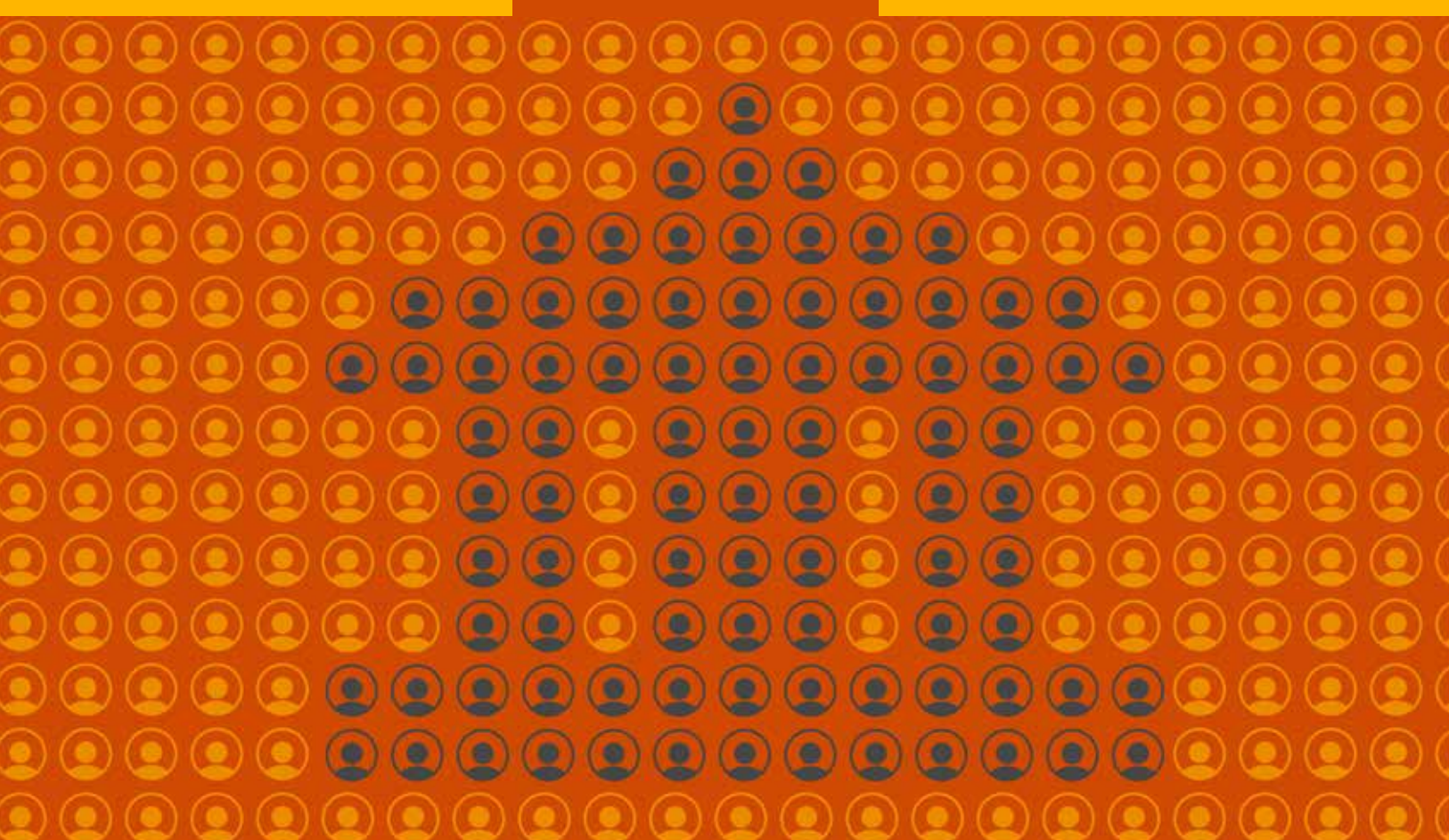


Government

Matters

Edition 1

March 2019



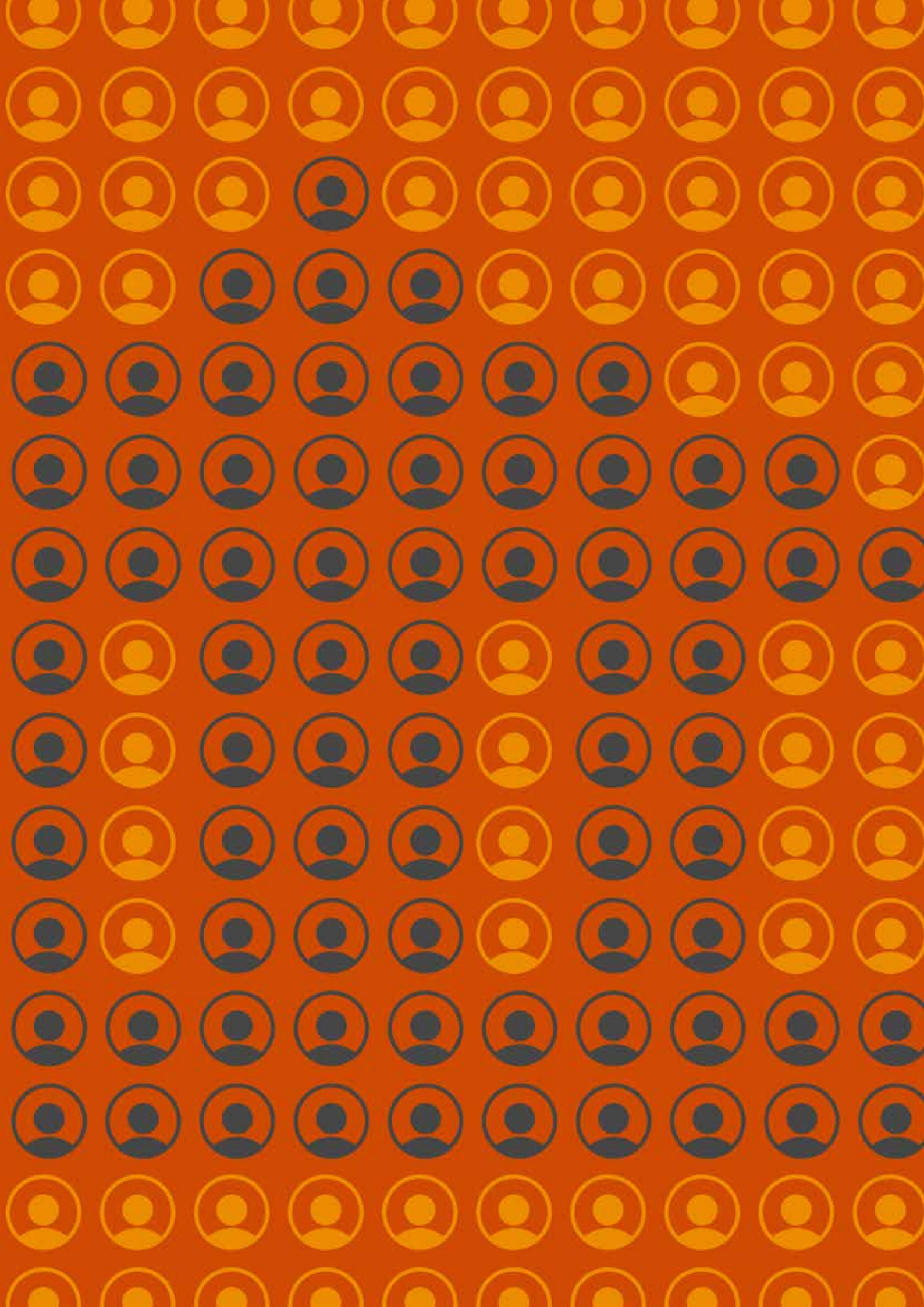


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Foreword

“ Welcome to the first edition of PwC’s new government focused publication “Government Matters”.

