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Projecting long-term fiscal outcomes

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Introduction

Many governments, mainly in developed economies, are adopting the practice of developing projections of their likely fiscal position over the long term. Such projections extend far beyond the three-year ‘forward estimates’ of expenditure and revenue that some governments produce and also beyond the timeframe of more traditional five-year economic development plans that are still the basis of planning for many governments in East and South-East Asia and elsewhere. While some longer-term reports present projections for at least two decades, others extend to 40 or 50 years.

From a slow start in the reform decade of the 1990s, when the Organisation for Economic Co-operation and Development (OECD) noted that only four countries produced reports of long-term fiscal projections, by 2009, 27 OECD countries were producing such reports (Anderson and Sheppard 2009).

This chapter examines the rationale for producing these reports, surveys international practice, critiques Australia’s experience and offers an agenda for further reform.

Rationale for producing reports of long-term fiscal projections

There are at least three broad rationales for governments to prepare and publish long-term fiscal projections:

- to establish a framework for setting short-term fiscal policy within a set of longer-term fiscal objectives that, as a minimum, span the economic cycle
- to understand the sensitivity and vulnerability of budget outcomes to exogenous forces over the longer term
- to demonstrate the sustainability or otherwise of current policies.

The OECD similarly suggests that fiscal projections provide a number of benefits for governments. In their words:

They raise the profile of fiscal sustainability, provide a framework to discuss the fiscal sustainability of current policies and the possible fiscal impact of reforms, and centralise responsibility for long-term policy analysis. (Anderson and Sheppard 2009: 9)

Underlying the first rationale, a country's economic performance at any particular point is the outcome of a number of forces, both international and domestic, which are interacting with and impacting on the underlying robustness of the economy. International forces include global financial, trade and currency crises. At the national level, governments use their fiscal policy to influence macroeconomic settings and address economic cycles while central banks target inflation through monetary policy.

Fiscal policy is affected, broadly, through governments adjusting their level and allocation of expenditure, as well as their taxation and other revenue-raising. However, fiscal policy is not always readily amenable to significant short-term change. In particular, it has an asymmetric 'stickiness' that has an expansionary bias. During an economic downturn, governments can undertake countercyclical increases in expenditure to ameliorate the reduction in economic activity and employment. That expansion usually coincides with reduced taxation receipts from company profits, personal income taxes and even value-added taxes, thus requiring the expansion to be funded through borrowings. The recent experience of the Global Financial Crisis (GFC) in 2008 provided innumerable

examples of governments resorting to fiscal policy—and their central banks providing supportive monetary policy—in an attempt to stave off recessionary outcomes.

In terms of its stickiness, some expenditure, particularly on major capital works, is bound contractually and governments have few options for reducing those outlays over the duration of the contract (and, when they do so, the consequences can be significant). Equally, there can be political lock-in when government expenditure creates a sense of entitlement among its many recipients. Reversal of this expenditure, as the economy levels out and ultimately enters its next growth period, is politically difficult.

Long-term fiscal projections can provide governments with an opportunity to publish evidence of the unsustainability of expansionary fiscal policy settings over the course of the economic cycle and to demonstrate the need to develop surpluses in periods of growth to pay down some of the debt incurred during downturns.

A second rationale for preparing reports of long-term fiscal projections is to be able to test the sensitivity and vulnerability of future budgetary outcomes to a number of plausible, significant exogenous influences on government revenue and expenditures.

A variety of factors largely outside the control of government can have very significant impacts on fiscal outcomes. Whereas many of these are largely the result of domestic and global economic cycles, some have longer-term structural characteristics. As will be discussed below, demographic change—which is inexorably reshaping economies from Japan and Italy to China and Australia—will have very significant fiscal implications for those countries. Another change, only partly related to ageing, is the ongoing increase in the cost of providing health services. A third factor, the fiscal impacts of which are not yet fully understood, is climate change. There are obvious future costs arising from the need to replace infrastructure likely to be stranded or made inoperable by forecast rising sea levels. Other sources of cost include the greater frequency of heatwaves and bushfires that most climate scientists predict. There will be costs and, in some cases, benefits from changes in agricultural practices in various regions in response to changes in temperature, rainfall and rates of evaporation.

