

**CHALLENGES CONFRONTING ECONOMIC
POLICY ADVISERS**

ADDRESS TO THE CURTIN PUBLIC POLICY FORUM

PERTH

4 SEPTEMBER 2007

KEN HENRY

SECRETARY TO THE TREASURY

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For the most part, the work of the public service involves the implementation of government policy decisions and the administration of programmes. But the public service also provides policy advice to governments.

This morning, I am going to talk to you about the role of the economic policy adviser in the public service. I will be discussing the importance of evidence, analytical rigour and strategic focus. I will emphasise the importance, above all else, of policy advice being compelling; explaining its relationship to the development of broader narratives about economic opportunities and vulnerabilities. I will discuss the role that such narratives can play in fostering support for necessary reforms; and in providing depth, focus and context for policy debate. Along the way, I will touch on some of the more important strategic, medium-term, policy challenges confronting today's economic policy advisers.

The challenge for policy advisers

The policy advising function is not well understood by the public, academics or commentators. In large part, I suspect, that is because of the complexity of the relationship between the public service adviser and the government decision-maker.

In providing policy advice, public servants are seeking to have influence. They are telling governments the course of action they consider should be

¹ I would like to thank Treasury colleagues, especially David Pearl, for assistance in the drafting of this speech.

followed on an issue. This is what governments expect of public service advisers. Of course, it is for government and, in most cases, the Parliament, not unelected officials, to take the decision; to determine whether, and in what way, things should change. And it is, for the most part, the special privilege, and responsibility, of the elected government to decide just what matters the Parliament should be asked to consider. Thus, public service advisers who want to change things have first to convince their minister of the need for such change; in turn, their minister must convince his or her senior ministerial colleagues, and at a minimum the Prime Minister; and, in most cases, the government then has to convince the Parliament.

Nothing is as important to the adviser's effectiveness as having the confidence, or trust, of his or her minister. Maintaining such confidence depends, in large measure, upon the adviser consistently demonstrating the following set of attributes whatever his or her level of seniority: First, a commitment to technical excellence; second, hard-headed, hard-working professionalism; third, the courage to give advice fearlessly; fourth, being both politically aware and apolitical; and fifth, and most importantly, protecting the confidentiality of the relationship.

These days you will hear a lot about the need for public servants to be 'responsive' to the government of the day. Responsiveness is critically important to the effectiveness of our system of government. It includes, though is not limited to, accepting that it is the job of the public service to implement government policy, to the best of its ability, no matter what view it might have had on the particular issue. Clearly, this is not going to

be a job for everyone; many people would have great difficulty implementing a decision that has not followed their advice.

Perhaps it is the occasional observation of public servants behaving in this way – that is, implementing government decisions that they are assumed, perhaps known, to consider sub-optimal – that leads some commentators to lament the loss of the ‘frank and fearless’, seeing its replacement by the ‘weak and malleable’ or ‘politicised’. Such conclusions are, generally, misplaced. Far from demonstrating weakness, what is usually being demonstrated is strength of character.

‘Responsiveness’ also demands that advice is provided when it is sought and in a timely fashion. There is a risk that the responsive public servant will misunderstand this point, and provide advice only when it is called for; only on those things about which the minister has indicated that he or she ‘wants’ to be informed. In extreme cases, where the minister ‘wants’ advice on something, but doesn’t ‘need’ such advice, the risk presents as obsequiousness. But there is also a risk, at the other end of the spectrum, of the responsive public service adviser ignoring those things which, while not being at the forefront of the minister’s mind on any particular day, are nevertheless things about which the minister has a need to know. Good public policy advisers understand both of these risks. Their behaviour is both ‘responsive’ and ‘responsible’. Judging whether and when to initiate a conversation with a minister on something about which he or she has a need to know, but on which advice has not been requested, is among the most difficult parts of the public servant’s job. It is also among the most important capabilities of highly performing advisers.

Effective public policy advisers, then, will have the trust of their political masters, and they will be both responsive and responsible. But what makes for effective policy advice?

Effective policy advice must have three qualities. It must embody the highest standards of evidence-based analytical rigour; it must have a clear strategic perspective; and it must be compelling.

