

Ian Little Memorial Lecture

The role of the economic policy adviser in Australia's growth and reform

Monash University

Tuesday 6 March 2007

- Ian's family – wife Clair Carter and daughters Natalie and Kristina; mother Jean Little and sister Helen Little
- Chancellor of Monash University, Jerry Ellis
- Vice Chancellor of Monash University, Professor Richard Larkins
- Mr Glenn Stevens, Governor of the Reserve Bank of Australia
- Current and former Secretaries of Victorian and other Government Departments

Introduction

It is both a great honour – and a great sadness – to deliver this inaugural Ian Little memorial lecture.

For 12 years, Ian served the people of Victoria with great distinction as Deputy Secretary and then Secretary of the Department of Treasury and Finance. He was an outstanding public sector leader and a highly effective and much-respected economic policy adviser.

Ian advised successive Victorian governments with great intelligence, skill and integrity. While always focussed on what was best for Victoria, he was also a strong leader in national economic debates. It is a measure of the respect that Ian inspired – and of his scrupulous independence and impartiality – that speakers at his public tribute in June last year included my predecessor as Victorian Treasurer, Alan Stockdale, and the Secretary to the Australian Treasury, Dr Ken Henry.

Ian was the very best of public policy advisers for three key reasons.

First, he was remarkably clear-sighted, and considered in his analysis of policy issues.

As Ken Henry said last year: "Ian wasn't motivated by the adrenalin rush of the quick-fix. For him, problems worth worrying about had a strategic dimension. They demanded a long hard look, an analytical crunch, and the solutions demanded painstaking implementation".

Having someone with those qualities leading our State Treasury was of enormous benefit to me personally – and to Victoria. I knew that I could rely upon Ian to present well-researched responses to every issue that was put before him – and to give pragmatic, yet principled, advice on those issues.

Secondly, Ian was passionate about being engaged in what might be described as the ‘battle of ideas’.

He relished the opportunity to contribute ideas and develop new policies – at both state and national levels. In a field in which people can become cynical and jaded, Ian retained his idealism, his enthusiasm and his commitment to ‘making a difference’ in public life.

Thirdly, Ian was an economist with a very broad outlook.

He understood that the role of the public policy economist is changing – and that governments are increasingly seeking an economic perspective across a much wider range of areas than ever before.

In particular, Ian had a strong and well-developed understanding of the role of the economic policy adviser in implementing reforms aimed at boosting productivity.

He was – in Ken Henry’s words – a “true champion of the cause”.

Ian’s commitment to that cause made him a leading player in the current National Reform Agenda being developed by the Council of Australian Governments – an agenda that aims to lift productivity and lift workforce participation.

Those reforms are a good example of a strong policy path being set by a government – in this case, the Victorian government – with the detail hammered out between State and Commonwealth Ministers, and through intense planning by economic advisers such as Ian and his counterparts in the Commonwealth and State Treasuries.

The National Reform Agenda is proof that – here in 2007 – economic policy advisers can no longer see themselves as confined exclusively to ‘State’ or ‘Federal’ matters. These days, governments demand a global and national perspective from their economic advisers.

Nor can advisers limit themselves to working within a narrow, strictly ‘economic’ or fiscal framework. The reform agenda is much bigger and much broader than that.

Recently, I was talking to an adviser in my Department of Treasury and Finance who said to me that public sector economists used to – in his words – “play in our own little box of revenue, expenditure and markets”. Now, he said, we’re being asked to come up with solutions to pretty much everything – from global warming to preventing diabetes; from early childhood development to managing an ageing population.

It’s a big change in many ways from 10 or 20 years ago. And it’s only going to continue as the pressure to keep up with global, social, demographic and technological change takes us further down the reform path.

Economic reform: past, present and future

Today, when we think of reform, we most likely think of the 1980s and the floating of the Australian dollar and the deregulation of financial markets. Or we think of the mid-1990s and the introduction of National Competition Policy.

These reforms have had a strong impact on Australia’s competitiveness, growth and living standards – generating benefits that have extended across something like two decades and that have only recently started to run out of steam.

The lesson from the reforms of the 1980s and 1990s is that to continue to enjoy economic prosperity, we must regularly – indeed continually – drive reform across all areas of public policy.

In particular, if Australia truly aspires to be a high wage, high skilled, competitive modern economy, we must continually review, reform and reinvest in the skills of our people.

Fast forward 10 or 20 years from now and try to picture what reforms we will be talking about. What will have delivered the best results and the most benefits for Australia over the next 15-20 years?

