

The importance of evidence for successful economic reform

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Evidence is a vital input to the policymaking process. In addition to ensuring the formulation of good policy, evidence plays a significant role in successful implementation by gathering community support for policy change. Evidence demonstrates to the community the costs and benefits that can be expected from policy reform. Sound evidence of the net benefits of reform is crucial in the successful implementation of any reform program.

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Introduction

Australia's economic reform experience to date has been remarkably successful. Living standards in Australia have increased since the 1980s relative to other industrial countries. In addition, reforms in Australia have not been reversed as in some other countries. A large part of this success is due to the strong public support for reform since the 1980s.

Although economic reform in Australia has resulted in significant net benefits, reform is not costless. The costs of reform tend to occur in the short term and can be concentrated on relatively small groups. On the other hand, the benefits of reform tend to materialise in the medium to long term and are widely spread across the economy. While the public may know how they will be affected by reform in the short term, the difference in the timing and distribution of costs and benefits mean make it difficult for them to determine how they will be affected in the long term.

Providing evidence of the potential and actual net benefits of reform is crucial in maintaining public support for reform. Evidence of the costs associated with pre-reform policies can mobilise community and business groups bearing these costs to support reform. More broadly, evidence of the net benefits of reform can convince the public that reform has long term benefits.

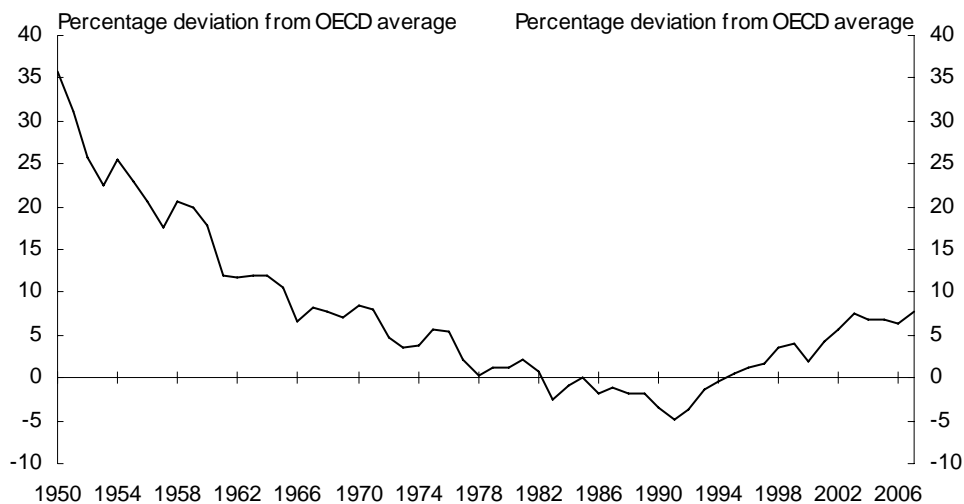
Ongoing reform is necessary to ensure continual improvements in living standards. But many of the reforms now facing Australia are particularly difficult – they involve multiple levels of government, complex environmental, economic and social systems, behavioural and attitudinal change and, in many cases, the benefits will materialise in the long term. Given the intractable nature of these problems, the extensive institutional change required and the timeframes involved, evidence of the net benefits of reform will be vital so as to gather strong, lasting public support for reform.

The purpose of this paper is to look at the critical role evidence played, and continues to play, in promoting the successful implementation of economic reforms in Australia. The first section of the paper provides an overview of Australia's economic reform experience since the 1980s. The second section examines the role of evidence in implementing these reforms. The third section looks at some of the lessons learned from the reform experience. The fourth section concludes.

Australia's economic reform experience since the 1980s

The wide-ranging macroeconomic and microeconomic reforms undertaken in Australia since the 1980s substantially improved the competitiveness, flexibility and resilience of the economy (OECD 2003). Living standards in Australia have risen substantially since the 1980s, reversing a sustained decline (Chart 1).

Chart 1: Difference between Australian and OECD average GDP per capita



Note: The chart includes all 30 OECD countries.

Source: Groningen Growth and Development Centre and The Conference Board (January 2008).

The economic reforms undertaken were broad-based, covering both macroeconomic and microeconomic policies and product, labour and financial markets.

The introduction of macroeconomic policies with a medium term focus improved Australia's economic stability. These included a medium-term fiscal framework and allowing an independent Reserve Bank to pursue an inflation target. Additional macroeconomic reforms were the floating of the exchange rate in 1983 and the relaxation of capital controls.

Good macroeconomic frameworks create a more resilient and predictable environment to underpin economic growth. In particular, low and stable inflation means that people's money is not losing its purchasing power. This allows them to better make long-range plans. Sustained low inflation is also self-reinforcing as businesses and individuals do not react precipitously to unexpected price signals when they are confident long-term inflation is under control. Low and stable inflation also means interest rates tend to be lower, encouraging investment to improve productivity and allowing businesses to prosper without excessive price volatility.