The third significant rationale is that projections of long-term fiscal outcomes can be used to model the impact of changes in programs and entitlements on projected future government expenditures and revenue. While some government programs can be adjusted in the short term in response to changing needs or fiscal circumstances, others have longer-term characteristics. In particular, retirement income policies that have defined benefit obligations bring with them accrued liabilities that last over many decades. Other benefit payment schemes are also difficult to radically adjust. Calls for further improvements to benefit levels can be modelled to demonstrate their long-term impact on fiscal balances, and hence their sustainability.

In the hands of a skilful and visionary leader, these reports can create an evidence base on which he or she can develop a narrative that helps to create a public understanding of the benefits of fiscal responsibility and provides support for, or at least acceptance of, any necessary shorter-term budget adjustment measures to achieve long-term prosperity. A recent 12-country survey (Anderson and Sheppard 2009) demonstrated this role of using such policy to justify balancing fiscal pressures and risks over an extended time horizon against political pressures for short-term spending.

International experience

The approaches to adopting legislative frameworks for fiscal responsibility policy settings vary across countries. They can be broadly categorised into two groups: those that set specific fiscal targets, caps or trajectories and those that essentially establish a set of fiscal principles and more transparent reporting standards. In reality, many countries have adopted some combination of both. An early example of the former was the US *Budget Enforcement Act 1990*, the focus of which was very clearly on reducing the budget deficit, to be achieved in large part by targeting discretionary expenditure.

The earliest well-known example of the latter form of legislation was New Zealand's *Fiscal Responsibility Act 1994*. At that time, New Zealand was pursuing a program of extensive economic and fiscal reform, and this had a profound agenda-setting impact, not only on Australia's Commonwealth Government, but also on the governments of many developed countries.

The International Monetary Fund's 2007 update of its *Manual on Fiscal Transparency* observed that New Zealand's legislation is 'a benchmark piece of legislation, which sets legal standards for transparency of fiscal policy and reporting, and holds the government formally responsible to the public for its fiscal performance' (IMF 2007: 95). The New Zealand Act sets out five principles of responsible fiscal management, including limiting public debt to prudent levels and maintaining an operating balance on average over the medium term. Similar legislation has been enacted in the United Kingdom with its Code for Fiscal Stability. Standards of fiscal transparency under such national legislation are generally more demanding than those suggested under the IMF's Code on Fiscal Transparency.

In 2006, the European Union (EU) published its first report on *Long-Term Sustainability of Public Finances in the European Union*, as part of its budgetary surveillance. Critical assumptions included the continuation of current policy, independent population projections and specified macroeconomic projections. Subsequently, demographic change has become an even more pressing issue and the EU has established the Working Group on Ageing Populations and Sustainability (EU EPC 2015). As the website of the working group notes:

The ageing of the population is becoming a growing challenge to the sustainability of public finances in the EU Member States. The increase of the ratio between the number of retirees and the number of workers will amplify expenditure on public pensions and health and long-term care and thus puts a burden on maintaining a sound balance between future public expenditure and tax revenues. (EU EPC 2015)

Europe is not alone in being impacted by demographic change and, in particular, the ageing of its population. In Asia, Japan is significantly affected, with its dependency ratio (the proportion of its working-age population to those not of working age) declining rapidly. Indeed, Japan's overall population is poised for a long period of absolute decline. As Jones and Fukawa (2015) note, Japan is currently running a level of gross government debt of 226 per cent. Such a high level of debt (described by the authors as 'unchartered territory') leaves the economy highly exposed to economic shocks, with little room to instigate countercyclical fiscal stimulus measures.

The consequences for Japan include ongoing increases in health expenditure, pressure on pension systems and a reducing base of both income taxes and revenue from consumption taxes and other economic

activity more generally. The upcoming working-age cohort will be carrying an increasing burden of paying for the publicly funded programs being supplied to the elderly. Jones and Fukawa (2015) suggest that, as a consequence, there is a very real need to promote social cohesion. The clear conclusion is that Japan needs a credible fiscal consolidation plan, on both the revenue and the expenditure sides, to restore some measure of fiscal sustainability.

Even in China, the impact of demographic change is having significant ramifications. The 35 years of the family planning law (somewhat incorrectly referred to as the one-child policy, given that there were exemptions for rural households and ethnic minorities) have led in part to significant issues with workforce availability and social security affordability. Accordingly, there was some relaxation of this policy in 2013 and, following the Fifth Plenum of the Communist Party of China in November 2015, it was announced that, in future, all couples would be able to have two children.

