

**TREASURY'S EFFECTIVENESS IN THE
CURRENT ENVIRONMENT**

ADDRESS TO STAFF AT THE HYATT

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Let me welcome all of you here this morning, particularly those of you who are new to the department, including our 2007 graduates and other staff who have recently joined the Treasury.

Before getting underway, a word from our sponsors: The Treasury Social Committee has asked me to remind you of the trivia night on 11 April. These events always attract a very healthy attendance, and – on the form of the past few years – unless you're a member of the executive, there is little risk of your table walking away with the wooden spoon.

It's a pleasure to speak to the whole department at these biannual presentations. They provide an opportunity to reflect on our achievements and to consider some of the challenges confronting us as a department. I use the phrase 'as a department' deliberately because what we can achieve depends on department-wide efforts. Increasingly, our effectiveness rests on cross-group work. The production of the second intergenerational report, IGR2, is an outstanding example. But remember, too, that very little can be achieved without those who provide the behind the scenes support – those who work in Corporate Services Division, the group support units and Strategic Communications Division.

Today, I will highlight some of our achievements since my last presentation and then I will turn to the key theme of this presentation — ‘Treasury’s effectiveness in the current environment’.

I’ll be discussing:

- some of the policy implications associated with the economy operating at close to full employment;
- some of the challenges that an election year will pose for you, in your work in the Treasury; and
- why our identity, encapsulated in our mission, values and capabilities, will be integral to our success in confronting these challenges.

ACHIEVEMENTS

First, I’d like to spend a little time on some of our achievements and highlights of the nine months since my last presentation to the department.

As usual, we have been extremely busy in supporting our ministers and fulfilling our role as a central policy agency, providing quality policy advice in priority areas and dealing with the never-ending work of government, including updating

legislation. In the short time I have, I will mention just a few stand-out achievements.

In a significant departure from our normal operations, with Macroeconomic Group leadership, and in partnership with the RBA, we became a major event manager — convening a meeting of the G-20 Finance Ministers and Central Bank Governors in Melbourne. It was the most significant economic and financial forum ever held in Australia and the culmination of Australia's year as chair of the G-20. The G-20 brings together representatives of around 85 per cent of global GDP (in purchasing power parity terms) and around two-thirds of global population. Real progress was made on a range of policy challenges facing the global economy. Convening this forum was a gargantuan logistical assignment. It was a triumph for the Treasury. I want to congratulate our 'globalisation warriors' — the Treasury officers who helped make this meeting such a success (often beyond the call of duty) — on a job well done.

In December and February, Revenue Group delivered significant legislation to give effect to the plan, announced in the 2006-07 Budget, to simplify and streamline superannuation. People in Revenue Group had been working on that plan for years. And they have shepherded it through Cabinet consideration, a quite

extensive community consultation, and legislative drafting. Last week I had the opportunity to share a few drinks and a few congratulatory remarks, with those most directly involved. I said then that, as an exercise in policy leadership, the superannuation reform is as good as anything I've seen the department produce in the 20-odd years of my Treasury career. It advances all five elements of our wellbeing framework and illustrates very well the various dimensions of the SES leadership capability framework: the shaping of strategic thinking, achieving results, exemplifying drive and integrity, cultivating productive working relationships and communicating with influence.

I noted also that outstanding achievements like these make a very significant contribution to departmental reputation, enhancing our credibility, and in that way contributing to the enhancement of capability right across the department.

Again, I say 'well done' to all of those involved in the G-20 and superannuation reform exercises.

In Markets Group and Fiscal Group, especially, we are working hard to develop worthwhile reform proposals with the States and other Commonwealth departments in the areas of energy, transport, infrastructure access, best practice regulation and human capital. These reforms, if endorsed by the Council of Australian

Governments in April and implemented properly, will help to boost productivity growth rates and go some way to compensating for falls in participation as the population ages.

We have also worked hard to develop frameworks for the consideration of water reform and climate change policy. All of us would wish that we had been listened to more attentively over the past several years in both of these areas. There is no doubt that policy outcomes would have been far superior had our views been more influential. That is not just my view; I know that it is increasingly widely shared around this town. But we are not giving up. Water has got away from us a bit in recent times, but it will come back for some quality Treasury input at some stage – it will have to – and we are, at last, right at the centre of policy development in the climate change area.