Analytical rigour demands soundness of empirical methods, analytical tools, models and frameworks. Analytical rigour should be the foundation upon which all advice is based; the ultimate assurance of its quality and credibility.

This part of the policy advising challenge is relatively well understood, if not always fully met. Yet it would be difficult not to share the view expressed recently by Terry Moran, Secretary of the Victorian Department of Premier and Cabinet: ‘For the civil service, a capacity to analyse problems rationally and empirically and to express options for action by governments is a basic ethical duty.’²

The notion of a sound strategic perspective is more difficult to define neatly. Strategic advice, at its best, has depth, looking beneath immediate events and preoccupations, to underlying drivers and trends; it has breadth, adopting a systemic rather than partial focus; and it has reach, identifying and addressing medium-term risks and opportunities. In the next part of the speech I will speak in more detail about this kind of advice and identify

² Terry Moran, ‘On leadership’, 2007 Leadership Lecture, Leadership Victoria, 7 June 2007.

some of the strategic risks and opportunities today's policy advisers should be thinking about.

Public service advisers are not the only people trying to influence policy decision-making. Numerous sectional, or stakeholder, interest groups have the same goal; and so too some sections of the media. This observation – that we are but one player among many – is usually summarised in the caution that we operate in a contestable environment. Our ministers also operate in a contestable environment.

To be effective in a contestable environment, policy advice has to be persuasive. Good policy advice is compelling. It is embraced by ministers, even if not immediately, and is impervious to the assaults of other players in the game, including those motivated by vested interest.

Public policy advisers who appreciate this point pay as much attention to the construction and presentation of an argument as they do the quality of its analytical content and the soundness of its strategic perspective.

Something that can, in principle, make advice more compelling could be called 'environmental management'. There are degrees of this activity. None of them is without risk.

Advisers do have a role, always to be played in close consultation with the government of the day, in helping to inform public debate on important policy issues. There is the opportunity to do this through consultations – both public and confidential – publications and speeches. For example, the *Intergenerational Report* and follow-up work on the drivers of growth – what we have labelled the '3Ps' of population, productivity and

participation – has had a significant impact on public debate about the implications of population aging. That impact makes it easier for governments, now and into the future, to take the policy decisions that will be required if we are to deal effectively with the demographic challenge. Without such ‘environmental management’ there would be a risk of policy responses being delayed until a time when the range of feasible responses could be much more limited.

However, advisers have to be careful. Any official who enters into the public policy debate must bear in mind that the objective is to make it easier for the government of the day to do what needs to be done. The objective is not to make the minister’s life more difficult. As I noted earlier, nothing is as important to the adviser’s effectiveness as having the confidence, or trust, of the minister.

The strategic perspective

I have spoken about the need for policy advisers to be both responsive and responsible. They must also have a strategic focus. Policy advisers must not allow what Owen Harries has called ‘the parochialism of the present’³ to limit and distort their perspective.

Strategic policy advice draws attention to medium-term (‘over the horizon’) opportunities and vulnerabilities, often from a whole-of-economy perspective, and provides accessible frameworks (or road-maps)

³ Owen Harries, ‘Radio National: Boyer Lectures – 30/11/2003: Lecture 3: A Democratic World’, <http://www.abc.net.au/rn/boyers/stories/s987627.htm>.

for managing these, based on a sound understanding of underlying drivers and trends.

Strategic policy advice should be distinguished from long-term projections, like those contained in the intergenerational reports. Such projections can be a powerful motivator for strategic thinking. Scenario analysis can also be used to foster and focus strategic thinking, if done well.

Some might draw a distinction between strategic advice and hard headed pragmatism, or argue that strategic advice is ‘optional’ or a ‘luxury’ for public service leaders occupied with the demands of the day. I do not share these views. At its best, strategic advice is firmly grounded in the practical, and there have been many instances of strategic thinking emerging from the midst of crises. The economic transformation programme embarked upon in New Zealand in the mid-1980s is a frequently cited example. A somewhat more controversial example is the twin deficits proposition influential in Australia in the second half of the 1980s.

The need for strategic thinking is best illustrated by the fact that the most important policy challenges facing Australia are complex, cross-cutting and have systemic implications. These challenges cannot be addressed through short-term, reactive and incremental decision-making. Moreover, in the absence of a strategic policy perspective, there is a risk that debate will focus on partial questions, short-term considerations, and the demands of special interest groups.