Opportunities to improve long-term fiscal outlooks

A number of multilateral agencies and academics have reviewed the quality of long-term fiscal reporting and identified opportunities for improvement. Three areas are particularly significant: reporting on a whole-of-public-sector basis, improving transparency and reporting on a regular basis.

In relation to the first of these three, the fiscal sustainability of the policy settings of any one level of government is a significant consideration for that government, for its constituents and for financial markets. In particular, the ability of the government's budgetary position to withstand long-term structural change as well as shorter-term economic and financial shocks is important. The principles of fiscal management, adopted by a number of countries, provide guidance on these matters.

However, at an economy-wide and whole-of-society level, there is also great benefit in understanding the projected long-term fiscal outcomes aggregated across all levels of government. Otherwise, a report

limited to the national government can say more about the policies of intergovernmental transfers than about the underlying fiscal outlook for governments as a whole.

Transparency is another international concern. A 2008 open budget survey by Carlitz et al. (2009: 1) concluded that ‘the state of budget transparency around the world is deplorable’. In a survey of 85 countries (Australia was not included), on average, they provided minimal information on their central government’s budget and financial activities. Only five countries, including New Zealand, made extensive information publicly available in accordance with generally accepted good public financial management practices.

Hameed (2005) explored the level of fiscal transparency across many countries, highlighting the importance for the community and financial markets of being able to accurately assess the social and economic implications of a government’s activities, not only in present times, but also into the future. Hameed used data from IMF fiscal reports, including on medium-term budgeting, and found that countries with greater fiscal transparency had better fiscal discipline (as well as better access to international financial markets and less corruption).

International agencies have surveyed and analysed the practices of many countries in producing long-term fiscal outlooks. The OECD has produced its *Best Practices for Budget Transparency*, in which it states:

1.7. Long-term report

- The long-term report assesses the long-term sustainability of current government policies. It should be released at least every five years, or when major changes are made in substantive revenue or expenditure programmes.
- The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long-term (10–40 years).
- All key assumptions underlying the projections contained in the report should be made explicit and a range of plausible scenarios presented. (OECD 2002: 11)

Similarly, the IMF *Manual on Fiscal Transparency* states that governments should publish a periodic report on long-term public finances and the focus of the projections should be on more than just demographic changes (IMF 2007: 15).

In an examination of fiscal futures, institutional budget reforms and their effects, Anderson and Sheppard (2009: 9, 10) draw some lessons. They offer six broad areas of reform, an edited version of which is set out below:

- Fiscal projections should be prepared on an annual basis to draw attention to the long-term fiscal consequences of current policies and to eliminate discretion over when projections are produced. Although concerns may exist about the political risks of publishing fiscal projections, attention must focus on the long-term benefits that come from transparency of the government's long-term fiscal position.
- Fiscal projections should incorporate comparisons with previous government assessments to highlight whether the government's fiscal position has improved or deteriorated. Many countries do not provide a comparison with previous projections; Australia and the Netherlands are two notable exceptions.
- Fiscal projections should include sensitivity analysis for changes in demographic, macroeconomic, microeconomic and other assumptions to illustrate the exposure, and general direction of the impact of this exposure, to fiscal risks.
- Fiscal projections should clearly present changes in the methodology, key assumptions and data sources to provide an assurance of their credibility and quality. Disclosure and justification of changes in the underlying assumptions are one means to provide assurance about the quality of the projections and a basis for an independent review of a country's fiscal future.
- Countries should use fiscal projections to illustrate the fiscal consequences of past reforms or general policy options. This has the potential to demonstrate to policymakers that improvements in the country's long-term fiscal position are possible but may not eliminate altogether the long-term fiscal challenge. However, policy options should not be presented as prescriptions or means of circumventing political consultation about the types and specifics of reforms.
- Finally, although fiscal projections should be directly tied to the annual budget process, they also should be linked to other budget practices and procedures to ensure that adequate attention is given to the fiscal consequences of current policies. This may be accomplished through linking the results of fiscal projections to fiscal targets, medium-term budget ceilings or entitlement benefit formulas through either hard or soft budget triggers.

Anderson and Sheppard (2009: 42) conclude by noting:

The expanding use of fiscal projections in countries with very different governmental and budgetary systems suggests that these recommendations are relevant to a broad range of OECD and non-OECD countries alike.