Internally, we have remained focussed on capability enhancement. In that respect, the development of the Information Knowledge Management initiative by our corporate services area is particularly noteworthy.

Of course, there are many other achievements that I could point to.

You should be proud of what has been achieved in the past nine months. The specific achievements I have identified are fine examples of the contribution we make as a central policy agency.

Now I should hasten to add that any organisation that rests on its laurels is destined to be disappointed.

Not that there is any real risk of resting on our laurels. The current economic and political environment simply won't allow it. That is where the 'challenge' bit comes in.

TREASURY'S EFFECTIVENESS IN THE CURRENT ENVIRONMENT

The theme for today's presentation is 'Treasury's effectiveness in the current environment'. The implication is that the environment has changed and we need to respond. Has it really changed?

The hallmarks of economic conditions for the past decade and a half have been the relative strength and stability of the economy, in particular of GDP growth [*Chart 1: GDP growth*]. Indeed, when publicly commenting on the economy we and the Treasurer often refer to the macro-stability of the economy. '15 years of continuous growth' is the oft-quoted refrain.

That macro performance owes much to decades of reform that have improved monetary, fiscal and structural policy frameworks.

Throughout the growth period, the economy has been trending ever closer to a state of full capacity utilisation – a state of full employment. Indeed, for macroeconomic purposes, it is probably reasonably safe to assume that we are already at full employment – or, at least, very close to the NAIRU: the non-accelerating inflation rate of employment. The last time we had an unemployment rate at today's level was in the June quarter 1976. Taking a broader measure of labour utilisation, the ratio of full-time-equivalent employment to the total population of working age is approaching historically high levels [*Chart 2: Employment*].

From a structural policy perspective, however, it would be quite inappropriate to consider that we have achieved a state of full employment. One only has to take a look at woefully low indigenous employment rates to appreciate the folly of that sort of thinking. But, from a macroeconomic perspective, things certainly have changed in recent years. And those changes have quite profound implications for policy thinking across many areas of government – implications that are far from widely recognised.

Policy implications

For the purposes of today, I will highlight just two key implications.

First, we need to have an appreciation of the consequences of policy intervention in an economy operating at, or close to, full employment. In the absence of externalities and other sources of market failure, a market free of policy intervention will allocate resources efficiently. Any government intervention will shift resources, including jobs, from one activity to another and impose a deadweight loss of efficiency on the economy.

Expansionary fiscal policy tends to ‘crowd out’ private activity: it puts upward pressure on prices which, all things being equal, puts upward pressure on interest rates. Depending upon the size of the interest rate response, the nominal exchange rate might also appreciate, squeezing further resources out of the traded goods and services sectors of the economy. As a rather crude, but nevertheless instructive generalisation, there is no policy intervention available to government, in these circumstances, that can generate higher national income without **first** expanding the nation’s supply capacity. Policy actions that expand the nation’s supply capacity target at least one of the 3Ps — population, participation or productivity – that we have been talking so much about in recent years.

Now you might be thinking that that’s all pretty obvious. It is, after all, a tautology. But one of my messages to you today is that

if you understand what I have just been talking about, then you are a member of a rather small minority group. The political economy hasn't kept pace with the real economy.

Consider, for example, recent commentary in the press which argues that the Government should support a nuclear power sector because jobs would be created. Where will the nuclear scientists and technicians come from? Is it seriously being suggested that they will come from the dole queue or from Indigenous Community Development Employment Projects?

The truth is that if present macroeconomic circumstances persist, unless **all** of the workers employed in the nuclear industry are immigrants who would not otherwise have been drawn to Australia, then every job 'created' by the nuclear industry will be a job 'destroyed' in some other industry. Ignoring transitional cost issues, there is nothing inherently bad about job destruction, of course; but the more important point is that there is nothing inherently 'good' about job creation either, unless it opens up an economic opportunity for someone who would otherwise not have a job or is associated with higher income than the job it replaces. And need I point out that if it belongs to the latter category, then it certainly doesn't need taxpayer support.

