieved or resolved little and have been soon forgotten. In some of the latter cases, members of the review groups may of course not be to blame. Sometimes even the best report can get overtaken by events. Sometimes the reviewers' remit is too constraining, or loaded. Sometimes (often?) the amount of time that is allowed for the task is too little, especially to permit adequate consultation when major policy issues are being assessed. Nevertheless, the Taskforce's experience demonstrates that a review group can use the discretion and choices available to it to make the best of the hand it is dealt.

The more important factors, in my view, relate to: team composition and development; strategies for consultation and the testing of ideas; developing

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implementation priorities, and providing ongoing advisory support in the implementation phase itself.

In conclusion, reaffirming my initial proposition, to the extent that the Regulation Taskforce has been successful in discharging its remit, this can be attributed not only to how the review was constituted by Government, but also to how it was ‘managed’ by the Taskforce itself. Hopefully, some of what we learned will prove helpful to those contemplating how to handle policy reviews in the future.