Australia's early innovations in fiscal reform

In Australia, several state governments were early innovators in introducing fiscal reforms and adopting longer-term fiscal perspectives. One of the principal motivations was to reduce their levels of debt. That the governments found themselves in this situation was the result of a series of events that began in the mid to late 1980s, including revenue reductions from falling asset prices, the national recession of the early 1990s and the failure of several significant state-owned financial institutions.

In 1988, the New South Wales (NSW) Government found itself unable to reliably assess the current and prospective financial position of the state. Accordingly, it appointed a group of prominent businessmen to undertake a commission of audit. In a period of just less than four months, and assisted by a secretariat of officials, this commission produced a seminal report that was to become a blueprint for subsequent inquiries by other Australian governments (NSW Commission of Audit 1988). The headline conclusion was that the state 'has been living beyond its means'.

An important initiative of the NSW Commission of Audit was to attempt to supplement the government's cash accounts with a more commercially focused set of accrual accounts. Essentially, under the cash accounting approach, a government's surplus or deficit position was determined by whether more or less revenue was paid into the Treasury than was paid out in a given period. The NSW Commission of Audit recommended that the preparation of an annual balance sheet and income and expense statement would significantly improve an understanding of the sustainability of the state's fiscal position. This approach more clearly identified the government's longer-term fiscal position by calculating the liabilities and assets of the state.

One of the more substantial liabilities was the employer-funded superannuation that was accruing to the government's public servants. This liability would need to be paid out (i.e. become actual cash expenditures) in future years as those public servants retired and started

drawing down their pensions. A second liability, which would equally result in cash expenditure and have a direct future fiscal impact, was the consumption of existing capital assets, which would require their subsequent replacement (in essence, a charge for depreciation).

A third liability worthy of a brief reference at this point is the one associated with government guarantees, memoranda of support, letters of comfort and so on, which are often provided to private businesses under the guise of economic development. These instruments are often (wrongly) perceived, or at least portrayed by both politicians and the business entities in receipt of them, as being essentially ‘free’ support from governments that have tangible benefits for the recipients, usually in the form of a lower risk premium on the cost of borrowings. Even better, they do not appear under a cash budgeting format and are therefore largely invisible to the general public. However, under the discipline of accrual accounting, such instruments are (correctly) perceived as being liabilities that are contingent on the outcome of specified events, especially the failure of the enterprise that was the recipient of the support. Real and usually very large expenditures can result from such events, and can have major impacts on future fiscal outcomes.

The NSW Commission also developed a framework for its analysis of the activities of government in the economy. The framework set out three fundamental questions:

- Why should the government expenditure be undertaken at all? What would result if the program/activity were abolished?
- What special features of the program/activity mean that the goods cannot be provided more efficiently and cost-effectively by the private sector?
- Why should parliament, ministers and senior public service executives be devoting scarce time to the mechanics of producing these goods?

In 1996, following the election of a new conservative government at the national level, and in accordance with one of the pre-election commitments of that new government, a select group of private sector leaders—mainly from the finance sector, and supported by a secretariat of officials—was tasked with investigating and reporting on, within three months:

The financial position of the Commonwealth Government with a view to advising the Government on the future management of its finances consistent with a medium to long-term goal of improving the Government's fiscal position. (National Commission of Audit 1996: 1)

Within those overall terms of reference, the commission was required to report on six matters, which can be summarised as follows:

1. the actual state of the Commonwealth's finances, including its assets, liabilities and contingent liabilities
2. the compilation of a 'whole-of-government' balance sheet for the Commonwealth Government
3. the impact of demographic change on Commonwealth finances, and how emerging pressures could be provisioned
4. the extent, condition and adequacy of Commonwealth sector infrastructure and possible remedies for any deficiencies
5. a methodology for developing and implementing financial performance targets for Commonwealth departments and agencies
6. current service delivery arrangements between the states/territories and the Commonwealth, and their effectiveness and efficiency.

The commission was also requested to provide advice on additional matters, which were included in another of the incoming government's pre-election commitments: to establish a Charter of Budget Honesty, which would encompass both governmental financial reporting requirements and fiscal policy objectives.

The ensuing analysis adopted a decision framework that was similar to the much earlier NSW Commission of Audit:

- Assess whether or not there is a role for government.
- Where there is, decide which level of government, and assess whether or not government objectives are clearly specified and effectively promoted.
- Assess whether or not effective activities are being conducted on a 'best practice' basis (National Commission of Audit 1996: vii).