I’d like to think that in 2020 people will be talking about the current COAG National Reform Agenda – initiated by Victoria – with its focus on human capital reform as a driving force for productivity improvement.

Last week, the Productivity Commission released its modeling of the National Reform Agenda, estimating that it will add something like 11 per cent to Australia's GDP over the next 25 years. Anyone looking back at these reforms from 2020 would surely see a \$100 billion boost to the national economy as a pretty good outcome.

I'd like to think that people will also be talking about the National Innovation Agenda – which Victoria advocated – and how it played its part in driving productivity and positioning Australia as a genuine global innovation leader.

People in 2020 will probably also be talking about what we did – or didn't do – to build a skilled and educated future workforce. And it's a pretty safe bet that they'll also be talking about how we responded to environmental challenges, such as climate change and water shortages.

In 2020, they'll certainly be very familiar with the impact of our decisions – because they'll be living with them on a daily basis. They'll be keenly aware of whether we took our opportunities or missed them; whether we used our natural advantages and resources to best effect – or whether we squandered them.

And – in all likelihood – they'll be keenly debating the impact of our decisions and reform efforts on things like GDP growth, unemployment, the Budget balance, inflation and interest rates.

By its very nature, the development of economic reform ideas tends to have an extended time scale. This is not simply because the issues are complex. It's also because a lot of good economic reform tends to be not especially popular.

One of the best political aphorisms I've heard is by Winston Churchill, who said that “whenever a Chancellor of the Exchequer does something which is popular, he has probably done something which is unwise”.

In other words, short term thinking and popularity are not usually the hallmarks of good reform – and that's something that doesn't fit neatly within our political cycle and our fondness for immediate results.

In essence, good reform is about seeing the opportunities for growth. It's about recognising our changing circumstances and adapting to them, while preserving the best elements of our economy and society.

It's a complex task – and it needs to be carefully considered; it needs to be evidence-based; and it needs to take a long term view of success.

I believe very strongly that the pursuit of reform should be a constant aim of governments – because the alternative is not stability, but stagnation.

I don't believe in reform for its own sake but, in a rapidly changing world, it's not too difficult to see significant opportunities for economic reform in one area or another on pretty much a daily basis.

That doesn't mean those reforms are necessarily achievable or desirable. But the opportunities are abundant – and it's the role of the economic policy adviser to bring out the dimensions of those opportunities and to help governments and communities to sift through the many choices they need to make and consider.

Filling that role with any degree of success requires a very good understanding of the frameworks of reform – and how to make those frameworks responsive to emerging problems and changing circumstances.

Frameworks for reform and the role of economic policy advisers

I think that, in recent times, we've seen some significant shifts in both the thinking behind those reform frameworks and in the ways in which governments and bureaucracies go about creating and managing them.

For a start, we now understand the importance of being able to respond decisively and flexibly to fast-moving global markets and events. That doesn't mean acting in haste: it means having in place a strong, credible reform framework that gives governments the confidence to make quick decisions whenever the need arises.

We also now understand that it's not always desirable to design economic policy using top down, one-size-fits-all solutions. We're moving away from a centralised, 'command and control' style of policy making towards a more customised and targeted approach.

Perhaps most importantly of all, we also have a much better understanding of the inter-connections between social and environmental reforms and economic outcomes.

For example, we now accept that reform efforts around skills will have a huge impact on driving competitiveness. We also now recognise the importance of the better allocation of our natural resources to achieving sustainable growth.

Generally these days, our reform frameworks recognise that tackling things like chronic disease or things like early childhood development or salinity will deliver substantial economic returns.

I think it's fair to say that there's now a pretty widespread consensus that social, human capital and environmental reforms may well be of even greater value than some of the more narrowly defined economic ones – although it's also true to say that some economists and some governments still have to be dragged kicking and screaming to the table.

What all this means is that the role of the public sector economist is becoming much more diverse, as it embraces areas of public policy that generally have been of little interest to Treasury departments – or, for that matter, Treasurers 20 or 30 years ago.

I'm sure that plenty of people see this as simply an excuse for the so-called 'dead hand of Treasury' to fall on just about everything.

John Maynard Keynes once described the 'dead hand' Treasury view as "you must not do anything because this will only mean that you can't do something else".

Not exactly a formula for reform.

But times have changed. And while Treasurers and their departments have to keep a tight fiscal grip, we no longer fit that historical 'dead hand' caricature.