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Microeconomic reforms were also implemented across the economy. For example, average tariffs have fallen steadily since the mid 1980s. In the late 1980s, and continuing into the 1990s, non-traded product markets were targeted for reform, notably in the areas of transport, communications and utilities. The removal of regulations restricting competition was expanded with National Competition Policy (NCP), which provided a comprehensive framework for economy-wide reform.

Since the early 1990s, Australia's economy has shown remarkable improvement. It is not possible to draw an explicit link between individual reforms and improved economic performance as their effects are interactive and attributions of causality to any particular element need to be drawn carefully. However, the timing of reforms and improvements in economic performance and living standards suggests that there is a link between economic reform and the productivity improvement that underpinned the strong growth in per capita incomes in the 1990s (Productivity Commission 2005).

Not only did NCP and other reforms contribute to the productivity surge of the 1990s, they also benefited individuals and businesses in a number of other ways (Productivity Commission 2005). Reforms significantly reduced the prices of goods and services such as milk, electricity and telecommunications. Households also benefited indirectly from lower prices for other goods and services made possible by cheaper infrastructure inputs from businesses. NCP also stimulated employment and wages, which further benefited individuals.

The competitive environment fostered by NCP and other reforms has also helped to improve service quality and reliability, and led to an expansion in the range of products and services available to consumers (Banks 2004). The expanded range of goods and services improves individual wellbeing. It increases the array of consumption possibilities people face and it enhances their ability to choose the life that they have reason to value (Henry 2004).

Most importantly, the benefits of NCP and related reforms have been spread across the community, including rural and regional Australia (Industry Commission 1996; Productivity Commission 2005). Modelling of productivity and price changes in key infrastructure sectors during the 1990s suggests a consequent increase in regional output (and thus income) in all but one of the 57 regions across Australia (Productivity Commission 2005).

The role of evidence in successful reform implementation

Opposition to reform is often due to complexities and uncertainties surrounding the costs and benefits of reforms and trade-offs between efficiency and equity

(OECD 2007a). Sound evidence on the net benefits of reform plays a crucial role in ensuring that the public has a clear understanding of costs of the pre-reform policy framework, the costs of implementing reform and the benefits of successful reform. Good evidence can also spur potential beneficiaries of reform to mobilise in support of reform.

The use of evidence

The Australian reform experience since the 1980s shows the importance of evidence in motivating support for reform. Its importance can be illustrated by using the examples of the tariff and competition policy reforms (Banks 2009).

In the area of tariff reform, quantifying the net benefits of reform played a particularly important role in convincing Australians to support reforms. It was in this area that the work of the academic economists, such as Max Corden, Victor Argy, Fred Argy, and Heinz Arndt, and the Productivity Commission and its predecessors was crucial. For example, modelling by the Commission in the late 1980s suggested that across-the-board tariff liberalisation and other microeconomic reforms could increase Australia's GDP by \$16 billion, or \$1,600 per household (1988 dollars) (Banks 2005).

The estimates of the net benefits of reform became part of the public debate and helped bolster public support. Of particular importance in convincing the public to support tariff reform were calls for reform from a broad spectrum of influential commentators, business groups, academics, politicians and public servants.

Evidence of the cost of *not* implementing reform also played an important role, especially where it mobilised business and community groups bearing the cost of the pre-reform policy framework to support reform. For example, the Commission's analysis of the costs borne by the mining and agricultural sectors as a consequence of manufacturing tariff protection spurred these two industries to support trade liberalisation (Banks 2005). Similarly, the Commission's analysis of the costs to the economy of inefficient government business enterprises in the utility sector helped to marshal business groups to support reform of government business enterprises.

The production of sound evidence also played a key role in the successful implementation of NCP. Evidence on the need for competition policy reform, the principles that should underpin reform and the net benefits of reform was generated progressively over the 1980s and 1990s through a range of reviews, policy discussion, analysis and learning (Productivity Commission 2005). This included the Hilmer Review, Industry Commission inquiries, work by government agencies such as the Economic Planning and Advisory Council, and work by privately funded think tanks, industry organisations and academics. The public dissemination of and debate about this evidence created a broad base of community support for reform.

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For example, modelling by the Industry Commission (now the Productivity Commission) suggested that the implementation of NCP reforms could generate a net benefit equivalent to 5½ per cent of GDP (Banks 2004). Although this estimate was controversial at the time, it is consistent with economic outcomes following the implementation of NCP. In particular, the Productivity Commission estimates that the productivity and price changes actually observed in key infrastructure sectors in the 1990s – to which NCP and related reforms directly contributed – increased Australia's GDP by around 2.5 per cent (Productivity Commission 2005).

Evidence also played an important role in identifying those that might be negatively affected by reforms. This allowed the introduction of measures to assist people and businesses adjust to reforms.

Community values

During the reforms of the 1980s and early 1990s, there was broad community support for policy change that would reverse the perceived stagnation and decline of the economy, particularly relative to other developed countries (Kelly 2000). In a period with many reforms, people assumed a 'swings and roundabouts' view that they may lose from a particular reform, but gain more from many others.