Strategic, impartial policy advice is a core responsibility of public servants, especially those in central policy agencies. No other actors in public life – academics, private sector analysts and consultants, journalists and commentators – can be expected to perform this role. More importantly, the knowledge that senior public servants take this responsibility seriously underpins confidence in the quality of our representational model of democratic governance. Public sector advisers who are unable, or unprepared, to think and marshal advice in strategic terms are letting down their political masters; and they are letting down the public.

Among the numerous medium-term challenges that today's economic policy advisers should be thinking about, I would draw attention to the following: First, the implications of the Australian economy operating at close to full employment and experiencing its highest terms of trade in more than half a century; second, the transformation of Australia's international environment, marked especially by the re-emergence of China and India, and the shift in global economic weight to the developing world; third, the globalising impact of the information and communications technology revolution; fourth, demographic change, not only here in Australia, but also in our near Pacific neighbours, and in Europe, India and China; fifth, and partly related to demographic change, global migration flows; sixth, increasingly challenging issues in the inter-relationships between energy, climate change and water; seventh, some deeply entrenched failures in environmental management, including loss of biodiversity, partly due to a history of exploitation of the 'commons';

and eighth, the opportunity to address instances of entrenched disadvantage, especially Indigenous disengagement.

Addressing these challenges will demand strategic policy interventions in labour force participation and productivity, and will have important implications for the future of the federation. Market mechanisms will have to be used to do more, not less, of the allocation task, but with more attention paid to the role of government in defining property rights, pricing for externalities, and representing the interests of future generations. And if all of that isn't sufficiently challenging, public policy advisers are going to have to find ways of reducing the complexity of the interactions between governments and citizens and ensuring that we have the tools that permit risk to be allocated to those in society best equipped to manage it.

The strategic policy adviser has a bit to do.

From strategic advice to economic narratives

I have argued that economic policy advisers must provide ministers with advice that is analytically-sound, strategically-focused and compelling. When advisers do this, they furnish ministers with a set of themes, priorities and strategies that can be woven into compelling economic narratives which, if told well, powerfully shape policy debate.

Narratives are stories, in whatever form they take – oral, written or visual. Conventional narratives in literature, the theatre or the cinema have a beginning, middle and end. Good ones provide drama, arising from a predicament that ensnares the principal character; they have plenty of

action – the steps the character takes to escape the predicament – with unexpected plot twists and complications thrown in; and there is a resolution, culminating in the achievement of a visionary aspiration or objective.

Economic narratives have some similarities. They are stories about our economic development: they describe a context of economic opportunities and risks confronting us; they set down, in broad terms, the policy actions that will respond to these; and they talk about the goals and aspirations we can realise, if we are successful.

Economic narratives have played a significant role in Australian public policy. Each phase of Australia's economic development – the Federation of the Australian colonies in 1901, the Great Depression, post-World War II expansion, the period of stagflation in the 1970s and early 1980s, and the subsequent internationalisation of the Australian economy, continuing to this day – has been accompanied by its particular economic narrative. These narratives have drawn on deeply-held community values and, sometimes, fears; they have been invoked in support of policy reform and institutional change; and they have given meaning and coherence to events as they have unfolded.

Narratives are a powerful, but perhaps poorly understood, leadership tool. They can have many authors, including political leaders and opinion-leaders in academia, the media and the private sector. They provide depth, focus and context for policy debate, furnishing advocates with persuasive arguments in favour of, and sometimes against, policy reform. They can be a force for good or ill. Good narratives are grounded in sound

economic thinking and policy analysis. They foster support for reforms that strengthen market frameworks, improve the allocation of resources and, over time, increase the wellbeing of the Australian people.

Dysfunctional narratives, on the other hand, are often associated with narrow interests and misguided policies – they can be invoked to resist necessary reforms, to the detriment of the community; they can stimulate fears and anxieties, without offering solutions.

Public debate often involves a contest between alternative, overlapping and conflicting narratives. One of the enduring benefits of an open society is the opportunity it provides for this contest to be played out. It is quite significant that the contest is not always played out between the major political parties. On many issues, the government and opposition of the day find themselves in broad agreement. Yet there is still a contest. In a pragmatic, somewhat sceptical, and empirically-motivated society like Australia, narrative contests often turn on practical results and commonsense. But they also turn on values – the capacity of a narrative to ‘speak to’, or ‘connect with’, the average person’s experiences and aspirations. I’ll return to this point.

