

Welcome to the East Asian Bureau of Economic Research (EABER). EABER aims to be the premier East Asian economics research forum and provide a single point of reference for the economics, finance and governance research community throughout the region and beyond. Through building research capacity and partnering initiatives, EABER facilitates the creation of high-level analysis and forward thinking on issues of importance to the East Asian economy.

### Institutions for enhancing economic policy performance

Dr. Philippa Dee\*

Economists often take a static view of economic policy and institutions. They identify the strengths and weaknesses of current policy, and the institutions that implement policy. They use economic theory to identify optimal policy, and institutions to implement it. When the optimal is not attainable for various reasons, they identify better policy and institutions.

#### Policy institutions

A dynamic view of economic policy and institutions needs to take an interest in how to get from current policy and institutions to better ones. This raises three subsidiary questions. How does the economic policy making process work? What stops better economic policies being adopted? And what institutions could lead to better economic policy making processes?

Ideally, the policy making process should allow for a careful analytical review of the following issues before policy decisions are made. What is the problem being addressed? What are the objectives? What are the policy options? What is the impact of each option on all stakeholders — business, consumers, government, and the community as a whole? What is the recommended option? What is the strategy to implement it? What adjustment assistance is required? Often such careful analysis is bypassed when there is seen to be an urgent need to do something. But careful prior review can make an important contribution to better economic policy making.

#### Policy review

Ideally, such policy reviews should be undertaken by institutions that (a) are independent, (b) take an economy-wide view, and (c) use review and consultations processes that are transparent.

Reviews cannot be effective if the reviewing agency is formally bound by current government policy, as line government departments are. Nor can they be effective if the reviewing agency has a strong implicit stake in the status quo, as regulatory agencies often do. An economy-wide view is required to ensure that the interests of incumbents and those with a stake in the status quo (including some regulatory agencies and line government departments) are balanced against the interests of those with a stake in policy change (upstream or downstream producers as well as consumers).

#### Independence and transparency

Transparent processes are critical, for several reasons. Holding public consultations during the policy review exposes the special pleading of vested interests. It also bolsters the ability of at least some countervailing interests to marshal against those vested interests, helping to ensure an economy-wide view. To a large extent, it can relieve the government from having to marshal those countervailing interests itself. Finally, the public release of a review document and its recommendations can make clear to the press and the general public how the various interests have been balanced for the best outcome for the community as a whole.

If an ideal policy making process involves these elements, what stops better policies being adopted? There are at least three reasons.

The first is that governments do not know what is best (or better) practice. This suggests that governments need help in undertaking careful policy reviews in order to identify best (or better) practice.

The second reason is that governments do know what better practice is, but face political resistance from vested interests. This suggests that governments need help in undertaking careful policy reviews in order to marshal countervailing interests.

### Paper of the Month

The paper of the month for December is **E-Finance Development in Korea** by **Dr Choong Young Ahn and Dr Doo Yong Yang**

### Upcoming Events

**Advancing East Asian Economic Integration:** The Institutional and Financial Foundations of Economic Growth and Integration in East Asia

**Date:** 22-23 February 2007

**Location:** Bangkok

**Hosted by:** The Fiscal Policy Research Institute, Ministry of Finance, Thailand and the Australian National University, Canberra.

**Institutional Strategies for Improving the Micro Economic Policy Foundations**  
Country Policy Meetings

**Jakarta:** 12 December 2006

**Kuala Lumpur:** 14 December 2006

**Hanoi:** 15 December 2006

**Tokyo:** 26 February 2007

**Beijing:** 27 March 2007

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The third reason is that governments do not want better practice, because they benefit from the rents created by bad policy (government is a vested interest). In this case, government-sponsored policy review institutions are likely to be sidelined or stillborn, as appears to have happened with the National Economic and Development Authority in the Philippines. But there is still a role for private or otherwise independent institutions to point out the costs of current policies, and to marshal countervailing interests for reform.

#### *Removing resistance to reform*

Independent policy reviews can help deal with vested interests in a number of ways. First, they can help set the agenda — policy change will not happen if nobody talks about it. Reviews can also set the parameters of the debate. The analysis in such reviews may be contested and thus controversial, but if it establishes a framework that takes into account consumer and other countervailing interests, it makes it much harder for these interests to be ignored. Reviews can also help to depoliticise a debate. Most governments will find it useful on occasion to take the heat off an issue by referring it for independent, objective study. Reviews can 'name and shame' the recipients of special deals. They can marshal countervailing interests, helping to build a coalition in favour of reform. They can identify policy combinations that lead to a so-called Pareto improvement, where at least some are better off and nobody is worse off. This helps to build a grand coalition for reform.

Independent, transparent, economy-wide policy reviews have a role in helping to build a pro-reform consensus outside of government. But governments with an economic reform agenda also have to build consensus within government. Good processes of policy coordination are required to ensure that all relevant ministries are consulted. Mechanisms are also required to ensure that final decisions reflect the public interest, not just narrow sectional interests. One such mechanism is to provide the coordinating

role to an agency that has broad, horizontal portfolio responsibilities, as has happened through the Council on Economic and Fiscal Policy in Japan. Arming such agencies with high-quality, independent policy reviews can also strengthen the public interest during the coordination process. Finally, mechanisms are required to ensure that coordinated decisions are abided by. A threat of budgetary sanction is one mechanism. Threat of exposure through ex post reviews is another.

#### *Getting a mandate for reform*

In all political systems, governments require a mandate of some sort, but a key question is how that mandate is cultivated. At one extreme, an elected government with a comfortable electoral margin could choose to implement an economic reform agenda in a 'crash through or crash' style — simply implementing reforms until the cumulative opposition from vested interests or public opinion erodes their electoral margin. Alternatively, they could attempt to influence the terms of the debate.

A reform program that makes provision for independent policy reviews may be slower than a 'crash through or crash' program. But it is likely to be more sustainable in the longer term. This is because public and transparent processes of policy reviews do not just identify reform options, they help 'sell' them in the face of opposition from vested interests, overly simplistic public and perhaps bureaucratic or political and Ministerial sabotage.

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