

# CANBERRA – OUT OF THE CLOSET

## HOW THE TREASURY DISCOVERED GLASNOST



by RUSSELL BARNES

***The efficiency of Australia's securities markets has benefited from the more 'open' approach to information by the Reserve Bank and the Federal Government. But how long will this 'financial glasnost' last?***

Processes associated with deregulation of the Australian financial system have tended to dominate perceptions of developments that have recently enhanced the effectiveness of domestic securities markets.

An often overlooked feature of deregulation has been a welcome increase in the volume and scope of official information provided to the capital markets — an improvement that can be traced directly to the deliberations of the Campbell Committee.

In its September 1981 final report, the committee encouraged the Reserve Bank, “to adopt a more open stance in its communications with the general community, so as to promote more informed financial markets and greater accountability to the community and the Parliament.”

Specifically, the Campbell Committee's report recommended that the bank should “inform the community clearly of the monetary policy it is seeking to implement, its underlying rationale and any specific constraints on the Bank's capacity to implement that policy; [and] provide ongoing analysis and commentary concerning current economic and financial conditions and the interplay of market forces and policy conditions leading to those conditions.”

While these recommendations focus specifically on the Reserve Bank's relationship with financial markets, the report generally favours more widespread openness of official activity.

For its part, the Federal Government has also displayed a willingness to give greater public exposure to its functions.

A particular example is the low-key but innovative program of specification and publication of multi-year spending plans (the forward estimates). Since 1983, this program has enhanced the ability of securities markets to cope with the direct and indirect consequences of Commonwealth budget activity.

The responsibility “to report on the Commonwealth's financial position to the Parliament and the public” is acknowledged in annual reports of the Department of Finance (established in December 1976 when the Commonwealth outlays function was separated from Treasury). Of course, public accountability for the Federal Government's revenue and outlays programs is not new, having been part of the Australian fiscal landscape since the publication of monthly “Niemeyer statements” started during the Great Depression.

Moreover, while the development of forward estimates has improved the Finance Department's capacity to fulfil its public-accounting responsibility, that role was not a major objective of the multi-year spending plans.

Rather, the forward estimates' role — whether as an analytical tool or as a medium for public finance information — was shaped mainly by the underlying fiscal climate of the past decade. That

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climate involved the Australian government sector in confrontation with lobby groups asking for a wide range of programs which would involve public spending well in excess of budget funding capacity. Successive Federal Governments were forced to impose increasingly tight restraint on individual outlays.

The critical step in the forward estimates process was taken in 1983 when the newly elected Labor Government decided to publish its multi-year spending plans to demonstrate the difficulty of reconciling competing spending claims with broad policy objectives.

While formal multi-year estimates of Commonwealth expenditure had existed since their incorporation in the 1979-80 Budget framework, their detail had remained confidential. In the words of the Finance Department, the decision to publish resulted in the substantial upgrading of the forward estimates and to "greater emphasis on accuracy of out-year estimates and to their full integration into the annual budget process".

When releasing the first "Forward Estimates Report" in March 1983, the Finance Minister, Mr Dawkins, observed that publication of the estimates was intended "to assist in the sharing of knowledge about the state of the economy and its prospects".

While the Forward Estimates Reports provide insights into the state of and prospects for the Australian economy, their principal (and unique) attribute is a detailed analysis of budget outlays as a rolling, three-year outlook. (Information in the reports is restricted — as the term "multi-year expenditure estimates" implies — to the outlays side

of the accounts. Corresponding revenue estimates are produced in Canberra, but only on a next-financial-year basis, and they remain confidential to Commonwealth budget officials).

The Finance Minister's reference to perceptions of the Australian economy and its prospects highlights the requirement for the forward estimates to account for changes in underlying economic circumstances over the following three years. For example, an increase in the general level of economic activity will reduce total unemployment benefits, while higher inflation will raise the whole gamut of Commonwealth payments.

Forward estimates methodology allows for the inherent uncertainty about future economic conditions by using a two-step process. The first step requires the Finance Department to formally specify certain economic "assumptions" about key variables that will affect government outlays. Somewhat oddly,

however, the department imposes a caveat on its assumptions, noting that they should not be regarded as forecasts, but rather as "notional assessments of an economic outlook which is highly uncertain even in the short term".

However, as the same uncertainties constrain formally-acknowledged economic forecasts, the "assumptions" can reasonably be taken to represent the "most likely" economic scenario envisaged by officials at the time the estimates were prepared.

Specifically, the insights into "the state of the economy and its prospects" provided by the Forward Estimates Reports concern growth in real Gross Domestic Product, annual inflation, wage increases and the number of unemployment benefit recipients. The exchange rate assumption is expressed in terms of the Trade-Weighted Index value of the \$A. Interest-rate changes (not levels) are taken into account.

The second step in the process — adjustment for "parameter sensitivity" — is less informative than the first, merely providing scope for adjusting aggregate outlays to account for economic parameter outcome that might differ from those assumed.