We hope this publication will showcase the incredible work that both politicians and public servants are doing in this country to deliver value to citizens. At the same time we hope to demonstrate that important problems are better solved together. PwC is a powerful multiplier of connections and innovation, we bring technology and passionate people together so that insights become impact, opportunities become outcomes and society benefits. We call this, The Together Effect.

In this first edition we cover a range of topics. From how changes in global trade decisions will impact Australia to how behavioural science could impact future regulation in the financial services sector.

We also asked our data and analytics teams to investigate the changing nature of our cities as well as develop a research study into trust in government institutions.

Your feedback is greatly appreciated, so please don’t hesitate to contact me with any comments or suggestions for future editions.

Thomas Bowden

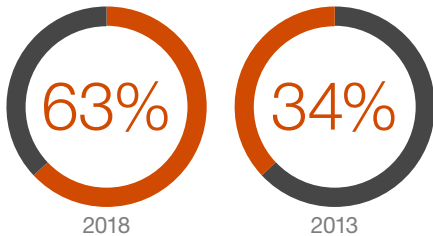
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1

Earning and sustaining citizen trust

by Diane Rutter and Victoria Yates

Earning and sustaining citizen trust



Declining citizen and customer trust is a growing concern for government and businesses alike. Five years ago PwC's CEO Survey found 34% of Australian CEOs were concerned about a lack of trust in business, a stark contrast to our most recent 2018 findings showing 63% rating trust as a major issue. But why is trust important, what makes it a critical force for government success, and where do we begin to build it?

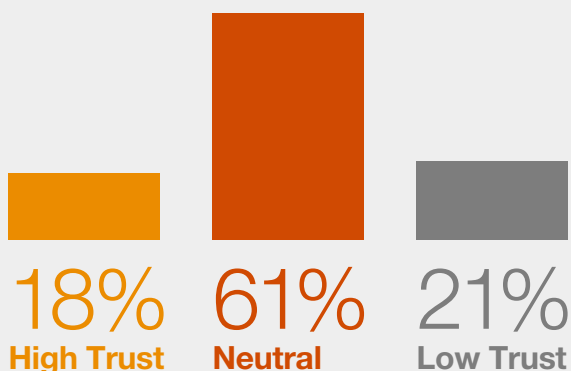
Trust is central to wellbeing

Trust is the cornerstone for any healthy relationship. Without trust, humans are hesitant to share, participate, collaborate, or believe the information they are provided. Interactions with government often relate to important life moments that are central to our sense of wellbeing - financial, social, mental and physical. Whether citizens are starting university, adopting a child, renewing a visa, or lodging a tax return, they need to have trust in the government organisations they are dealing with in order to feel safe, secure, confident and supported.

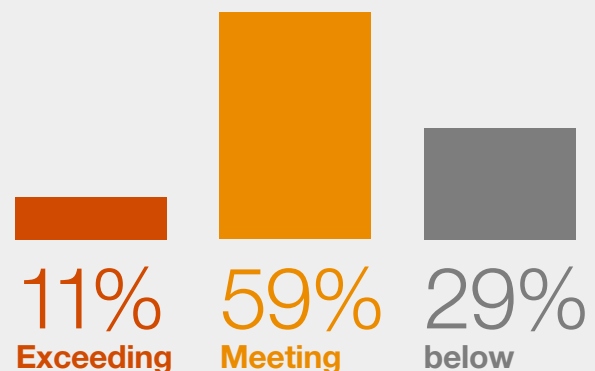
This trusted bond is critically important to maintain. When trust is broken, fear sets in and we no longer feel we are in safe, reliable hands. Rebuilding trust presents a significant challenge; often taking years of continued positive action to restore. If citizens do not trust governments, it becomes harder for government policies to succeed – policies that exist to support the very wellbeing of the citizens they are designed to benefit.

Australians are generally neutral in their feelings of trust towards Government

To what extent do you trust Australian government institutions?



To what extent are government institutions meeting your expectations?



December 2018

For government success, the trust deficit must be addressed

If citizen trust is a key driver for the success of government, current data suggests we are at a crucial time for action. According to the Edelman Trust Barometer, trust in government around the world fell to record lows in 2018, and although modest increases have been reported in the 2019 study, citizens around the world are struggling to trust that their governments are working in their best interest.

PwC's Centre for Citizen Research recently¹ surveyed 500 Australians to gauge current levels of trust in government (state and federal). A key finding of the research is that less than one third of Australians trust government, and the vast majority are neutral in their trust (neither trusting nor distrusting). This finding is supported by the results of the 2019 Edelman Trust Barometer

study which found that while trust has grown for all organisations (NGOs, Government, Business and Media), government remains in 'distrust' territory amongst the general population.

To effectively implement the scale of change and reform that will be required for the growing Australian population, government needs to focus on rebuilding trust. When it comes to the legitimacy and impact of our political system, ease of doing business, sustaining a healthy and functioning democracy and consequently the wellbeing of citizens and society, trust is the number one driver. Yet, despite, or perhaps in spite of its importance trust continues to be seen as confusing, ambiguous and ill-defined.

Understanding the drivers of trust

What are the drivers of trust, and where should government be focused to build trust?

Through research and practice, PwC has found two sets of drivers are important to understand, establish and grow trust in government - the micro-interactions such as the provision of services to citizens and the macro-interactions; such as policy making and communications that drive perceptions.

Micro-level drivers of trust: experience and expectations

At the micro-level, trust is driven by the competence of government and the experience of interacting with government ('experience trust'). It is the interactions that citizens have with government that impact their everyday lives.

The major drivers of experience trust are dependability and accountability in service delivery. They are of equal importance and are shaped by the ability of citizens to rely on government to be responsive to their needs, resolve issues in a timely and efficient manner and to use personal data responsibly.

“ I think they (government organisations) sincerely want to help people who really need it and have done so in times I have needed them”

- Survey participant

The recent research confirms citizen satisfaction with service delivery experience is directly related to their level of trust and advocacy in government. The research also supports that satisfaction and by association trust is driven by the extent to which experiences exceed, meet or fail to meet expectations. As citizens become more connected, educated and empowered, their expectations of experience and performance rise. When governments are not equipped to meet those expectations, trust begins to erode.

“ [I don't trust some Government Institutions] because they continuously fall short of public expectations of service and complaint resolution”

- Low trust citizen

Macro-level drivers of trust: values and perceptions

At the macro-level, trust relates to political institutions and the functioning of democracy - or policy making - the ability of governments to manage economic and social issues, and to generate positive expectations for future well-being ('values trust'). It relates to the degree to which citizens share common values, align with the social purpose of the organisation and identify with the way government organisations conduct themselves and deliver overall economic value for the country.

“ I don't trust some government organisations] because they are only interested in their own agendas instead of helping the general public”

- Survey participant

The major drivers of values trust are centred around transparency, honesty and fairness. These drivers work together and are shaped primarily by macro perceptions around ethical decision making, fair citizen treatment and the extent to which public interests are valued over self interest. Values trust is also influenced by broader and sometimes extraneous factors such as word of mouth, brand perception and media.

