There’s plenty to privatise at the Treasury Department

Judith Sloan, The Australian, 12:00AM May 23, 2017

This year’s budget is based on a fantasy concocted by the Treasury that, in turn, is willingly accepted by Scott Morrison because it suits his political purposes. The pretence that company tax receipts will grow by 40 per cent in the next four years and income tax receipts by close to 30 per cent allows the Treasurer to make the far-fetched claim that the budget will record a small surplus in 2020-21.

He can spend up big, showering money on health, education, infrastructure and pet projects while professing to be a sensible and credible economic manager. Without the cover of Treasury’s faux forecasts, cloaked in a veneer of economic mumbo-jumbo, he would be unable to make this claim. The Treasurer and Treasury are lying in the same bed.

From my point of view, this raises the question: how do we solve a problem like Treasury?

The quality of the work undertaken by Treasury has been in decline for at least a decade. Traditionally, Treasury was regarded as a prestige department and working there always carried a certain cachet. But the combination of its appalling forecasting record and the provision of ill-informed, secretaryabysmal policy advice have robbed the Treasury of the status and respect it once enjoyed.

Neither is the appointment of the present departmental secretary likely to slow the decline of an agency that now lacks credibility. John Fraser had once worked at Treasury, reaching the exalted position of deputy secretary, before leaving to develop a successful career in international investment banking. He was appointed as secretary to the Treasury by the Abbott government in 2015, with the enthusiastic backing of then treasurer Joe Hockey.

There are so many examples of egregious errors in the forecasting of the budget outcomes that it is difficult to know where to start. Let me just give you a flavour of the mistakes. In the 2010 budget, the claim was made that government receipts would top $399 billion in 2013-14; they came in at $363bn. The claim was made that there would be a cash balance of $5.4bn for 2013-14; there was in fact a deficit of $44bn.

In the 2014 budget — I’m not just picking on Labor governments — government receipts this financial year were going to reach $437bn; they will be lucky to get to $406bn.

I’m sure you will agree these are not trivial errors; they are out-of-the-ballpark mistakes that have serious consequences. In particular, they en courage governments to embark on unaffordable spending programs and lead to the unsustainable accumulation of government debt that will have to be paid off by our children and grandchildren.

Quite a few of Treasury’s forecasting problems start from its inability to estimate with any precision what is going to happen to key economic parameters: real and nominal gross domestic product growth, changes in employment and unemployment, the terms of trade and movements in wages.

When Martin Parkinson was Treasury secretary, he commissioned a lame, supposedly independent report analysing the department’s economic forecasting performance. The review panel was strictly barred from considering the short-lived mining tax; you know, the one that was forecast by Treasury to raise more than $12bn in four years but raised nothing. The conclusion was that the Treasury was no worse than private sector forecasters but all were bad, particularly at picking turning points in the economy.

But here’s the rub: Treasury has hundreds of staff and these private sector forecasters have a handful. There are more than 850 staff at Treasury, with more than 80 in the senior executive service. It is costing taxpayers close to $200 million to run this. Unsurprisingly, Morrison decided to top up Treasury’s funding in this year’s budget by close to $30m across the forward estimates. Note also that, in recent years, Treasury has been spared the efficiency dividend that applies more generally to the public sector.

A core function of Treasury is to model the tax base and thereby generate reliable estimates of future revenue. On this score, the Treasury fails miserably. Indeed, in the information provided in the budget papers, it is conceded that the standard error on revenue projections four years out is as high as plus or minus $50bn, close to 3 per cent of GDP.

Recently, there have been some minor changes made to the forecasting methodology used by Treasury, but the optimism bias that has been so evident in the past decade or so remains in place. Where once the trend growth of the economy was simply bunged in for years three and four of the forward estimates, a guess is now made about what the actual figures will be. Instead of simply using the most recent information on commodity prices at the time of the budget and applying them for the next four years, more realistic estimates are now used.

Even so, it is not clear whether these changes have made any real difference to the excessive sanguinity of the underlying figures in the budget. Does anyone believe that wages will be growing by 3.75 per cent in four years given that they are growing by less than 2 per cent today? And does anyone believe GDP will be growing by 3 per cent in 2019-20 and 2020-21, notwithstanding the Treasurer’s bald assertion there are better times ahead (or so he hopes)?

So how do we solve a problem like Treasury? For starters, close down the expensive and pointless Sydney and Melbourne offices created by the incumbent secretary. And the decision to create yet another division, to deal with structural reform, headed by an economic modeller, is impossible to justify. Treasury hasn’t been involved in devising significant micro-economic reform options for years. And as for Treasury’s boasts — check out the annual reports — that “significant work on tax reform” is being undertaken within the department, please spare us. And bragging about the work on “competition and productivity-enhancing reforms”? Let’s get real. And what about this howler: Treasury is the “pre-eminent economic adviser”?

It’s time for Treasury to take some of its own medicine. Why not contract out the economic forecasting function using a competitive tender? It certainly would be cheaper than having the huge standing army of underperformers. When it comes to policy advice, particularly in relation to tax, there are many alternatives to Treasury.

The core problem is that this government has no incentive to rein in Treasury. As long as it serves up more dollops of economic claptrap that suit the government’s political aims, the Treasurer will just go along for the ride. Pity the long-suffering taxpayers.