While good narratives can be very powerful motivators, it’s worth bearing in mind that they can also become dysfunctional over time. A good story isn’t necessarily based on assumptions and propositions of enduring relevance, and it can take one down paths of unintended, perhaps even perverse, consequences.

I’ve been speaking at a rather abstract level. Let me make things more concrete by referring to the most important, and arguably enduring,

Australian economic narrative in the past quarter century. This narrative concerns the proposition that Australia had to open its economy to the world to achieve sustainable growth and rising living standards. To put it slightly differently, it is a story of a successful quest to find harmony between the necessity of international engagement and the desire for economic security.

The narrative's action is evident in the broad sweep of economic reforms that started in the early 1980s, were deepened and broadened in the 1990s and have been added to in this decade. Indeed, the same economic narrative continues to drive policy development today. You are all familiar with the main elements of the story, but the bits I'd highlight include: the floating of the currency in 1983 and the liberalisation of the capital account, the liberalisation of the domestic financial sector, the progressive dismantling of industry protection, competition-enhancing product market reforms and greater labour market flexibility. Supporting the narrative has been a credible economic proposition that the aggregate gains from policy reform will be large enough to permit those adversely affected to be 'looked after', and a social commitment that they will, in fact, be looked after.

Market liberalising measures exposed sheltered parts of the economy to competitive forces, both external and internal, making the economy more flexible, and ultimately more resilient and productive. They drove access to cheaper, better and a wider range of inputs and final goods and services; a more efficient allocation of labour and capital, supporting specialisation in areas of comparative advantage; access to international financial

markets, enabling the financing of investment, smoothing of consumption, and management of risk; transfer of technology and skills; and enhanced competition in domestic markets, promoting innovation and competitive pricing. And they were complemented by a wider range of reforms designed to enhance the efficiency of resource allocation and support macroeconomic stability, including: tax reform; strong medium-term frameworks for monetary and fiscal policy; a clearer articulation of the operational independence of the Reserve Bank of Australia; and measures to boost national savings, including through superannuation, and reduce public sector debt.

These reforms interacted in powerful, mutually reinforcing ways, fundamentally transforming Australia's system of economic governance. They took us from a highly-protected and over-regulated economy with a short-term and reactive macroeconomic policy focus, to an open, flexible and dynamic economy, with expectations anchored by credible macroeconomic policy frameworks.

The results of the economic transformation have been well documented. Australia is experiencing its 16th consecutive year of growth; our living standards, measured by real GDP per capita, are now well above the OECD average; unemployment is at 32 year lows; workforce participation is at a record high; and inflation has been well contained, the headline rate averaging just 2.5 per cent a year since the economy emerged from the recession of the early 1990s. Just as importantly, our more flexible economy has proven extraordinarily resilient in the face of major shocks, including the Asian financial crisis of 1997-98; the bursting of the tech-

bubble in 2000; the United States recession in 2001; a very severe drought; and, in recent years, the global commodities boom that has given us terms of trade that, at other times in our history, would have sparked damaging inflation breakouts and macroeconomic policy crisis.

The policy reforms and economic outcomes of the last quarter century have been well documented, but it is important not to lose sight of the powerful narrative which underpinned, gave direction to, and marshalled support for these changes: The proposition that Australia had to open its economy to achieve sustained growth and rising living standards.

The ultimate mark of this narrative's success is that it is, today, taken for granted. When it was first articulated, however, it challenged a long-established conventional wisdom. This was the view, held by many policy-makers and opinion-leaders throughout Australia's history, that economic security – that is, both prosperity and stability – could be achieved only by insulating the economy from market forces, both international and domestic. The new narrative did not overturn this protectionist belief-system overnight, but in the course of the 1980s increasingly it set the tone for national debate on economic policy. A small number of academics, policy-makers and political figures had always championed its insights, but it was eventually accepted, grudgingly in some cases, by a much wider array of opinion leaders and interest groups, including unions and protected industry sectors. Ultimately, it won the support of a large section of the Australian community. It told them a story about Australia's place in the world, and the changes we

needed to make to secure our economy, that was both credible and compelling.