Summary

What can you do now to start building trust?

All areas of government have a significant opportunity to build trust. Doing so will require a series of intentional actions, interventions and symbolic activities tailored to improve both the experience trust and values trust.

Increasing experience trust requires designing and delivering the customer experience with trust in mind - with a particular focus on designing for dependability and responsiveness. Importantly, as citizens access multiple services for a multitude of reasons, the focus needs to be both vertical (within an organisation) and horizontal (across organisations) to ensure consistency across the board. Specific opportunity exists to better align experience with expectations around:



Effortless access

Making it easy for citizens to engage through their preferred means of communication at their preferred time (e.g. easy to use mobile apps, after hours phone services). To achieve this requires a deep understanding of how customers want to engage and adopting a continuous improvement mindset to service operations.



Connected services

Improve information sharing between services so that citizens accessing multiple services in response to a particular circumstance or life event have a more seamless experience. Public and private sector organisations should work together to solve customer pain points by improving the overall journey experience end-to-end; not just the component parts.



Responsiveness

Trust cues should be designed and hardwired into the customer experience, for example accelerated pathways for urgent cases or 24 hour return call policies. Keeping customers informed of progress is critical and employees should be empowered to resolve customer issues end to end, rather than just their part of the process.

Increasing values trust requires a focus on decisions and conduct, both experienced and perceived. Integrity, fairness and honesty is assessed broadly and has many tangible and intangible influences. Specific opportunities to build values trust include:



Behaviours

Work in true partnership with citizens; co-design and collaborate with them in the development of policy and services and ask their feedback to continuously improve.



Mindset

Put citizens at the heart of business cases; focussing on how every dollar spent will bring value back to taxpayers and improve the lives of citizens very tangibly.



Communication

Build citizen awareness of what government is doing to improve trust and translate this into what it will mean for them - in the same way a private organisation communicates to investors. Provide progress updates to ensure expectations are aligned with reality; be honest about what is working, what hasn't worked and what is going to change.

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Workforce Planning in the Public Sector: Balancing capability and affordability

by Ben Neal and Stephanie Waddon

Introduction

The workforce of the future will look significantly different to today; effective workforce planning will be essential to enable a successful transition.

The public sector is experiencing unprecedented levels of change. Shifts in technology, workforce demographics, pressure on staffing budgets and expectations of how citizens and businesses interact with government are all shaping the workforce of the future.

More people expect digitally-enabled services, and government departments and agencies need to work in an agile way to effectively meet these expectations.

Many organisations are embracing the challenge, building partnerships with each other and industry to ensure future success. Yet limited insights into current workforce capability and future requirements often impede these efforts. PwC's 21st CEO Survey¹ found that 79 per cent of Australian CEOs are concerned about the availability of key skills.

Investment in activities that affect the here and now is understandable, but a more strategic view of threats and opportunities will help bring the future into focus.

To determine future workforce skill and capability requirements, we need longer planning horizons, and alignment between strategy choices and workforce implications.

Unreliable workforce data and limited analytics capabilities result in executives resorting to simplistic measures of success. For instance, remaining within workforce caps demonstrates an ability to manage staffing numbers but shows no initiative to build capability for the future. Having the right number of staff can't be the only important issue. Shouldn't we consider the mix of skills and capabilities too?

Shaping the future of the public sector workforce requires us to look past the current standard to consider how workforce affordability and capability is valuable to the business.

A mature approach to strategic workforce planning and the development of meaningful people analytics will equip executives to make informed and effective decisions about their workforces for the long term.

Trends affecting the workforce



Technological breakthroughs

Rapid advances in technological innovation



Demographic shifts

The changing size, distribution and age profile of the world's population



Rapid urbanisation

More people moving to live in cities



Shifts in global economic power

Power shifting between developed and developing countries



Resource scarcity and climate change

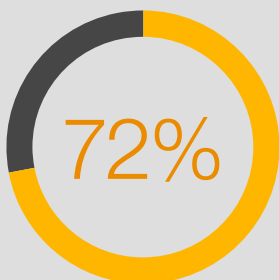
Extreme weather, rising sea levels and water shortages

PwC Workforce Planning Survey

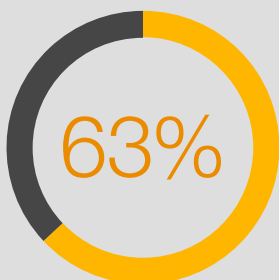
Progress in workforce planning is slow because most organisations focus on short planning horizons.

highlights²

The impact of future workforce requirements, demand drivers and external trends needs attention.



...of respondents were not satisfied with their ability to **predict future workforce needs** to deliver the right people, at the right time, at the right cost.



...of respondents felt that their existing strategic workforce planning approach did not adequately take into account or address the possible impact of **external future workforce trends**.



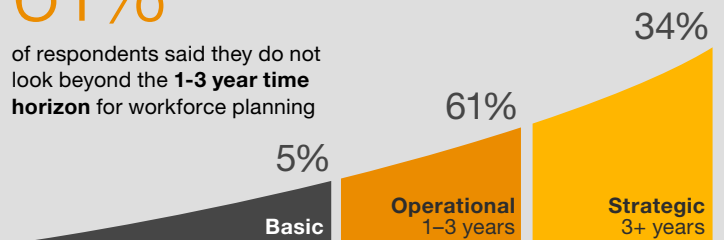
...of respondents did not understand their organisation's workforce **demand drivers**, or have strategies in place to **address critical capabilities**.

Planning can be improved and stretch beyond the three-year horizon.

53% of respondents were confident that workforce planning **enabled** delivery of the **right talent**.

61%

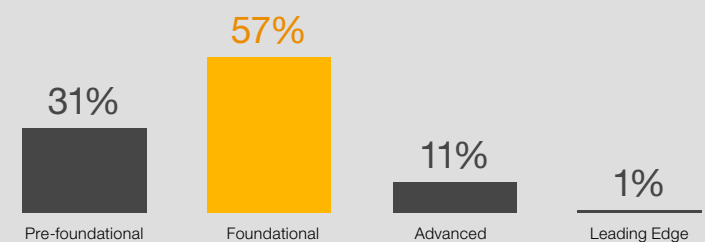
of respondents said they do not look beyond the **1-3 year time horizon** for workforce planning



Using data and analytics to inform the workforce planning approach

57%

of respondents said they were operating at a **foundational** level of maturity, which involves basic core HR analytics, tools, metrics, analysis and simple dashboards.



Data integration governance:

70%



have a manual data analytics process and disparate data sets, which increases manual errors and lowers data confidence.

People capability:

73%



believe that their analytics function is under-resourced, and doesn't have a sufficient level of analytics capability to deliver insights.