A few years back, Britain's Chancellor of the Exchequer – Gordon Brown – said that he wanted his Treasury to be "both a ministry for finance and a ministry for long-term economic and social renewal".

I share that view.

Here in Victoria, I want our Treasury to be a department that feeds the government's appetite for reform.

I want it to be a department that works with us to drive reform in areas as diverse as boosting productivity, lifting skill levels, investing in infrastructure and improving lifelong education and learning.

I want it to be a department that helps Victorians to develop lasting solutions to the big environmental issues of our times – not only global warming and water, but also matters such as reducing the loss of biodiversity, containing urban sprawl and managing our natural resources more responsibly and sustainably.

Thanks in no small part to Ian Little, Victoria's Treasury is now much better placed to do all of those things.

Let me give you just one example of the department's reform edge: PPPs – or public private partnerships.

There are a range of areas that I could use as examples of Victoria's policy leadership. But one area that both Ian and I were passionate about was driving value for money in infrastructure investment through public-private partnerships.

PPPs – in one form or another – have been around for a long time. But for most of that time, the main focus and effort going into PPPs was directed towards one singular goal: pushing infrastructure spending off the government's balance sheet.

That led to some unsustainable contracts, it led to some very poorly executed projects and it led to some pretty unsatisfactory outcomes for both taxpayers and the private sector.

Victoria can rightly claim leadership in setting a new direction in PPPs.

Six years ago, we became the first Australian government to develop a proper policy framework for PPPs – one that is driven primarily by 'value for money', underpinned by a strong commitment to government retention of core services and the application of a rigorous public interest test.

Within our 'value-for-money' policy, we've provided for a variety of partnership models – and that flexibility means that Victoria is now leading Australia in the development of a national market for PPPs.

We were also the first in Australia to develop PPP guidelines for business. And we were the first to develop Standard Commercial Principles and Project Alliancing Guidelines for PPPs.

Currently, we've got around 16 PPP projects underway in the State worth around \$4.5 billion – and it's fair to say that Victoria's leadership has been a significant catalyst in pulling Australia up behind the United Kingdom as the second most developed PPP market in the world.

Victoria's model and guidelines have been taken up not only by other Australian States, but also by other countries. What's more, the World Bank is applying Victoria's model to its infrastructure projects and the United Nations has identified our approach as being of benefit to regional governments in Asia and throughout the Pacific.

It's an example of national and international leadership in reform – and Treasury advisers have played a big part in that success.

The Government for its part certainly set the goals, parameters and pace of the PPP agenda – but it is Treasury advisers who have developed the detailed guidelines of the policy, overseen its implementation and provided advice to both the private and public sector on specific projects.

And they've done all that in a relatively new field, with very little in the way of Australian or overseas practice to guide them.

Regulation reform

Another area where we are expecting more from our public sector economists is in bringing innovative approaches to the task of regulatory reform.

It's very clear that we're seeing unprecedented growth in regulation – both nationally and internationally. It's equally clear that we need some new ideas and strong action to stop being smothered by unnecessary and costly regulation.

And there's no doubt that the potential economic benefits from regulatory reform are very substantial indeed.

Look at the Netherlands, one of the international leaders in best practice regulation. The Dutch estimated the burden of their regulation to be €6 billion – and then set themselves the target of reducing that burden by 25 per cent, or €4 billion.

They identified areas where regulation could be streamlined, set about reforming those areas and then they measured the results against their €4 billion target.

So, for example, abolishing the requirement to keep a register of visitors to dairy farms led to a saving of €13 million. Reforming food labelling regulations saved a further €5 million.

Overall, the Dutch regulatory reforms have reduced administrative costs to businesses by 10 per cent and the government there is on target to achieve a 25 per cent reduction by the end of next year.

I've also been looking closely at what's happening in the United Kingdom, particularly in relation to what they call 'beneficial risk' – something which recognises that governments cannot entirely eliminate risk without imposing significant regulatory cost on the community.

And of course when you think that those costs are not just borne in the immediate impact of regulation. Over-regulation can also end up stifling creativity and flexibility, with serious consequences for innovators and entrepreneurs.

Here in Victoria, we've adopted a three-pronged approach to reducing the regulatory burden.

First, like the Dutch, we've set ourselves a target of cutting the existing administrative burden of regulation by 15 per cent over three years and 25 per cent over the next five years.

We've also made a commitment to ensuring that the administrative burden of any new regulation is met by an 'offsetting simplification' in the same area. No other Australian Government has set such a rule.

And finally, we're targeting both compliance and administration 'hot spots' through a program of reviews and incentives.