Some might argue that the market-opening reforms of the past quarter century could have taken place without any supporting narrative. They might point out that by the early 1980s it was obvious to all that Australia's pre-reform economic model was not working. And they might add that once the initial reforms were in place – those that exposed the economy to the discipline of international markets – the pressure for subsequent measures, especially to increase the flexibility of product and labour markets, was unavoidable. There is something in these observations, but they are overstated. Moreover, even if the observations are correct, it doesn't follow that the narrative I have been talking about played no role. By the early 1980s it should have been obvious to all that the inward-focussed, heavily regulated, protectionist model was failing. But it was far from obvious to all that the market liberalising initiatives of late 1983 and 1984 were necessary. They were, in fact, quite controversial. One reason for their being so controversial was the fact that, at the time, the compelling narrative I have been talking about had not been clearly articulated. Indeed, it wasn't until after then Treasurer Paul Keating's famous 'banana republic' statement in the middle of 1986 that the narrative started to gain traction.

Further support for the power of the narrative comes from noting that when governments in other countries have introduced ambitious reforms without persuasive narratives that could be understood and accepted by their citizens, the reforms have met with strong resistance; in most cases,

reforming governments have lost office. Australia's dominant, market-opening economic narrative, in contrast, has proved remarkably resilient. Its core promise – to bring international engagement and economic security into harmony – took some time to realise. In the early years, there were some dramatic setbacks. The early steps to open the economy exposed it more directly to the harsh judgements and vagaries of international capital markets. In the course of the 1980s, we experienced dramatic swings in the value of the currency, our current account blew out and our foreign indebtedness escalated. Yet throughout this period of instability and turmoil, mainstream political and community support for the market-opening narrative did not seriously falter. Even in the midst of the recession of the early 1990s, with the unemployment rate climbing to 10.9 per cent, the narrative wasn't seriously damaged. While there certainly was some vigorous debate, as one would expect in an open society, the reform imperative had developed sufficient momentum to sustain forward progress in those difficult years. Nothing better makes that point than the fact that in 1992 and 1993, with unemployment hovering above 10 per cent, tariffs were cut.

It's worth considering why the dominant economic narrative of the past quarter century has proved so remarkably resilient and influential. I would highlight three things. First, the narrative articulated clearly an embarrassing failure – our standard of living was falling relative to that of an increasingly integrated developed world. Second, the narrative appealed to deeply-held community values and aspirations – our nation's enduring quest for economic stability and prosperity, and, at the individual level, the high value we place on opportunity. And third, the narrative

provided a clear statement of the reform strategy, grounded in well-reasoned economic principles – setting out what we needed to do, and why, to respond to the challenge.

Ultimately, as I have said, the particular power of this narrative was its ability to reconcile, to bring into harmony, two seemingly contradictory realities, our desire for economic security, on the one hand, and the necessity of international engagement, on the other.

I have noted that the dominant narrative of the past 25 years is no less relevant today. The Government's wide-ranging international policy agenda attests to that – our hosting of the G-20 forum of finance ministers and central bankers last year, our hosting of APEC this year, our commitment to institution-building in the Pacific, the effective partnership we are building with Indonesia, and our close ties with other key regional powers. Important parts of the continuing domestic reform agenda should also be seen as part of that dominant narrative.

But I wonder whether the very success of the narrative – reflected in the fact that Australia's economy is now open, flexible and resilient, with low inflation and low unemployment – won't have some people wondering about a broader narrative that might support the next phase of our economic development.

I don't have such a narrative in my top drawer; and even if I did, it would be presumptuous of me to start reading from it. But if I were to sit down and write one, I reckon I would start by observing that most of the big policy issues we talk about today concern attempts to reconcile, or bring

into harmony, the ideas of opportunity and sustainability. These are broader concepts than international engagement and economic security – the two key elements of our current narrative – and they have been with us for centuries, not decades.