Analysis was mostly retrospective:

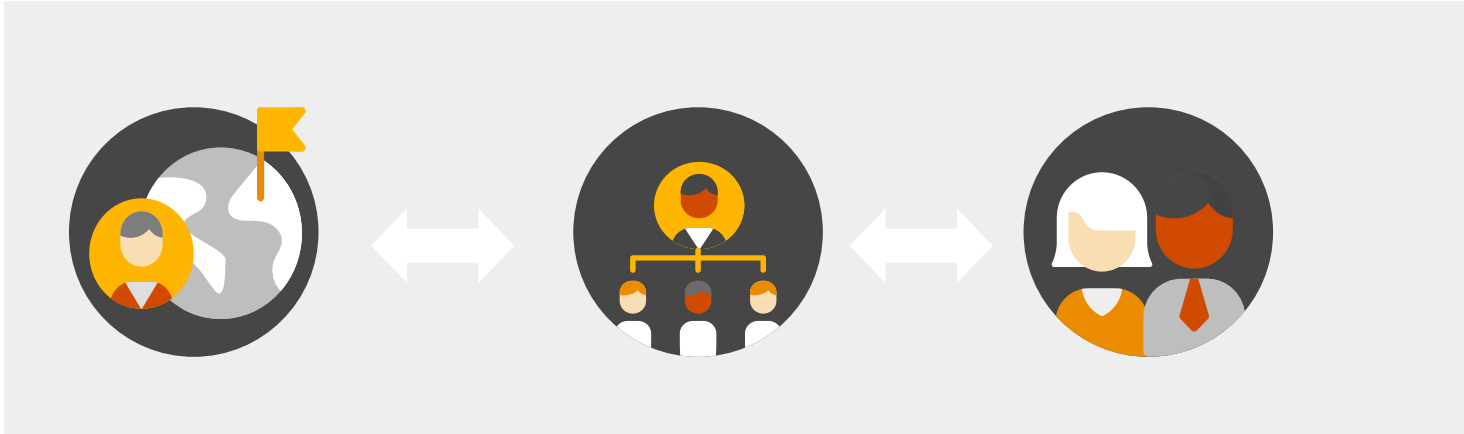
70%



focused on retrospective (what happened?) rather than future focused (what will happen and what should we do?).

Implications

Without an appropriate focus on longer-term, strategic workforce planning, the impact will be broader than localised workforce challenges.



Organisations

Leaders need to consider what capabilities will be required in the future and have firm plans for how they will build, buy, or borrow talent to ensure they can deliver against strategy.

Workforce planning is an essential part of an enterprise planning approach, but only 53% of respondents were confident that their current practices were enabling the delivery of the right talent at the right time².

Competition for the right talent remains tough. Without an appropriate focus on scenario planning and impact modelling, organisations could fail to consider a range of external and internal drivers, increasing their workforce risks.

In lieu of a clear plan, organisations continue to make short-term decisions based on affordability, without considering long-term capability requirements.

Employees

In one way or another, all roles will be affected by change over time — the question is to what degree can this be effectively managed to minimise negative effects on the workforce.

Digital transformation will profoundly affect the types of roles, business processes, customer behaviours, and ways of working within our organisations.

Leaders must ensure their workforces are future-ready. By developing a clear understanding of their current and future workforce capability, they can determine the workforce gaps and implement strategies for skills development.

Reassuringly, survey results indicate employees are ready to transition and open to enhancing their skills, with 74 per cent of respondents saying they are prepared to re-train to remain employable in the future².

Citizens

The public sector is under increasing pressure to deliver effective and affordable citizen-centric services, and organisations must evolve to more agile and innovative ways of working.

Key to success will be determining the core capability an organisation requires to be successful, and effectively training, mobilising, and motivating that workforce.

Leaders must decide what capabilities they will build themselves and what they will buy from the market. Each role should have a career pathway showing how people can be retrained and redeployed, ensuring sustainable employment options as roles are affected by change.

By taking this approach, organisations can continue to deliver high-quality services to citizens as the world around them changes.

Opportunities

Effective workforce planning requires a focus on internal and external factors

Focusing on workforce capability, not just affordability



Increasing or decreasing the size of a team to achieve budgeted staffing levels is too simplistic: there must be a focus on critical capabilities.

Essential questions to ask are:

- How will the organisation's strategy or operating model change over time?
- How will this affect workforce demand in the short, medium and long term?
- What are the identifiable and material gaps between supply and demand for critical skills and capabilities?

Plan for the future through workforce scenarios



- The public sector can better position itself for the future through a variety of workforce solutions
- Leverage 'what-if' scenarios and determine workforce capacity and capability implications for each
- Scenarios show the resultant talent gaps when different events occur and when workforce decisions are made
- Consideration of various potential future outcomes is a key enabler for business leaders and decision makers

Managing the total workforce



- Across the public sector, traditional silos continue to exist within HR and Finance
- Both public servants and contractors need to be considered in determining workforce supply
- Agile workforce practices will mean organisational effectiveness relies on the ability of a blended workforce to come together to solve complex problems regardless of individual employment arrangements

Start from where you are...

To mature your workforce planning capability and look further to the future, we recommend taking action across four activities

Align business strategy and capabilities to your workforce strategy



Workforce planning should be done alongside business planning in a 'two track-process'. One is operational and aligned to business and budget planning, and the other a longer horizon, data driven, strategic sweep that accounts for seismic shifts in workforce supply and demand.

The second track must forecast the impact of changes in the environment including technological, generational and cultural, and define the required future workforce to meet these challenges.

Look for iterative improvements to your workforce planning process



For organisations with workforce planning processes in place, analyse the strengths and weaknesses of your approach and look for opportunities to improve.

The key is to concentrate less on cyclical workforce planning processes, and more on continuous improvement to the overall approach. Value comes from embedding processes, measuring outcomes, digitally-enabling the process wherever possible, using better data, and building your workforce planning capability.

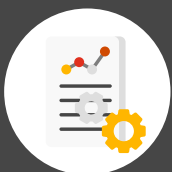
Accelerate development of critical capabilities



Once you have identified capability and capacity requirements, a tactical approach is essential to accelerate the development of critical capabilities. This means having a robust action plan in place to build, buy, or borrow to address capability gaps.

Successful organisations accelerate the development of critical capabilities to maximise investments—and carefully consider the breadth of available reskilling, upskilling, and employment models.

Build confidence in your data to power your people decisions



Data-based insights can tell you a lot about your people and drive better decisions at every level. However, data is rarely harnessed and taken from analysis to action.

HR needs to lead the change in building confidence in data across the employee lifecycle. With the right data, you can create simple but powerful models to scenario plan and predict future needs.

Build from there and deliver sustainable change over time

Understanding your workforce planning capability is essential to improving it

So how do you move beyond operational to strategic?

Investment in building organisational capability is key to enable data-driven decisions, and equip your organisation to meet future challenges.

Understanding how you compare and how you can get to the next level will help build your workforce planning maturity from operational to strategic.

A shift from operational to strategic workforce planning won't happen overnight. It is a critical business capability that must be developed and built over time.

With commitment, support, and a focus on improving the approach and alignment to strategic planning, improvements can be made that will enable business strategy and increase workforce agility.

To bring your workforce planning capability to life, we recommend that you position your leaders to respond

Workforce planning cannot be seen as only HR's responsibility. HR is the natural custodian of the approach, but for strategic workforce planning to be effective it must be owned by the business. Leaders are typically inexperienced at this activity. Maturing organisational effectiveness will require a combination of building both a technical centre of excellence to design and govern the enterprise approach, and leadership effectiveness in data-driven decision making. The development of localised workforce strategies and agile workforce management of increasingly blended workforces will also be critical to success.

Empowering your leaders to take ownership of their workforce affordability and capability challenges and holding them to account for the outcomes of their decision making are tangible levers that organisations can pull to ensure that leaders across the enterprise work together to make informed decisions that consider the impact on government, employees, and society as a whole.



Summary

The future does not need to be feared, merely planned for

What should you do now to help anticipate impending change?



Where do you want to be?