The report elaborated on what constituted 'best practice'—the two defining characteristics being that it was input efficient and outcome focused.

One of the major recommendations of the report of the National Commission of Audit (1996: 211) was that the Commonwealth Government should ‘adopt accrual accounting principles as the basis for an integrated budgeting, resource management and financial reporting framework both at the agency level and at the aggregate budget sector level’.

The report recommended the Commonwealth introduce legislation that would require the government of the day to set and report against a clear fiscal strategy, which would include setting targets and benchmarks.

The Charter of Budget Honesty

Following the report of the National Commission of Audit in June 1996, the Commonwealth Parliament passed a law to create the Charter of Budget Honesty. As noted in Section 1 of the *Charter of Budget Honesty Act 1998* (Cwlth):

The purpose of the Charter is to improve fiscal policy outcomes. The Charter provides for this by requiring fiscal strategy to be based on principles of sound fiscal management and by facilitating public scrutiny of fiscal policy and performance.

In similar fashion to the New Zealand Act, Australia’s Charter of Budget Honesty sets out the principles of sound fiscal management, including maintaining a prudent level of general government debt, moderating cyclical fluctuations in economic activity and ensuring policy decisions have regard to their financial effects on future generations. In terms of the last, the treasurer is required to publicly release, at least once every five years, an intergenerational report (IGR).

The IGR has had, from its inception in 2002 to its most recent issue, a focus on ageing. This is mandated in the charter, Section 21 of which states:

An intergenerational report is to assess the long term sustainability of current Government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change.

In the foreword to the 2015 IGR, the then treasurer made the following point (Australian Treasury 2015: iii):

It is fantastic that Australians are living longer and healthier lives but we need to address these demographic changes. If we don't do something, we risk reducing our available workforce, impacting negatively on growth and prosperity, and our income will come under increasing pressure.

The 2015 IGR makes a number of substantive points that have implications for the long-term fiscal outlook (Australian Treasury 2015: vii–xvii).

In terms of basic demographics:

- Australians will live longer and continue to have one of the longest life expectancies in the world. In 2054–55, life expectancy at birth is projected to be 95.1 years for men and 96.6 years for women, which is an increase of around three years for both.
- Both the number and the proportion of Australians aged 85 and over will grow rapidly. In 1974–75, this age group numbered around 80,000 people; however, by 2054–55, nearly two million Australians will be aged 85 and over. While there were 122 centenarians in 1974–75, there are expected to be around 40,000 by 2054–55.

There will be significant fiscal and economic impacts:

- There will be fewer people of traditional working age compared with the very young and the elderly. At present, there are an estimated 4.5 people aged between 15 and 64 for every person aged 65 and over, but, by 2054–55, this is projected to nearly halve to 2.7 people.
- Over the next 40 years, the proportion of the population participating in the workforce is expected to decline as a result of population ageing. A lower proportion of Australians working will mean lower economic growth over the projection period.
- That said, female employment is projected to continue to increase. Today, around 66 per cent of women aged 15 to 64 are employed. By 2054–55, female employment is projected to increase to around 70 per cent.
- During the 1990s, Australia's multifactor productivity (MFP) growth was especially high, with an estimated average of 2.2 per cent growth per year. This has been widely attributed to economic reforms during the 1980s and 1990s. These reforms created more competitive and flexible markets in which businesses became more efficient and

innovative, and new and improved technologies were adopted. More recently, Australia's MFP growth has been relatively flat, as has been the case in many other developed economies.

A limited number of items will drive the expenditure side of the Commonwealth Government's fiscal outlook over the long term:

- The 2015 IGR identifies health as the biggest item of budgetary increase over the next 40 years. Commonwealth Government health expenditure is projected to increase from 4.2 per cent of gross domestic product (GDP) to 5.5 per cent by 2054–55. (In 2013–14, total expenditure on health by all governments, individuals and the non-government sector represented 9.8 per cent of GDP [AIHW 2015].)
- Expenditure by the Australian Government on aged care services is projected to almost double, from the current 0.9 per cent of GDP to 1.7 per cent.
- Expenditure on age and service pensions was projected to stabilise at a little lower than the current 2.9 per cent of GDP, though this was based on government proposals not agreed by the parliament; nonetheless, projections based on current legislation still reveal only modest increases, to around 3.5 per cent of GDP, thanks in part to reforms in the 1990s.