The concepts of opportunity and sustainability underpin a range of economic, environmental and social policy debates. Some of their economic policy dimensions are well understood. The Government's two Intergenerational Reports, issued in 2002 and 2007, have highlighted a number of these. Those reports have drawn attention to the fiscal and broader economic pressures associated with our ageing population and provided a framework for thinking about how best to respond to them. This framework is summed up in the '3Ps' – the truism that our ability to satisfy the material aspirations of future generations of Australians depends upon our population, labour force participation, and productivity. The central message of the two intergenerational reports has been that our ability to satisfy those aspirations, and also to secure the long-term sustainability of the budget, depends on the pursuit of further productivity- and participation-enhancing reforms.

Labour force participation relates to a broader notion of economic opportunity. Policies that lift labour force participation – including vocational education and training, tax and welfare changes to reduce disincentives to work, retraining of the structurally unemployed and employment initiatives for Indigenous Australians – also enhance economic opportunities. As does anything that governments might be able to do to ensure, in Noel Pearson's compelling words, that Indigenous

people ‘have the capabilities to choose a life that they have reason to value’.⁴

The enhancement of economic opportunity, based on positive incentives and robust capabilities, remains the most practical thing governments can do to advance the development of their citizens.

But what about sustainability? Many Australians would see development as being unsustainable, almost by definition, and they would view the enhancement of economic opportunity as being antithetical to sustainability. Because so much of our past expression of economic opportunity appears to have been associated with environmental degradation, they might appear to have a strong argument – being able to point to the destruction of about 99 per cent of our temperate native grasslands and the biodiversity they used to contain; extensive weed infestation, soil erosion and salinity; the extermination, in recent times, of 61 species of flora and 54 species of fauna; and the fact that another 1,551 species of flora and fauna are regarded by the Department of Environment and Water Resources as either ‘critically endangered’, ‘endangered’, ‘vulnerable’ or ‘conservation dependent’.

But this view, understandable as it is, is based on a misunderstanding of economic opportunity and, indeed, of development. Economists see opportunity and sustainability as being very closely related concepts: unless I can sustain past achievements am I not denying myself the opportunity of further development?

⁴ Noel Pearson, Cape York Agenda, Cape York Institute for Policy and Leadership, 2005; available at: <http://www.cyi.org.au/WEBSITE%20uploads/Documents/Cape%20York%20Agenda%20final.pdf>.

Indeed, many economists would agree that our improved living standards have not always been consistent with sustainable development, given that, unlike the people from Europe who came to this continent 220 years ago, we do not have the opportunity to appreciate the existence of species like the thylacine and 114 others. Few of us will ever see a yellow-footed rock wallaby or a hairy nosed wombat. Those who went before us have denied us these opportunities. And in that loss of opportunity there has been, in the language of Nobel Laureate Amartya Sen, a loss of freedom – a loss of ‘freedom to have – or safeguard – what (we) value and to which (we) have reason to attach importance’.⁵ That freedom should be seen as constitutive of development.

A concern with sustainability, then, can be viewed as safeguarding a fundamental component of development.

In recent years, we have been thinking about the impact on the sustainability of our relatively strong recent economic performance of an imminent ageing of the population, brought on by the collapse in the birth rate that occurred in the late 1960s and 1970s. Population ageing is going to affect the opportunities of citizens in virtually all developed countries.

But Australians have more reasons than most for thinking about opportunity and sustainability. Ours is the driest inhabited continent on earth and, if the climate change science proves right, the inhabited parts of the continent are only going to get a lot dryer. The energy-intensity of Australian production is well above the OECD average, and climate

⁵ Amartya Sen, ‘Why We Should Preserve the Spotted Owl’, *London Review of Books*, Vol.26(3) February 2004.

change mitigation efforts will make energy more expensive over time. Much of our increasingly valuable mineral wealth is to be found in pristine, but fragile, ecosystems – including in the Kimberley and the Top End – some of it world heritage listed. We have the most geographically dispersed population among OECD countries and a land transport system that is operating under considerable pressure. Several of our neighbours in the Pacific are becoming increasingly fragile; with increasing expectations on us to address deep seated governance and development challenges. And we have our own governance challenges, with three levels of government operating in an increasingly complex environment reflective of a distinct lack of coherence in accountabilities.

In the articulation of these challenges I can discern the raw materials for a powerful narrative to guide future economic development; a narrative that would appeal to strong community values and aspirations, to sustain what we have and to enhance economic opportunity; a narrative that would be both relevant and compelling.