Look beyond the three-year horizon: what role does your business serve in five to ten years?

How do your people deliver this?



How can you get there?

Do you know what changes you need to make?

How will you align the affordability concerns of today with the capability needs of tomorrow?



Is your workforce planning up to the task?

Are you confident you have the internal capability to create a joint agenda between finance and HR?

How are you engaging with your people to design 'best-fit' initiatives and drive lasting change?

There is no doubt that the workforce of the future will look very different to the one we see today.

And workforce planning is no longer only for select organisations with unique operational requirements.

To ensure you are on the front foot to meet this change, no matter what size or focus your organisation or department has; we recommend you use strategic workforce planning to guide your talent strategies, and plan affordable workforces without compromising on capability.

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3

Can a trade war be won?

by Jeremy Thorpe, Mark Picton and Luke Branson

Can a trade war be won?

Since the end of World War II the world has been on a path of trade liberalisation, with the reduction of tariffs a core tenet and facilitator. The World Trade Organization, which supplanted the post-war General Agreement on Tariffs and Trade in 1995, now counts 151 countries as members and another 32 governments have applied for membership. However, the ongoing US-China trade dispute is undermining the existing multilateral trading system and dramatically changing the state of play.

The critical question in this unprecedented situation is: can a trade war be won?

Many Australians have not lived through a recession or a trade war

While global trade agreements have stalled, Australia has continued to push for freer trade through regional and other multilateral and country-specific trade agreements. This enthusiasm for freer trade reflects that:

78-95%

Internationally-engaged Australian businesses take a favourable view of Australia's trade agreements, and trade liberalisation, with exporter adoption of Australia's free trade agreements ranging between 78 and 95 per cent.¹



↑ \$8,448

Australian households have benefited from trade liberalisation, with real per household income increasing by \$8,448 over the past three decades.²

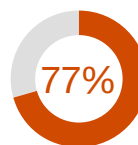
Within this context of freer trade, it can be hard to calculate how a trade war might impact on Australian businesses and governments.

Many of Australia's major export sectors will be affected

A trade dispute between the US and China has obvious ramifications, both positive and negative, for a range of Australian industries.

Resources

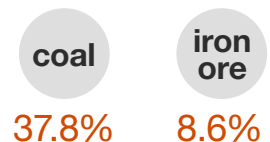
The US imposition of tariffs on steel and aluminium products will affect key Australian iron ore and coking coal customers: China and Japan. Given China's status as Australia's number one destination for resources exports (51 per cent), any reduction in China's growth as a result of the trade war could potentially impact on Australian miners.



Given that an estimated 77 per cent of Australian exports to China are consumed in the domestic market, one might expect that Australian iron ore and coal exports would be insulated from the effects of US tariffs; however, this view doesn't take into account the broader application of the US tariffs on steel products sourced from:

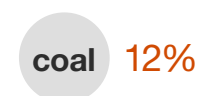
Japan

which imports 37.8 per cent and 8.6 per cent of Australia's black coal and iron ore respectively



India

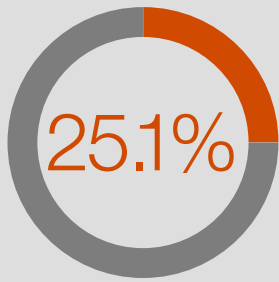
which imports 12 per cent of Australia's black coal³



South Korea

which imports 6.2 per cent of Australia's iron ore⁴





China accounts for 25.1% of export demand for Australian wine



\$32.2bn

Australia's 3rd largest export in 2017 was education worth \$32.2 billion



3.2% → GDP

4.9% →



Tourism contributes 3.2% to our GDP and 4.9% to Australian employment

Agribusiness

Australia currently exports 25 per cent of our rural produce to China, which remains our largest agriculture, forestry and fisheries export market. Should China further increase tariffs on the US, this would create pricing advantages for Australian agribusiness and see it gain further traction in China after earlier successes gained by the introduction of the China–Australia Free Trade Agreement.

Demand for Australian wines and grains may also grow following Chinese retaliation against US imports of wine and soybeans. China accounts for **25.1 per cent of export demand for Australian wine**.⁵ Any decline in US wine sales in China could therefore reap benefits for Australian producers.

Tourism

Tourism contributes 3.2 per cent to our GDP and accounts for 4.9 per cent of Australian employment.⁶ It's important that our tourism sector remains well insulated from the trade war.

Australia benefits handsomely from Chinese tourism thanks to their burgeoning middle class eager to spend money. Each tourist from China is worth \$8,000 to the Australian economy, 60 per cent more than the average tourist.⁷

As such, any reduction in Chinese tourist numbers, due to falling economic growth or otherwise, could heavily impact on Australia's economy.

The US tourism industry by contrast, is already suffering from the trade war:

- Chinese bookings to the US are nearly 10 per cent behind last year's numbers, compared to an upwards trend of 5.5 per cent worldwide.
- Group travel (six or more visitors) to the US from China in 2018 is down 34.4 per cent compared to 2017 levels.⁸

This reduction is not only due to a falling yuan, but also from Chinese government warnings about travel to the US.

Education

Education-related services (which includes tuition and living expenses) was **Australia's third largest export in 2017, worth about \$32.2 billion**. Chinese students accounted for nearly 30 per cent of Australia's international student enrolments in 2017, which is more than double the next biggest cohort of international student enrolments in Australia (India, 11 per cent).⁹

Even without any overt Chinese pressure on students not to study in Australia,¹⁰ if a trade war causes the yuan to fall it would weaken the purchasing power of the Chinese middle class and hence lower enrolments in Australia.

To understand the aggregate impact, it is necessary to appreciate the specific structure of the tariffs

While it is relatively easy to identify the likely major impacts on Australian exports as outlined above, the exact impact on global trade is shaped by the interaction of a number of factors:

- **The disparity of trade between the US and China.** The US is significantly less reliant on exports to generate wealth than China. Therefore, it is more likely to be able to sustain a decline in exports without domestic repercussions.
- **Products to which the US has applied additional tariffs.** So far, the US and China are applying tariffs to products of relatively minor importance to Australian exporters and so any effects are less likely to be felt directly.
- **The countries excluded from the imposition of US tariffs.** The exclusion of other countries has a significant impact on Australia's economic position. For example, exclusion of Australia from US tariffs is unambiguously beneficial for Australian industry, and Australia is better off if Mexico and Canada are included in the tariff net.
- **The degree of retaliation by China.**

The sensitivity of exports to US tariff decisions is shown in the following table. Somewhat surprisingly, our modelling shows the pattern of tariffs applied by China and the US, and our exemptions from US tariffs, means that Australia may benefit from the current evolution of the US-China trade war. Equally, the scenarios demonstrate that the impacts of small changes to the tariff categories and exclusions can easily swing from positive to negative.

Long-term annual impact of different tariff arrangements on exports (A\$ million)

	US-imposed tariffs	US	China	Australia
Scenario 1	Chinese Steel 25%	-403m	-644m	-45m
	Chinese Aluminium 10%			
Scenario 2	Steel (most countries) 25%	-1,723m	-372m	177m*
	Aluminium (most countries) 10%			
NAFTA, Australia, Korea and some South American countries excluded				
Scenario 3	Steel (most countries) 25%	-1,005m	-482m	542m*
	Aluminium (most countries) 10%			
Australia, Korea and some South American countries excluded				
Scenario 4	Steel (all countries) 25%	-2,459m	773m	-183m
	Aluminium (all countries) 10%			
Scenario 5	Current US tariffs (including NAFTA)	-16,784m	-6,931m	1,134m
	Chinese and other retaliation			
Scenario 6	Current US tariffs (excluding NAFTA)	-17,530m	-6,836m	780m
	Chinese and other retaliation			

* In this scenario the modelling probably overstates the benefits to Australia. A limitation on this simulation is that the US excluding Australia, Korea and some South American countries appears to be predicated upon 'voluntary limits' on their exports to the US. Positive results for East Asia and South America are strongly driven by their gains from relatively better access to the US metal markets.