Clearly, the expectation of a long-term rise in health costs (as has already been occurring) will have a major impact on fiscal outcomes. However, while older Australians, per capita, are much greater consumers of health services than younger people, this is not the most significant cause of these escalating health costs. As recognised by the 2015 IGR (Australian Treasury 2015: xvi): 'The report explains how non-demographic factors, including higher incomes, health sector wages growth and technological change, are more significant drivers of the projected increase than demographic changes.'

The Australian Productivity Commission reached a similar conclusion in 2005 (PC 2005: xii): 'In itself, population ageing should not be seen as a problem, but it will give rise to economic and fiscal impacts that pose significant policy challenges.'

The policy response proposed by the Productivity Commission was that '[m]ore cost-effective service provision, especially in health care, would alleviate a major source of fiscal pressure at its source' (PC 2015: xii). There is a rich literature, and many well-researched government-commissioned

reports, which sets out constructive agendas for improving the efficiency of health service delivery. It is inevitably the politics of gaining acceptance for reform from the powerful medical and pharmaceutical lobbies that limits the success of these reform initiatives.

The IGR has proved to be a very useful tool for long-term policy analysis at the Commonwealth level. By way of example, Whiteford's (2015) commentary on the 2015 IGR drew attention to the implications of maintaining current welfare policy settings over the long term. He points out that, if current policies for the indexation of working-age payments and family payments are continued, the recipients will be increasingly worse off relative to the average worker. In relation to income support for the unemployed, for example, a single unemployed person currently receives about 19 per cent of the male total average weekly earnings—described by Whiteford (2015) as already being recognised as inadequate—but, in 40 years, this would nearly halve, to only 10.5 per cent of the income of that average worker.

A critique of Australia's 2015 IGR and directions for further reform

The Commonwealth Government's *Intergenerational Report* is one of the world's leading reports on projections of long-term fiscal outcomes. Nonetheless, it does have structural limitations that are, at times, compounded by other detrimental features. On the structural side, there is concern over the potential for politicisation of the report, as well as concern with its limited scope. An operational concern is the limited transparency associated with the preparation and release of supporting assumptions and modelling.

In terms of the possibility of politicisation of the report, the 2015 IGR—the fourth since its inception—received a mixed reception when it was released. Reactions by notable commentators published on an academic current affairs online website, *The Conversation* (theconversation.com/au), provided a sample of views.

John Daley (2015) wrote:

The Intergenerational Report aims to provide a long-term picture of future Australian prosperity, and the sustainability of government budgets. It should be a serious report. But this year it resembles a Harry Potter movie.

... [M]ost of the report is about the sustainability or otherwise of the Commonwealth Budget.

The Commonwealth abandoned its previous agreement to contribute to the long-term growth in hospital costs paid by the States ... And of course, it simply transfers the deficit problem to State governments to solve.

Perhaps the most worrying issue is that the report glosses over the long-term problems of the real world. Health costs are assumed to grow much more slowly over the next 10 years as a result of specific measures taken by governments. Previous *Intergenerational Reports* have all made the same assumption, and they've all been wrong. Health costs have generally continued to spiral upwards, consuming an increasing share of government budgets.

Stephen Duckett wrote:

The report is an overtly political document—highlighting the wondrous benefits which would accrue if the government's 2014 Budget had passed and the horrendous situation we'll be in if it isn't.

Unlike previous intergenerational reports where the political agenda was less overt and took at least five minutes to discern, the politics of today's report are designed to hit you between the eyes.

... The overall picture painted by the *Intergenerational Report* isn't all bad. Despite the politics, it highlights sensible issues—we can't keep running deficit budgets forever, we need to increase workforce participation rates (for women and older people who can) and we need to increase productivity (which we are doing but we need to go a bit faster). (Pears et al. 2015)

Hal Kendig wrote:

The 2015 *Intergenerational Report* (IGR) is a strong political statement that more than ever places population ageing and older people centre stage in public and political debate. It provides Treasury's technical projections (albeit based on questionable assumptions) wrapped in the Treasurer's political interpretation (aimed at Senate budget debate). (Pears et al. 2015)

As is evident from these reactions to the 2015 IGR, many commentators consider it was a particularly political document. This can be traced back to the enabling legislation, which provides for the treasurer (a minister of the government, not an independent agency) to release the report.