The next time any of you get an opportunity to write a coordination comment on a Cabinet submission that proposes a taxpayer-funded handout for some stunning new investment proposition – and I predict that some of you won't have to wait very long for such an opportunity – I suggest you draw attention to the submission's failure to identify the businesses that will lose labour, and be forced to reduce output, if the proposal is agreed to. I won't suggest that you go so far as to recommend that the sponsoring minister be required to write to the chief executives of each of those businesses explaining why it is in the national interest that their operations contract.

In present fiscal circumstances, there is a temptation to think that all problems can be solved by government spending. Such spending adds to aggregate demand, of course. In the environment in which we have been developing policy advice for the past 30 years or so, while we have worried about the efficiency of government spending and the macroeconomic impact of the consequent fiscal stimulus, we have probably not been as concerned about the possibility of diverting resources from more to less productive areas.

Indeed the use of some fiscal 'grease' has, on occasion, been used successfully to 'buy' reforms that have enhanced the country's

productive capacity — the flexibility and capacity that I spoke about before.

But in a full employment economy it will almost always be the case that government activity that doesn't expand the economy's aggregate supply potential will indeed reallocate resources from higher to lower productive areas, and in so doing reduce aggregate output – by definition.

The second implication of operating in a full employment economy is that the community appetite for reform is considerably smaller. There is a growing view that the good times will roll on forever, especially given the strength of the fiscal position.

Much of our recent macroeconomic and fiscal success is based on past reforms, assisted by the terms of trade. A significant proportion of the latter may be transitory. A steadily ageing population will also pose substantial challenges for the fiscal position and for our economic growth performance, as outlined in the IGR.

The risk of complacency, and its economic consequences, is clear.

So this is where you come in. Our challenge is to develop policy advice that leads to government decisions that expand capacity

and enhance flexibility. In the current economic environment, the pay-off for the wellbeing of Australians could be especially high.

Of course, to have that impact, our advice needs to be both analytically rigorous and compelling. We need to be savvy as well as sound.

The Election

It is almost certain that 2007 will be an election year. That brings with it a number of challenges, opportunities and obligations. 2007 will test our mettle as apolitical public servants.

When the election is called, the Government takes on what is known as a ‘caretaker’ role. By convention, during the caretaker period, the Government does not take any major policy decisions that would bind an incoming government and the Australian Public Service (APS) must not presume a particular election outcome.

During the caretaker period, the Treasury provides to ministers only material which is necessary for the ongoing business of government or factual in nature, such as the provision of economic notes or data for inclusion in speeches. But we take on additional responsibilities. These include:

- the costing of government and opposition election commitments;
- the preparation of two incoming government briefings — a ‘red book’ addressed to a Labor government and a ‘blue book’ addressed to a Coalition government; and
- as required by the Charter of Budget Honest Act, the preparation of the *Pre-election Economic and Fiscal Outlook* report — which ensures that the public is well-informed about the state of the nation’s finances.

The Executive Board will provide more guidance on the details of these arrangements as we move closer to the election. Today, I would like to highlight two key implications of the pre-election environment.

First, we need to be even more acutely aware of our role and our identity as part of an apolitical APS. This is a key feature of our system of government. The legislated APS values make it clear that the public service is apolitical, yet responsive to the government of the day. In a pre-election period, we need to be particularly vigilant in balancing our duty to be responsive to our ministers with the need to be non-partisan, non-political, in the advice that we provide.

The schematic in Chart 3 might help you to think about the role you should be seeking to play as an adviser to government

[Chart 3: Dimensions of advice].

Our capacity to ensure that our work is ‘responsible’, and not just ‘responsive’, will be put to the test. How successful we are will impact on our integrity as public servants and our long-term effectiveness. If, at any time, you feel uncomfortable with what you are being asked to do, or being directed not to do, speak to your general manager, executive director, or to me.

Secondly, divisions will be under pressure to respond to the growing number of policy proposals leading up to the calling of an election and once the election is called. At this time, there is a greater than usual risk of the development of policy proposals that are, frankly, bad.