Comments

China and the US: substantial losses

Australia: notable loss (exports increase overall [including steel and aluminium], but as China is a major customer for inputs into the affected products, US tariffs reduce price and amount of Australian exports of minerals and coal)

Other countries: better placed to gain as purchasers of those inputs or sellers of the outputs

US: significant damage to economy (despite increasing and reallocating the losses globally, tariffs are a tax on domestic consumers and industrial users)

China: less damage (some US competitors also now subject to tariffs; those major suppliers excluded from the tariff are effectively protected from competition)

Canada and Mexico: greatest loss as previously subject to zero tariffs

Australia: gains due to terms of trade improvements (import prices decline more than export prices)

Across the board: exports for all countries fall, creating disruption

NAFTA partners: significant losses

Latin America: significant losses

China: gains (tariff increases are relatively smaller)

China and the US: most damaged as the main imposers of tariffs

Australia: benefits reduced with exclusion of Mexico and Canada from US tariffs

The critical question for legislators and regulators:

Policy makers should not be complacent about this modelling that shows Australia as a winner from the current trade dispute. Australia has done well in an international environment of expanded global trade under the umbrella of the WTO, and a disruption could harm the country in ways beyond the immediate impact of tariffs.

We should never be advocates of countries seeking to raise tariffs and impose other trade barriers, but we should equally be open to the possibility that some trade skirmishes provide Australian firms with real opportunities to step forward for their own benefit, and the country as a whole.

Who wins and loses from a US-China trade war is a dynamic question, shaped by the actions of governments (and their advisers), as well as individual organisations.

In a trade war, government need to understand that businesses face a myriad of choices about:

- managing currency risk
- supplier choice and diversification
- customer and market diversification
- domestic and international supply chain optimisation
- anti-dumping
- dealing with counterfeiting
- marketing

Governments have direct roles in a number of these decisions (e.g. as regulator and trade negotiator), but needs to be active to understand how business is responding, or not responding, to position us to weather a trade storm.

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4

How can behavioural science support better regulatory design?

by Jeremy Thorpe and Jason Collins

How can behavioural science support better regulatory design?



The Financial Services Royal Commission has made headlines for many reasons, not least the implications for immediate legal actions against sector participants, pressure on financial regulators to step up their game, and changes to regulatory arrangements in the finance sector.

Beyond the immediate challenge to the financial sector status quo, the most far-reaching impact of the Commission may ultimately be its nuanced challenge to regulatory orthodoxy in Australian legislatures and regulators. This article explains how the implications for the financial sector might play out.

The traditional framework for regulatory design

It is each legislature's prerogative to pass laws as they see fit. However there has been an acceptance, at least at a bureaucratic level, since the mid-1990s following the Hilmer Review, that government interventions in markets should generally be restricted to situations of market failure and that each regulatory regime should be directed at the relevant market failure or failures.¹

This is built on the principle that, as a general rule, efficiency is maximised when markets are allowed to operate unhindered. However, when a market fails, this can create a legitimate reason for government to step in and correct the failure.

A market failure exists 'where the characteristics of a market are such that its unfettered operation will not lead to the most efficient outcome possible'.²

There are four commonly accepted situations in which market failure exists:



Externalities (sometimes called Spillovers)

When an activity or transaction has positive (benefits) or negative (costs) welfare effects on others who are not direct parties to the transaction.



Public goods

Where provision of a good or service for one person means it is available to all people at no additional cost (i.e. they are non-excludable and non-rivalrous).



Severe information asymmetries

Where producers have information that consumers do not. It should be stressed that 'There is nothing unusual about the asymmetry of information available to a supplier and a consumer. Many products are complex, difficult to compare, have considerable importance for the wellbeing of consumers or are provided over a long period of time.'³ A market failure can be said to exist only when the information asymmetry becomes so severe as to distort actual market outcomes.



Natural monopolies

Where it is more efficient for one firm to supply all a market's needs than it would be for two or more firms to do so.

The presence of a market failure is a necessary, but on its own insufficient, condition of government intervention. Government involvement in markets can lead to costs and inefficient outcomes. In assessing policy instruments to deliver the most appropriate and effective response to a specific market failure, it is necessary to ensure the least restrictive option is implemented and unintended consequences are limited.

The rise of information disclosure as a regulatory tool

While not every information asymmetry or externality needs a regulatory response,⁴ governments have increasingly turned to mandatory information disclosure to address perceived market failures.

This approach is primarily useful in situations where an information asymmetry means one party (usually the consumer) has insufficient information to make an informed decision on the relative quality of the products on the market.

Hence, we have seen information disclosure used in a range of different environments, including health, financial services and education.



Health

In a health context, information disclosure is used to:

- distinguish between healthy and less healthy options (e.g. the Health Star rating on packaged food products; the number of standard drinks in a bottle of alcohol; the kilojoule food-labelling scheme)
- issue blunt health warnings (e.g. on cigarette packaging).



Financial services

In financial services, information disclosure is currently used in:

- standardised 'comparison rates' for advertising home loans
- product disclosure statements alerting prospective customers to the costs, significant benefits and risks, and fees and charges associated with a product.



Education

In education, standardised information about every school is available on the MySchool website.

The expectation is that such disclosures will inform consumers directly, or through third parties that collate the information in a usable format (e.g. comparison websites), enabling them to make better decisions.

The risks highlighted by the Royal Commission

Information instruments work in a relatively indirect manner – essentially changing behaviour through more informed decision-making. However, their effectiveness is limited by the extent to which consumers, and in some cases suppliers, act on the information provided.

Information instruments rely on consumers being willing and able to use the information as intended. In some cases, where relatively straightforward messages are being conveyed, it is likely that the majority of consumers will use the information correctly (e.g. warning labels on dangerous goods). In other cases, the information provided requires greater interpretation or background knowledge, and it is less certain that individuals will respond in the manner intended.

Evidence from the field of behavioural economics finds that individuals are not perfectly rational individuals with an unlimited capacity to absorb and process information. They are not motivated to continually update their knowledge on all issues relevant to their lives because of limited time and attention spans, and being faced with information overload on a daily basis.

In the financial services context, behavioural economics has found that individuals buying financial products are especially prone to making systematic errors in their decision-making.⁵

Therefore, it can't be assumed that individuals will always seek the best information in making purchasing or investment decisions or, equally, that they are able to judge what the 'best' information is.⁶

The Royal Commission has called attention to the fact that financial services have a number of characteristics that mean that an optimal outcome is not guaranteed by regulating information disclosure. As the Deputy Chair of ASIC notes, financial products and services:



are inherently complex and often require consumers to make important decisions



involve risk and uncertainty. Yet, as the UK financial services regulator notes, people are generally bad (even terrible!) intuitive statisticians and so are prone to making systematic errors in these decisions



represent extreme examples of 'credence goods', in that the quality may not be known for years or even decades after they are purchased. The consumer is obliged to take the product's value on trust since they may not possess the expertise to determine whether it has been appropriately supplied



include products that are infrequently purchased and so provide limited opportunity for feedback and learning.



often involve significant sums of money.⁸

What implications should policy makers consider in future regulatory design?

