

# Understanding Budgets – an economic toolkit

Dr Nitin Gupta  
Economics Section  
Parliamentary Library



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# The truth about Budgets

- A statement of intentions and priorities
- Its all about revenue and expenditure
- A tool of fiscal policy – one of several levers
- Marginal changes and continuing commitments
- Assumptions about projections
- Govt. vs. market – a spectrum
- Provides information, allocates resources, and creates expectations and rules



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# The toolkit

- How well understood is the problem?
- How will success be measured?
- Should the government do this?
- What will the reaction be?
- How effective will it be?
- Where does the buck stop?



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# How well-understood is the problem?

- Many social issues plagued by info problems
  - Relevant factors sometimes cannot be directly observed or measured
  - State of mind, abuse, talent, addiction
- How is the problem reported?
  - Direct or indirect (proxy) indicators?
- How well do they reflect the problem?
- How do you address a problem that cannot be measured?



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# How well-understood is the problem?

- Indicator quality has real policy implications
  - Mental health, violence, workplace discrimination and obesity
  - From a vicious to a virtuous cycle
  - ‘The fence or the ambulance?’
- Are we targeting proxies or the underlying problem?
- Contrast with the coverage of bankruptcies, foreclosures and stock market volatility



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# How will it be measured?

- Many economic terms are misunderstood and misapplied
- ‘Innovation, efficiency and productivity’
  - How are these defined and measured?
  - These are not synonymous terms
- Improved processes or reducing wastage?
  - Increased output per unit cost or simply cost cutting?
  - Traffic management vs road maintenance



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# Should the government do this?

- Is there a market failure?
- The question of ‘externalities’
- Positive – private actions lead to social benefit
  - Research
- Negative – private actions lead to social harm
  - Noise or environmental pollution
- What happens if government does not do this
  - Under-production of ‘good’ things
  - Over-production of ‘bad’ things



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# Should the government do this?

- Funds for renewable energy subsidies or technical feasibility studies for resource sites
  - Very expensive and risky ventures
  - The government shares the burden
  - Safeguards public interest - helps to balance efficiency, profitability and sustainability
- *CSIRO and the US Environmental Protection Agency*



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# What will be the reaction?

- Consider reactions to measures
- Who are the ‘winners’ and ‘losers’?
  - Who faces greater & more immediate measurable impact?
  - Easier said than done!
- What incentives and resources do they have?
  - Who is more likely to organise?



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# What will be the reaction?

- Expected: mobilisation or apathy?
  - *Tobacco Plain Packaging Litigation*
  - Global cigarette companies used IP laws to sue Australian government
  - Government needed to champion the ‘winners’
- Unexpected: ‘look before you leap’
  - ‘Moral hazard’ or ‘adverse selection’
  - Sense of loss is more acute than equivalent sense of gain; easier to not give than to take away
  - Creating a new class of beneficiaries



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# How effective will it be?

- Will the net result be positive?
- Are there conclusive and time-specific statements about results/benefits?
- Maintain a critical approach
- Cost-benefit analysis:
  - Costs are underestimated, benefits overestimated
  - Costs are immediate, benefits come with a lag
  - Costs are fixed, benefits are uncertain



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# How effective will it be?

- Industrial/innovation investments
  - Transitioning away from the resource-based economy
- What are the assumptions regarding benefits?
  - State of technology
  - The ‘1-10-100 Rule’
  - Global competition
  - How responsive will actual activity be to this incentive? Look at the ‘fine print’



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# Where does the buck stop?

- Complex problems/unclear accountability
- *Combating financial fraud and misconduct*
- ‘Polycentric governance’
  - Treasury – develop taxation and economic policy
  - ASIC – corporate regulator
  - APRA – financial sector regulator
  - ATO – collect taxes
  - Multilateral taxation treaties



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# Where does the buck stop?

- Consistency of incentives, expectations, and cultures across stakeholders
- Clear lines of authority and accountability
- Conflicts of interest – ‘Like a fox guarding a hen’
- Regulatory capacity exists for new technologies, products and practices?



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# The Questions Revisited

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Thank you!



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