The introduction to Forward Estimates Reports includes the observation that the estimates "are based upon present government policies, and should thus be regarded as assessments of the budgetary consequences of maintaining existing activities rather than as forecasts of future outlays. In effect, they provide a benchmark from which future changes can be measured."

To maintain overall fiscal control, any such future changes, whether involving new or re-ordered spending, need to be

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assessed in the context of underlying macro-economic objectives. The same applies to any changes to existing policies.

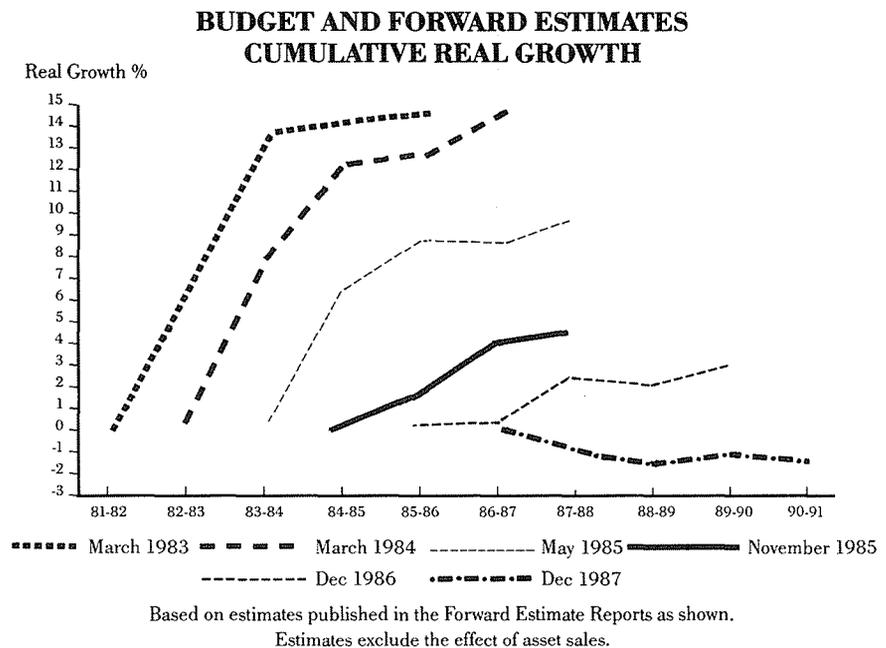
A formal framework for the assessment and quantification of any conflict between program objectives and overall policy objectives is provided by the "reconciliation table", which is published annually in Budget Statement No. 3. By providing a full analysis of differences between forward estimates of expenditures and corresponding budget outlays, the Reconciliation Table highlights changes — and hence reasons for change — in both specific spending categories and/or overall budget expenditure.

The advent in May 1987 of the "Budget Initial Measures" and the May 1988 Economic Statement have recently added an extra dimension to this process, in that forward estimates of expenditures are first reconciled with the May Expenditure Estimates, which in turn are reconciled with Budget outlays estimates.

The Reconciliation Table has thus become an indispensable tool of fiscal analysts because it exposes differences between publicised fiscal intent and actual performance. In that sense, the decision to publish the table is one of the most informative elements of the entire forward estimates process.

The expansion of official information flows over the past decade has been largely a consequence of unique underlying economic and political circumstances. Nonetheless, there can be no doubt about the major impact the changes (including development and publication of the forward estimates) have had on the effectiveness of domestic monetary and fiscal policy.

The increased flow of published information about Reserve Bank oper-



ations — both its short-term liquidity management role and the broader administration of monetary and financial policies — has contributed significantly in recent years to a major decline in domestic interest rate volatility.

Correspondingly, publication of official forward spending plans has contributed to the achievement of major structural reform of the public sector, shown by the dramatic decline in real budget outlays since 1983. Publication of the information has helped with the task of achieving widespread support for a policy of expenditure restraint.

A further benefit of the increased publicity about government financial activity has been the flow of facts which allow capital markets to make more informed decisions about the markets'

relations with government.

Significantly, there is no formal regulatory or legislative backing for the government's recently expanded information flow; in most cases it has arisen from the Government's willingness to embrace greater openness.

However, we rely totally on the disposition of the government of the day to continue to volunteer insights into its activities. While the enlistment of public support for the task of reducing real outlays growth was a powerful incentive leading to the decision to publish in 1983, there is no guarantee that the interests of governments will continue to be served by giving the public open access to forward spending plans.

At some future time, changed circumstances might result in the government of the day choosing to deny access to vital information. For so long as there continues to be an absence of a formal requirement to publish annual Forward Estimates Reports, a more introspective government could simply discontinue what is presently a gratuitous service.

Given the advances achieved over the past decade — both in policy effectiveness and the market's understanding of the plans of the Federal Government — it would indeed be unfortunate if the current and future benefits of releasing the forward estimates information were to fall hostage to a change in underlying economic circumstances and/or political administration. □

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