The Royal Commission explicitly challenged the overt reliance on mandated disclosure as a means of addressing market failures and, specifically, information asymmetries.

The critical question for policy makers is, if information disclosure can't be relied upon as a tool to ensure an adequate level of informed decision making, what is the alternative regulatory approach?

Clearly every market failure needs to be considered independently but what are we likely to see in the financial

services environment is a shift towards prescriptive product regulation. That is, rather than allowing financial service providers to do what they want as long as they disclose specific details in a certain way, the response is likely to mean increasing reliance on standardized features and default products. This has already been seen in the superannuation sector with the introduction of MySuper products.

Such an approach may reduce the risks for less-informed consumers as this simplification reduces the likelihood of consumer misjudgment.

There are at least three potential risks associated with such a shift in regulatory approach:

1. There is a risk of reduction in product innovation and alternative options for sophisticated consumers
2. Constraints on innovation may also restrict the development of innovative products that improve the wellbeing of less sophisticated customers by circumventing or better accounting for the customer's decision making processes
3. Regulation that restricts access to products on the grounds of protecting consumers (e.g. tighter income/expense verification for home loans) risks pushing people to the 'shadow banking' system where there is less regulation

These risks are likely to be considered as acceptable in both efficiency and equity terms in light of the behavior identified by the Royal Commission. However, the concern is that this changing mindset will be applied unquestioningly and the opportunities to use the lessons of behavioural economics to improve outcomes will not be taken.

Product disclosure statements can be more effective if they are:

<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">Standardised</div> <p>to make competing products easily comparable</p>	<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">Meaningful</div> <p>and well-presented using visual aids such as images and graphics to facilitate decision-making</p>	<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">Brief</div> <p>to avoid information overload</p>	<p>The current decision-making environments for financial services products therefore have considerable scope for redesign. The Royal Commission's findings now present a unique opportunity to redesign existing and new products to better work with how people actually behave rather than how we expect them to.</p> <p>Humans may be irrational decision makers, but behavioural economics can offer a suite of innovative new tools to better account for customer indecision, procrastination and confusion, irrespective of industry. If policy makers can successfully incorporate these tools into regulatory design it may mean the difference between the status quo and a future environment that carefully and actively considers how we actually make decisions.</p>
<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">Accessible</div> <p>by omitting complex technical details</p>	<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">De-biased</div> <p>to capitalise on human strengths. For instance, presentations of risk using frequency rather than probabilistic representations can improve understanding</p>	<div style="background-color: #f9a825; padding: 10px; margin-bottom: 10px;">Tested</div> <p>to understand that the designed disclosure actually works as intended and to iterate toward better disclosure</p>	

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5

How to plan cities, not just projects

by **Jeremy Thorpe, Stephanie Hall and Jonathan Cairns-Terry**

How to plan cities, not just projects

Australians are great at planning and delivering individual projects. But we're not so good at planning our cities. To create cities that maximise and share the opportunities to live, work and play, we need a shift in mindset.

PwC recently embarked on a project to understand Australian cities through the eyes of its residents. We wanted to know what it was like to live, work and play in Australia's largest cities. For example, how affordable is housing? How accessible are jobs, schools and hospitals? What entertainment or cultural activities exist within reach of a particular area?

The series, called CityPulse, took a deep dive into Sydney, Melbourne, Brisbane, Perth and Adelaide. But unlike most other indices, CityPulse is not intended to rank cities.

The real point of difference is a comprehensive intra-city comparison. By understanding each different part of a city, we have a starting point for discussions about shaping the city as a whole.

And with the current national emphasis on making our cities more liveable - particularly in an age of strong population growth - such discussions are more important than ever. So over the past several months, we shared our CityPulse findings with politicians, bureaucrats, businesses, community groups, our own staff, and other stakeholders.

CityPulse is a national cities dataset across three simple measures – 'live', 'work' and 'play'. It looks beyond economic opportunities to provide insights about what makes our cities truly liveable, down to an almost suburb level (ABS Statistical Area 2) . CityPulse provides a baseline for discussions about shaping our cities.



Live

A well-functioning city is one where people feel safe, comfortable and can access the services they need. 'Live' measures the overall amenity of a locality. It includes factors such as housing affordability, crime rates and services such as health care and schools.



Work

Does a city provide its residents with economic opportunity? Are there viable employment options? 'Work' assesses business activity, employment rates, access to jobs and economic performance.



Play

Liveable cities provide ways for people to connect, explore and recharge. 'Play' measures opportunities for entertainment, dining and cultural or sporting activities along with access to outdoor space.

To see the results for your locality, visit pwc.com.au/citypulse

One of the strongest themes to emerge from these conversations was the fact that we don't currently plan cities. What we plan is individual projects.

It's clear that there needs to be a mindset shift. We need to focus on the holistic quality of life in different parts of our cities.

We need to put the broader needs of the community first, rather than construction for construction's sake.

With this in mind, we've highlighted some ways we can work together – government, business and community, to start breaking down the barriers to enable citizen-centric city planning.

“ Have honest conversations – don’t be afraid to talk about CityPulse scores

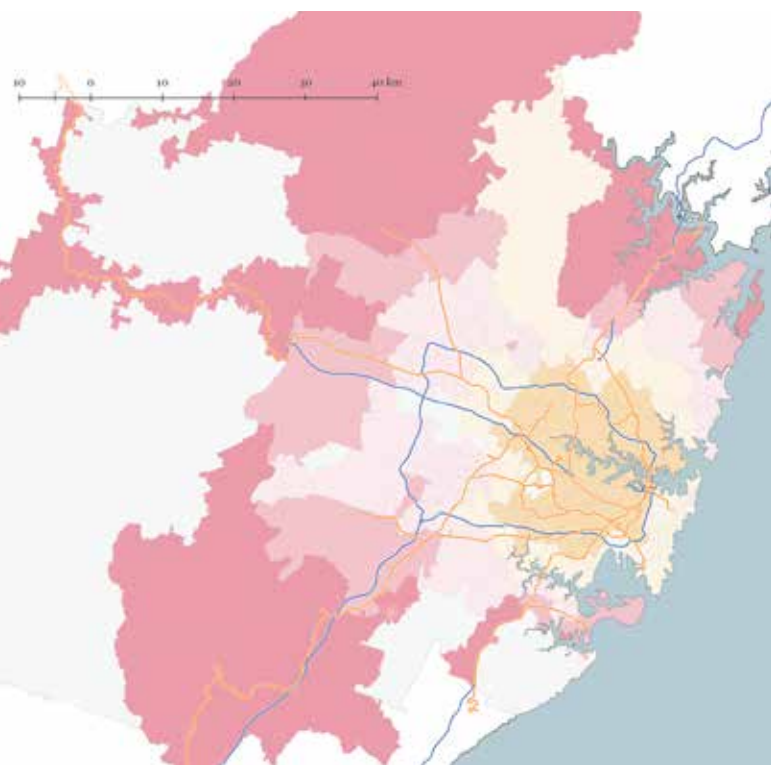
CityPulse was intentionally designed to get us away from a scoreboard mentality. We avoided a single metric and did not publish leaderboards. But inevitably, readers will benchmark scores from their localities against others.

