TARGET30

REDUCING THE BURDEN FOR FUTURE GENERATIONS

SNAPSHOT

Strengthening Australia's Fiscal Institutions

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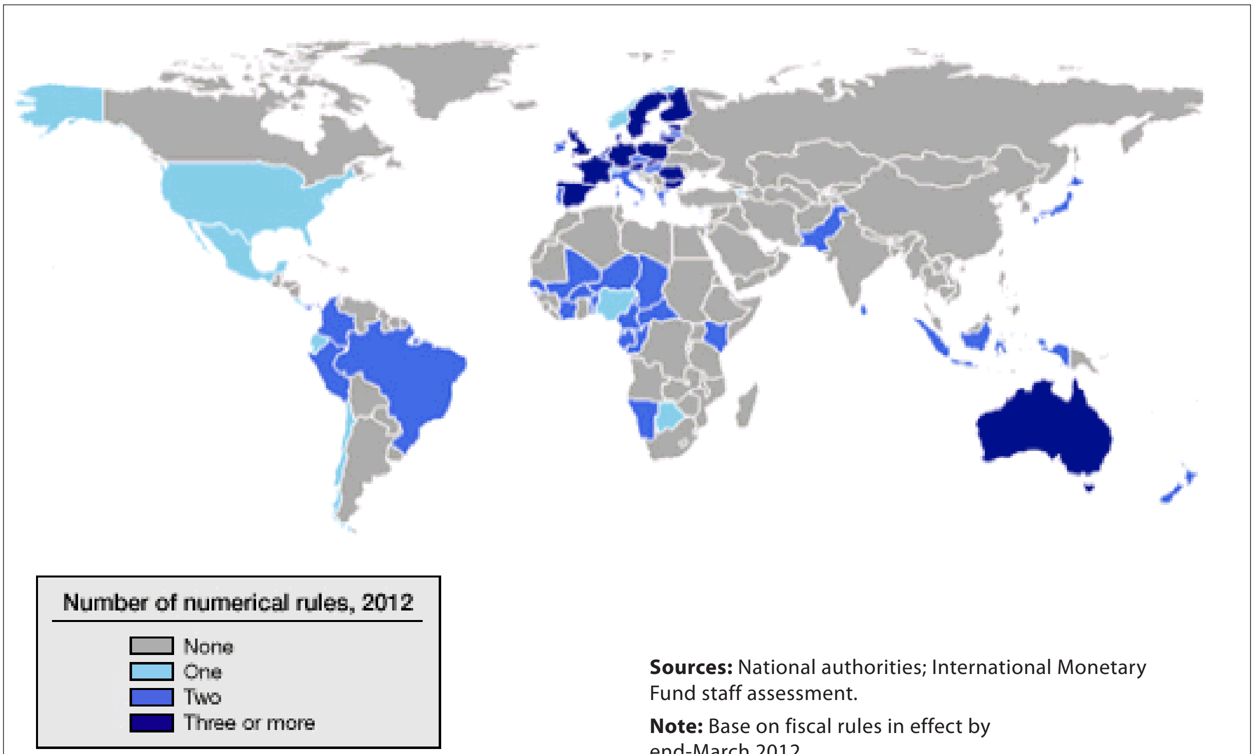
The Australian experience

- The deterioration in the federal government's fiscal position reflects a failure to adhere to a rules-based framework for fiscal policy to guide spending and tax decisions.
- Fiscal policy has been distracted by the pursuit of macroeconomic stabilisation objectives that are inconsistent with the institutional design of Australia's overall macroeconomic policy framework.
- An independent central bank pursuing an inflation target, combined with a floating exchange rate, renders the change in the budget balance as a share of GDP from one year to the next an irrelevance from a cyclical perspective.

Why do we need fiscal rules?