More so than at other times, we need to be mindful of the high opportunity cost of proposed policy actions, to advocate sound and wellbeing-enhancing policy action — capacity building measures, better functioning markets, less system complexity and greater fiscal discipline — and to educate others on the full implications of policy interventions in the current economic circumstances.

We will confront uncommon policy challenges this year. But keep in mind that in every challenge there is an opportunity.

Let me draw together some of the strands that I've outlined so far:

1. both the probability and the cost of policy error in the current environment is especially high;
2. this election year will increase our workload, responsibilities and risks; but
3. we can make a difference to the wellbeing of Australians by our rigorous analysis and taking advantage of the opportunity to pursue further reform.

Ensuring future success

As you all know very well, policy decisions – even relatively minor ones - can have a major impact on the wellbeing of the Australian people. Our principal role is to ensure that the advice going to government is well-thought out and convincing. That is part of what it means to be a central policy agency.

Treasury identity

Treasury's identity, which encompasses our mission, values and capabilities, can be summarised briefly as follows [***Chart 4: Identity***]:

We are a central policy department of the APS providing high quality, timely advice and services to our ministers to improve the wellbeing of the Australian people [Chart 5: Wellbeing].

As a central policy agency we have both the opportunity and responsibility to make a significant contribution to the quality of the lives of all Australians, now and in the future. **[Back to Chart 4]**

This role, this purpose, makes me proud to do what I do. I relish the fact that we have such a privileged position in government and a unique capacity to make a difference. And I see in the things that you do, everyday, that you share this pride and embrace the extraordinary opportunity that each of you has.

To be effective, to make the most of our opportunity, we need to exploit our capabilities **[Chart 6: Capabilities]:**

- bring a whole-of-economy perspective to our day-to-day work;
- test vested interest;
- apply analytical rigour;
- develop strategic approaches, not just the ‘quick fix’;
- be sensitive to the policy environment of the day; and

- understand how policy influences the wellbeing of Australians, individually and collectively.

We must think strategically on all issues, not just those within the ambit of our direct portfolio responsibilities.

Many of the policy problems that we face today have a whole-of-government character. There is no room for silos between central, line and operational agencies; nor between levels of government. Examples of such problems include the adverse impact on workforce participation that arises from the interaction of the tax system with the welfare system; the severe capability deprivation suffered by most Indigenous Australians; widespread environmental degradation, due in part to a history of inappropriate pricing of the nation's natural resources; and water rationing in much of the populated areas of the continent. We can't tackle these problems alone. But neither can anybody else. More significantly, they won't be tackled effectively without our strong input.

The Government, our ministers and other agencies are under no compulsion to rely on our advice. In respect of water, that point is all too obvious. We are competing for influence with other central agencies, line agencies and independent policy advisers, such as think-tanks, commentators and consultants. What gets us to the

policy table is a reputation for deep analytical rigour *and* economy-wide thinking.

These skills are a capability that we need to nurture organisationally and in all of our people. And that nurturing could have implications for individual career paths.

For example, some of you will take the view that your personal capabilities will best be developed by moving around various areas of the department. But it is also the case that some areas of the department require officers with a deep understanding of certain complex matters and in these areas high turnover rates will not be helpful. I know that there are many views in the department on the Executive Board's attitude to these things. Not all of the views I've heard are ones that I would recognise from Executive Board discussion. At the risk of further confusion, let me make just a couple of points: First, I consider it entirely feasible that somebody could become Secretary to the Treasury having only ever worked in one policy group before being promoted to the SES Band 3 level (i.e., executive director). One reason I consider that to be feasible is that both my predecessor and I did just that. Second, whatever your career profile, you will not be promoted to the SES Band 3 in the Treasury unless you are able to demonstrate a capacity to think deeply in several areas of

the department's work, and to do that thinking within a framework that embraces the Treasury as a whole. If you consider that you would need to move frequently, from one group to another, to acquire that capability, then you may choose to do so, and we will be happy to facilitate it. Obviously, I never considered it necessary in my case, and I have no expectation of it being necessary in other cases.

While on the issue of the myths of moving, it is interesting to note the data from the last four bulk rounds, which shows that 80 per cent of internal applicants that were promoted remained *in situ* within their groups.