However, following the recession in the early 1990s there has been a growing anti-reform sentiment, partly reflecting reform fatigue, a lack of awareness of the benefits of reform, concerns about the distribution of benefits, uncertainties and costs of reform (Kelly 2000). Similar sentiments have been roused in other developed economies, with the public's attention focused on the drawbacks of globalisation and market-based reform (OECD 2007b).

Findings from the Australian Social Attitudes Survey suggest that Australians hold a mixed view of the main elements of economic reform and its impact on the economy and society (Duncan, Leigh, Madden and Tynan 2004; Pusey and Turnbull 2005).

For example, protectionist policy measures continue to hold strong appeal in the community, even though average tariffs have fallen (Table 1). In the 2007 Australian Social Attitudes Survey, 50 per cent of Australians surveyed agreed that the Government should use tariffs and restrict imports to protect industry.

On the other hand, the majority of respondents like the benefits of free trade and place a high value on economic growth (Table 2). The views of the general community also contrast strongly with economists. In 1992, 92 per cent of Australian economists surveyed agreed that 'tariffs and import quotas usually reduced general economic welfare' (Anderson and Blandy 1992).

Table 1: Support for protection, 1995-96 to 2003, per cent

<i>Australia should continue to use tariffs to protect its industry</i>		
1996*	1998*	2003
59	57	58
(n = 1716)	(n = 1825)	(n = 1900)
<i>Australia should limit the import of foreign products to protect its national economy</i>		
1995#	1996*	2003
78	71	66
(n = 2294)	(n = 1765)	(n = 2098)

Source: #National Social Science Survey 1995; *Australian Election Study 1996, 1998 and The Australian Survey of Social Attitudes 2003.

Table 2: Attitudes to free trade, 2003, per cent

	Australians should use tariffs to protect industry	Australia should limit import of foreign products to protect the economy	Free trade leads to better products available in Australia
Agree	52	65	49
Neither agree nor disagree	25	19	28
Disagree	12	15	18
Don't choose	10	2	5
n	(2108)	(2142)	(2148)

Source: The Australian Survey of Social Attitudes 2003.

These results need to be taken seriously by policymakers. Research by the IMF and OECD shows that a lack of public support for reform is the main reason why industrial countries have failed to implement reform (IMF 2004; OECD 2007a; Høj et al. 2006). As evidence of the net benefits of reform can mobilise public support for reform, disseminating evidence on net benefits is crucial for the success of any reforms.

The lessons that can be learned

One of the key lessons learned from Australia's reform experience in the past quarter century is the need to remind people of the benefits of reform, so that they do not focus solely on costs. This is partly due to the differences in how people feel about costs and benefits: people feel losses more keenly than gains (Kahneman 2003). The fact that the benefits of reform are widely spread and are not always easily identifiable may help explain why people have become more averse to reform.

Another important lesson is to consider compensation and or transitional assistance that help people adjust to reform. The aversion to reform that developed in the late 1990s appears to relate particularly to the fear that reform will lead to a loss of income, job losses and negative impacts on communities (Henry 2008). While at the aggregate level, economic reform increased incomes and living standards and reduced unemployment both in city and country Australia, some individuals suffered in

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adjusting to a more competitive and flexible economy. Future reform should also include measures to assist people adjust to the new arrangements.

As Australia's reform experience shows, providing evidence of the net benefits of reform can mobilise community support for reforms. For example, the Productivity Commission (2007) analysis of the potential benefits from implementing the National Reform Agenda. However, the mere existence of such evidence will not be enough if the momentum for future reforms is to be maintained. Strong leadership and a clear, persuasive reform narrative will also be required to promote the benefits of reform and persuade the public to support policy changes (Henry 2007). In addition, the public's willingness to trust those who are advocating policy reform may depend on the extent to which they are confident that assistance will be available to help them adjust.

It may be that the challenge facing governments in using evidence to persuade the public to support reform is more difficult today than it was a quarter of a century ago. The public are richer, may feel that they have more at risk than to gain from reforms, and fear that narrower reforms mean that the cost of one reform will not be offset by gains from others. This reluctance may be exacerbated by the fact that the benefits of many of the reforms being tackled by governments today could take decades to materialise. This is because these reforms involve multiple levels of government, complex environmental, economic and social systems, and require behavioural and attitudinal change.

Conclusion

Social attitudes towards economic reform are important, as successful implementation of reform relies upon community support for policy change.

There is evidence that the economic reforms undertaken since the 1980s have provided many wide-spread benefits. This includes macroeconomic benefits that have resulted in more stable economic growth and low and stable inflation. It also includes microeconomic benefits that have resulted in a greater amount of choice for consumers, lower prices and improved quality of services.

However, there are mixed views from the community surrounding economic reform. For example, protectionist policies continue to hold strong appeal, while most people still want the benefits of free trade and place a high value on economic growth.

This highlights the need for a clear, persuasive reform narrative. An awareness of the costs and benefits of reform, and the costs of not undertaking reform, are important. It also reminds policymakers of the need to take community views into account when designing policies. The costs of economic reform need to be recognised and arrangements to assist transition can be an important part of policy design.

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Maintaining support for economic reform is important for Australia's future prosperity. Strong underlying economic fundamentals are vital for future economic growth and make it easier to deal with short term shocks.

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