Modelling by the Department of Treasury and Finance suggests that implementing this policy will not only improve Victoria's competitiveness and increase our attraction as a place for investment, it will also increase Victorian GSP by 0.2 per cent or around \$500 million per year.

We're very committed to achieving these substantial benefits and all Victorian Government departments are now well-advanced in drawing up plans to reduce red tape for businesses and community groups.

I think it's another good example of public sector economists working with government on the cutting edge of reform to deliver very substantial benefits across the entire community.

It's also a good example of how economic policy advisers really do need to be fully engaged in the current ideas debate, ready to produce and to apply new knowledge, tools and techniques.

That's something Ian Little understood very well.

He was a great advocate of learning from international best practice and of exploring things such as game theory, information economics and behavioural economics.

And he was also a strong believer in experimental economics and in testing policies and ideas.

Innovation and experimentation

In Victoria, we have been very willing as a government to run pilot programs and to test out ideas in this field.

Pilots allow us to try out truly new and often ambitious new ideas – ideas that can inform and lead policy in Victoria and Australia. And they also allow us to tolerate some degree of failure along the way.

My view is that if you want to be innovative and want to take the long-term view as far-sighted policy makers, you have to be prepared for some failures.

It's very clear that risk aversion is the biggest killer of innovation. What's more, when something doesn't work out as expected, it is very rarely a straight-out, irredeemable failure. There is always something to learn from failure.

Talk to scientists and engineers about this and they're very quick to point out that the exploitation of failure is a step along the road to success.

I think that governments could well take a leaf out of their book. I think we need to understand very clearly that the fastest way to fall behind in a rapidly changing world is to be complacent, to rely upon what has worked in the past, and to be so scared of failure that we never experiment with new ideas.

Despite the risks, my view is that we should not be afraid to test new policies and approaches in the real world.

To give you an example in the area of environmental resource management: in Victoria, around 12 per cent of the State's remaining native vegetation is on private land, but it supports 30 per cent of Victoria's threatened species populations. What's more, 60 per cent of the native vegetation remaining on private land is a threatened vegetation type.

So from a variety of perspectives – climate change, biodiversity, preserving habitat – it's pretty important to get it right when it comes to managing native vegetation on private land.

In the past, governments traditionally adopted a centralised approach to biodiversity. If someone had a protected species or plant on their land, we aimed to get onto that property and take whatever protective action was necessary.

It was often a pretty heavy-handed, bureaucratic way of doing things and – not surprisingly – it didn't exactly encourage people to do the right thing. In fact it meant that people often would do anything to keep the government off their land.

We decided to trial a market-based, auction approach, which we called Bush Tender.

Under Bush Tender, people can nominate a price for the protection of biodiversity assets on their properties. If that price is favourable relative to other bids received, it is accepted – and successful bidders are then given the resources they need to protect biodiversity on their land.

In other words, landowners are given an incentive to identify and properly manage biodiversity – instead of an incentive to conceal or mismanage it.

Overall, Bush Tender has delivered a far greater amount of biodiversity protection through our allocated budget than the Government anticipated or expected. In fact, it has been so successful that we've extended it into other parts of Victoria and it has also been picked up by other Australian States.

It's yet another good example of public sector economists bringing a fresh approach to a framework for reform – and of the good outcomes we can achieve when we're willing to break with traditional ways of doing things and take some considered risks.

Being in the business of innovation and experimentation also means being open to taking inspiration from wherever we find it – and that means building strong links with academics, researchers and innovative private companies.

A great example of this is the Economic Design Network, funded by the Australian Research Council, the Victorian Government and various institutions.

The Economic Design Network, supports research in economic theory and experimental economics, and then facilitates the application of this research to the design of economic policy.

If you're not familiar with the Network, please have a look at the work they're doing.

I think it will give you a sense of the very significant developments occurring in economic policy – developments with the potential to bring about truly fresh and innovative ways of delivering government services.

I think it will also give you a sense that this indeed a very exciting, challenging and gratifying era to be working in public economic policy.

Commonwealth/State relations and the forward reform agenda

Of course, being an effective economic policy adviser is not only about coming up with new designs for economic policy.

It's also about understanding your role in a political economy – that not-so-perfect place that tends to mess with the nice, clear-cut theories you learned back in Economics 101.

As I said earlier, reform is not always popular, and advisers to government have to appreciate the many political pressures and multiple dimensions that affect the development and implementation of policy.

In Australia, that means understanding how the reform imperative fits within the framework of a federation.