Analytical rigour and economy-wide thinking gets us to the table, but it's not enough. If we are not effective in communicating these messages to our ministers and stakeholders and influencing their thinking, we will fail in our mission.

The quality of our relationship with Treasury ministers is of vital importance for very obvious reasons. We need to be responsive to our ministers, tailoring our advice to the current economic and political environment, but at the same time safeguarding the integrity of our advice. We need to nurture our ministers' confidence and their trust in us. As I have noted on other occasions, I have never known the Treasurer to not welcome frank

and honest advice when it is provided in-confidence and in good faith.

Given the nature of our system of government, we need to remember that we don't have the power — and nor should we — to determine policy. That is the business of governments and Parliaments. But for us, it is not good enough to say 'well, we told them, but they wouldn't listen'. We have to try to make the case so compelling that they not only listen, but also act — that the government of the day and the Parliament do in fact do what is required in order to improve the wellbeing of the Australian people.

We must also be conscious of the need to influence our partner agencies and, on occasion, community stakeholders at large; to convince them of the need for real reform and the costs of poor policy.

Influence demands effective interpersonal engagement — through teamwork and collaboration, using clarity of argument, with persistence, perseverance and with respect.

Hubris does not deliver results. *[Back to Chart 4]*

Personal conduct

At the end of the day, our effectiveness in carrying out our mission hinges not just on *statements* about our identity — it hinges on the excellence of your individual contribution within the department. It hinges on how you add value through your personal conduct. Let me outline some of the key interpersonal attributes that I expect from all officers in the Treasury [*Chart 7: Values*].

I expect individuals to be ethics and values driven — to model respect, honesty, consideration of others and fairness. This is a threshold condition made clear in the Treasury values. It is a crucial precondition for effective team performance. There is no more corrosive effect on workplace morale and effectiveness than unethical and inconsiderate behaviour.

I expect officers to be collegiate — including across areas (units, divisions, groups) — to contribute to their broader work area enthusiastically. This means consulting colleagues. It means being team focussed. Proper teamwork consistently produces powerful results. Only a cursory look at our record of achievement demonstrates how crucial this is.

I also expect you to value diversity, including being open to alternative ideas and views, being sensitive to differing work styles and preferences and the perspectives people bring to the workplace, including those that reflect particular professional, educational and life experience and socio-economic background. Recognising and utilising diversity strengthens teams, facilitates a more satisfying and productive workplace and contributes to the robustness of our advice.

Interpersonal and intellectual excellence are key values of this organisation and are integral elements of our effectiveness, reputation and influence. We need to nurture them in all of our people at all levels.

Clearly, the department expects a lot of you. But you are entitled also to expect a lot of the department.

You can expect that your managers will listen to your concerns. You can expect real consultation on matters of importance and that managers will consider very seriously the feedback you provide through various mechanisms, such as staff surveys.

You can also expect that the department will assist you in developing your individual capabilities to ensure that you can excel. I expect managers at all levels, with the support of

corporate services, to have this uppermost in their minds. To this end, managers must continue to focus on investing in professional development and means of increasing our technical advising capacity. If you are new to the department, I do not expect that right from the outset you will have all of the technical skills required to do your job, nor do I expect you never to make a mistake – but I do expect you to want to learn; indeed, to have a passion for learning. You have been selected because you have the right attributes, the potential and the capacity to learn from your experiences and add value.

Of course, learning is not limited to new starters. All of us can learn from both our successes and our setbacks. In fact, I am keen for ongoing evaluation to be established and firmly embedded as part of our learning culture.

Concluding remarks

Let me sum up.

It is an exciting but challenging time to be working in the Treasury. There is always an imperative for sound policy advice and meaningful reform but the stakes this year are especially high and the cost of policy error is great.

You shouldn't be daunted by these challenges. Instead, I want you to embrace the opportunity that comes with them – the opportunity, particularly, to develop policy approaches that will lift the economy's supply potential – in the dimensions of productivity and participation – to improve the wellbeing of the Australian people on a sustainable basis. We have the capabilities and values to deliver on our mission.