What this means in practice is that the treasurer's department (the Treasury) prepares the report, in consultation with other departments as necessary, but the treasurer has the opportunity to guide its central messaging. In each of the four IGRs published to date, the government of the day has placed emphasis on some matters ahead of others (usually consistent with their underlying ideology). However, the latest report attracted greater criticism on this score.

An alternative approach would be for the report to be prepared by an independent, competent agency, free from opportunity for the government of the day to craft some of its messages. In this respect, Australia has had a history of nearly two decades of benefiting from an agency—the Productivity Commission—which is known for its independence, transparency and broad-based policy analysis and advice. The commission is created, and protected, by its founding legislation, the Commonwealth's *Productivity Commission Act 1998*.

The commission describes itself in the following terms:

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interests of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by consideration for the wellbeing of the community as a whole. (PC 2013: ii)

In essence, the three core operating principles of the Productivity Commission are:

- It is independent. The commission is established under its own Act, its independence is exercised by commissioners who are appointed for fixed periods, it has its own budgetary allocation and permanent staff and it operates at arm's length from the government and other agencies. Its findings and recommendations are independently arrived at based on its own analyses and judgments.
- Its processes are transparent. The commission's advice, analysis and modelling are all open to public scrutiny. It holds public hearings and specialist workshops and releases draft reports for public and expert feedback. Its final reports and recommendations to governments are also released to the public.

- It adopts a community-wide perspective. The commission's Act requires it to always be driven by consideration of the best interests of the community as a whole. It takes into account all relevant economic, social, regional and environmental perspectives.

In 2005, an objective analysis of the long-term economic and fiscal outlook for Australia was prepared by the Productivity Commission in response to a request by the state premiers, territory chief ministers and the prime minister through the forum known as the Council of Australian Governments (COAG). The commission's report *Economic Implications of an Ageing Australia* (PC 2005) was prepared on an independent basis. It contained no political interpretation of the results, but laid bare the range of scenarios facing the country, for all to ponder.

A second structural concern with the IGR is its limited scope. Its sole focus is on projections of the fiscal situation of the Commonwealth Government. While there is great value in each government, within their level of responsibility, conducting such an exercise, it nonetheless presents a partial view.

In Australia, where the sovereign states have responsibility for some large budgetary items, there is a need to understand the total public sector fiscal outlook. This is especially so given the states and territories are responsible for expenditure on public hospitals (while recognising that the Commonwealth provides significant financial support for their operation) and public education, as well as community services, policing and many other public goods and services.

The IGR's portrayal of the Commonwealth's future fiscal position therefore reflects, in part, the level of financial support provided by the Commonwealth to the states. A reduction in Commonwealth budgetary support for public hospitals, as proposed by the national government in the 2014 budget, will show up as an improved fiscal outlook for the Commonwealth, but only because it fails to reflect the passing on of the greater fiscal pressures that will be faced by the states.

Australia's experience with long-term fiscal reporting leads to the obvious point that there is a need to supplement such reports with a report that adopts a whole-of-government (national and subnational) focus. The terms of reference for the 2005 report by the Productivity Commission required it to take a 40-year perspective and report on:

1. The likely impact of an ageing population on Australia's overall productivity and economic growth.
2. The potential economic implications of future demographic trends for labour supply and retirement age, and the implications for unpaid work such as caring and volunteering.
3. The potential fiscal impact of the above factors on Commonwealth, State and Territory and, to the extent practicable, local governments. (PC 2005: iv)

The ensuing report encompassed all public expenditure and revenue-raising across the three levels of government. As such, it presented a more comprehensive picture of both the economic and the fiscal outlooks for the Australian economy as a whole. The Productivity Commission's 2013 update followed in similar fashion (PC 2013).

On the issue of transparency, and in contrast to the Commonwealth's IGR, the Productivity Commission's report was prepared in an open and transparent manner, with the commission calling for submissions and holding workshops. The commission also published its extensive databases, laid out its assumptions and released its modelling results and technical papers. New Zealand also makes its model publicly available so that any analyst can test and report on the outcome from other assumptions.

Given the commission's international reputation in terms of its processes (as well as the quality of its reports), it is well placed to produce an objective and transparent report that encompasses all levels of government and that regularly updates the baseline fiscal, economic and social outlooks over the longer term. Such a report can serve as a platform for debating an agenda of productivity reforms that will be required to address the country's looming policy challenges.

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