It also means understanding that in every area where we need a serious national effort – human capital, regulation, innovation, climate change, water – cooperative Commonwealth/State relations are critical to meeting the reform challenges ahead.

Let me give you one example: health.

In the old days, people used to die from injury or infection – and we built our health system around treating those things, most evident in our investment in drugs and acute hospitals. But now, the developed world has undergone an epidemiological transition. Now, it is non-communicable or chronic diseases that will take most lives.

For example, it's estimated that the number of adults in Australia with diabetes has trebled since 1981 – and that almost one in four people over 25 have diabetes or a pre-diabetic condition.

Victoria's Department of Human Services has estimated that over \$1 billion of income is lost by 25 to 64 year old Victorians each year due to poor health associated with smoking, obesity and high blood pressure.

That's why just a few weeks ago the Premier released Victoria's plan to address the growing impact of obesity and type-2 diabetes. Victoria's plan is Australia's first proposal under the National Reform Agenda and confirms that we are prepared to back our reform agenda with concrete and measurable initiatives.

Pretty clearly, we need to shift the focus of our health system more towards preventing these diseases – and not just for the sake of better personal health. It's also crucial for developing a more productive workforce and for increasing participation in our economy.

Making that shift is not about a bit of minor tweaking. A very substantial national effort is needed.

And – as in many other areas – it’s a bit difficult to see how we can succeed in that effort while we continue to cling to constitutional arrangements that are now more than 100 years old – and while we stick with an inherently unfair and unbalanced fiscal relationship between the Commonwealth and the States and Territories.

And certainly, from where I sit, we need much stronger and much more effective national collaboration across a range of fronts.

I see that collaboration as a fundamental pre-requisite for making good economic policy in Victoria and Australia. And I, as did Ian Little, see reform in Commonwealth / State relations as being one of the key areas for economic policy advisers to address over the next few years.

Conclusion

While I was thinking about what I wanted to say in this speech, I started thinking about what advice Ian might give to young economic policy advisers starting out in government or the public service. And I think there are seven qualities he might tell them that they need to succeed and maximise their contribution.

First, I think he would tell them to always provide frank and fearless advice (although perhaps not too fearlessly and being ready to duck where necessary!). It’s not always an easy thing to do, but public policy makers – people like me - do want to know the full range of policy options. We don’t want to hear what it is we already know.

I think Ian would also say, I heard him use the expression many times, that you need to ‘get out of the ivory tower’. Working in a Treasury department can sometimes be isolating – and you must always think through what particular reforms will mean for business, individuals and the wider community.

Thirdly, advisers need to be clear about ends and means and the difference between them. You need to understand that strong economy is not an end in itself. Good policies, a strong budget and a strong economy are the means to improved opportunities, a better quality of life and a higher standard of living for all Australians. That’s why we do them.

Fourthly, you need to respect and understand markets. Ian Little was a great believer in the power of markets. A market isn’t always perfect, but it is a long way ahead of the next best option. Victoria’s irrigation system is the most efficient in Australia

because we let water move to where it adds most value – and understanding that principle is absolutely critical to making good public policy.

Fifthly, Ian would also say that you need to take a long-term view and think beyond political cycles. All the big economic reforms of the past 20 years have involved in many ways some short-term pain for long-term gain. But where would Australia be today without those long term reforms such as floating the dollar, means-testing pensions, deregulating financial markets, superannuation and National Competition Policy ?

You also need to make sure that the facts are right. Treasurers need to be 100 per cent confident that the information we're relying upon is 100 per cent accurate. Recent Australian political history shows that the public and the media take a particularly dim view of Treasurers or indeed aspiring Treasurers who get their facts badly wrong – to say nothing of the potentially disastrous policy consequences.

Finally, I think Ian would tell you that communication is vitally important. A great idea, a great policy reform, will never become an influential idea unless it is effectively expressed.

It's no accident that many influential economists have been skilled communicators from Adam Smith to Keynes, from Galbraith to Friedman and others.

Young economists who want to be truly influential can only benefit by working on combining their analytical skills with clarity of thought and the ability to articulate ideas simply and effectively and succinctly.

Ian had all of these qualities – and some eight months after his death, I still miss his passion, his knowledge, his enthusiasm and his commitment to Victoria.

I know that those who worked with him in the Department of Treasury and Finance also continue to miss his guidance and leadership.

Once again, tonight I extend my condolences to Ian's family. And – once again – can I assure them that Ian's legacy is one that will be recognised, supported and honoured by successive Victorian governments for many years to come.