- The government's spending and tax decisions still have important microeconomic and efficiency implications that, in turn, influence long-run economic growth outcomes.
- A failure to balance the budget over time can be costly in terms of the burden of public debt interest and the need to increase future taxes in the absence of offsetting expenditure restraint.
- The cost of public sector borrowing is not just the interest rate on outstanding government debt, but also the efficiency cost of future tax increases needed to repay the debt.
- Expectations for the future path for net debt can undermine confidence even if current levels of debt are low by international standards.

Figure 1. Countries with fiscal rules (national and supranational), 2012



Sources: National authorities; International Monetary Fund staff assessment.

Note: Base on fiscal rules in effect by end-March 2012.

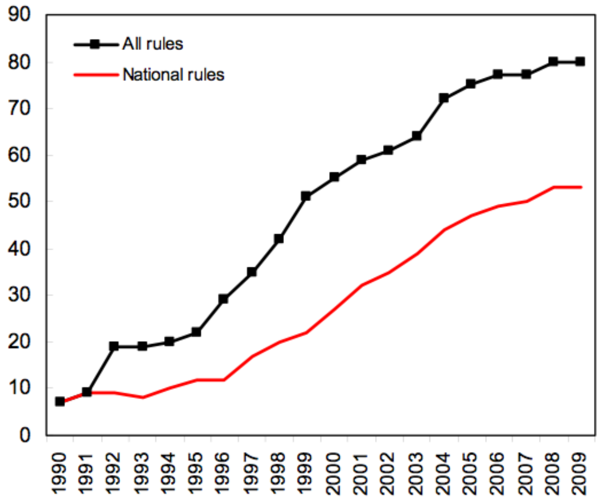
International experience

- There is a growing international trend of adopting independent fiscal institutions coupled with legislated fiscal policy rules.
- Local and international experience show that independent fiscal institutions and fiscal rules, both individually and in combination, can lead to improvements in budget outcomes.
- Australia should draw on this local and international experience to strengthen its fiscal institutions to better address both the current structural budget deficit and long-term fiscal challenges arising from an ageing population.

What should be done to improve fiscal rules?

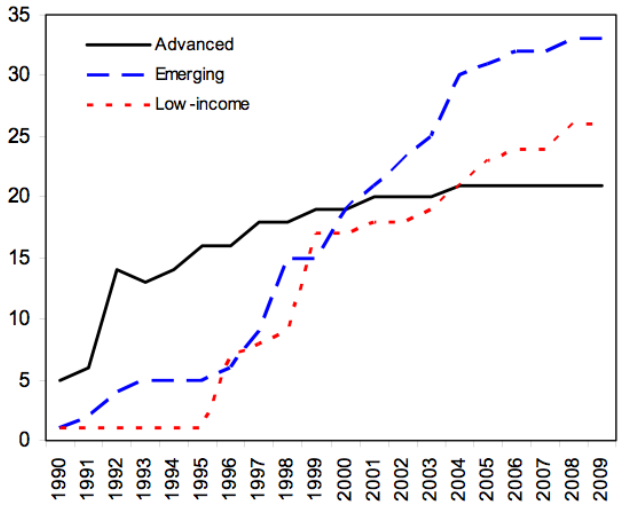
- An independent statutory Fiscal Commission should assume responsibility for formulating the fiscal and economic parameters that frame the government's tax and expenditure decisions.
- The commission should also monitor and enforce a new set of legislated fiscal rules.
- These rules include limits on the budget balance, net debt, revenue and expenditure as a share of GDP, along with a rule limiting real growth in federal expenditure on an annual basis.
- The remuneration of all Members of federal Parliament should be reduced by 1% for every percentage point breach of the fiscal rules for the duration of the breach.
- A rules-based fiscal policy regime also provides a framework through which policymakers can focus on reducing the size of all levels of government in Australia to 30% of GDP and below to be achieved over 10 years, as proposed by the CIS' TARGET30 program.

Figure 2. Number of countries with fiscal rules



Source: International Monetary Fund.

Figure 3. Number of countries with fiscal rules by type of country group



Source: International Monetary Fund.

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