We observed, particularly among politicians, a concern that a ‘bad’ score meant she or he had ‘failed’. Some felt that it was best not to talk about the CityPulse results.







But in reality, lower than average scores reflect long-term dynamics. It might be due to a decades-long pattern of under-investment or new development that’s still in the establishment phase. It might reflect geographic factors. It’s rarely about what the politician is or isn’t doing in the short-term.

We shouldn’t hide from the perception of ‘poor’ CityPulse results. Rather, let’s use the insights as a roadmap for targeting future investment.

Jobs accessible by car within 30 minutes
Greater Sydney



Legend

 Non-residential	 Below average
 Rail	 Close to average
 Motorway	 Above average

“ Use transport investment as a tool for equality

Citizens in the outer suburbs have lower access to amenities compared to those close to the CBD. Our CityPulse map shows how job accessibility is unevenly distributed across Sydney, for example.

Transport investments represent a significant opportunity for transformational change and greater equality. We need to consider how to maximise the value of these projects for the city as a whole.

So when we plan new transport investment, we should ask ourselves some critical questions.

Does it reinforce existing corridors? Does it give even better access to those who are already provided for, but fail to address existing gaps? Does it open up new areas? Does it give previously underserved communities access to all the city has to offer? Will it lead to new opportunities for development and employment?

We also need to consider the unintended side-effects of such projects. For example, rising property values as a result of new transport links can displace existing residents. This is especially true for those who don’t own their own home or have rental security. With careful planning, these impacts can be mitigated. One solution is to require developers to include a mix of housing, including affordable options.

“ Start with the needs of a place, not a piece of infrastructure

Planning critical infrastructure means looking at the long term infrastructure, land-use and transport strategies. Plans have to be developed collaboratively, ensuring that transport and infrastructure are guided by land-use. The result should be a place-based approach to planning and investment decisions.

Place-based planning means seeking first to understand the needs of the citizen. The objective is then to create places where people want to live, work and play.

By putting the citizen at the centre, we can plan places holistically. It means that investment decisions, like the inclusion of a new piece of infrastructure, are not made in isolation.

This approach leads to the exploration of place-based business cases. These cases do more than weigh up costs and benefits. They also take into account the benefits of complementary land uses, densities and amenities. And they capture community benefits, as well as economic benefits.

CityPulse is one way to evaluate the liveability of our cities and precincts. It takes a citizen-centred approach, using data to ensure investment decisions lead to better places, not just projects.

“ Tell stories about how great cities happen

CityPulse shows us what happens when we invest in key infrastructure. The places with transport, services, amenities, employment hubs and the right housing generally have higher scores across live, work and play.

These are areas that have grown significantly in the last decade and will continue to thrive with continued investment.

CityPulse shows us stories of how great places happen. Now we need stories of how great cities can happen if we make well-planned, holistic decisions.

A clear vision for the future will help citizens see the purpose of the disruption in the present. This means less about the ‘dollars spent’ and more about the ‘minutes saved’. Less about the ‘economic uplift’ and more about the ‘reachable jobs’.

Just as CityPulse has helped reveal the ‘now’, we need tools that bring together and visualise data in a way that shows future potential. These tools must evaluate and communicate options in ways that are meaningful to citizens.

“ Plan now for 2066 (and beyond)

CityPulse provides a point-in-time assessment of how our cities work and points to where we need to improve. But we also need to be mindful of the future.

By mid century and beyond, Australia will be different in many ways. Two demographics in particular stand out in terms of how our cities need to develop.

First, there will be a lot more of us. In most states, our cities will need to accommodate significantly larger populations. This has clear implications for balancing concerns about sprawl and density.

Second, our age profile is changing. Across the next five decades there will be more younger and more older Australians. In other words, a hollowing out of the working population as it

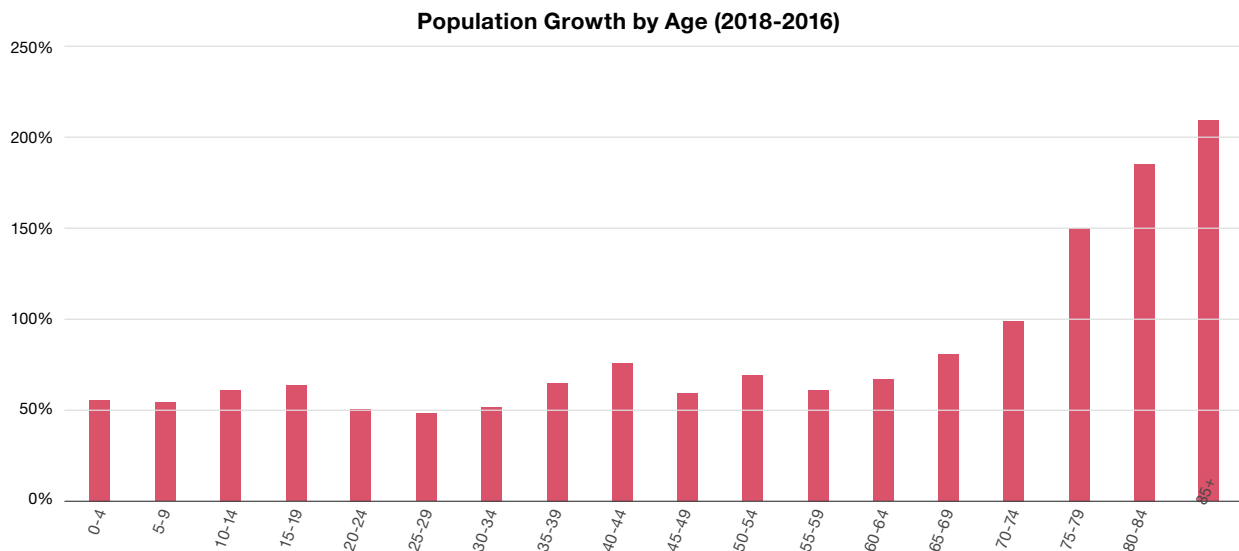
falls from 65.5% of the current population to 61.8% of the 2066 population. This has implications for the supply and location of many social services.

It also means that what we are doing now will not be the answer for 2066. The increasing and changing population will need more childcare and school facilities, as well as more aged care and health facilities. Will our transport system support this shift in social infrastructure?

Our planning today should take account of our long term future. What are the decisions we can make today that the citizens of 2066 will thank us for?

State	Population 2018	Projected population 2066	Growth 2018-66	Growth 2018-66
NSW	8,000,000	13,090,000	5,090,000	64%
Vic.	6,470,000	12,030,000	5,560,000	86%
Qld	5,010,000	8,720,000	3,700,000	74%
WA	2,600,000	4,760,000	2,160,000	83%
SA	1,740,000	2,210,000	480,000	28%
Tas.	530,000	580,000	50,000	10%
ACT	400,000	770,000	370,000	93%
NT	250,000	440,000	190,000	76%
Australia	25,000,000	42,600,000	17,600,000	70%

Source: Australian Bureau of Statistics (2017), 3222.0 - Population Projections, Australia, 2017 (base) - 2066



Source: Australian Bureau of Statistics (2017), 3222.0 - Population Projections, Australia, 2017 (base) - 2066

How can we move forward from here?

CityPulse has kick-started important conversations about what makes our cities work.

Critically it has revealed the need for a mindset shift. A shift towards the holistic quality of life in different parts of our cities, putting the broader needs of the community first. And a shift away from engineering-driven construction for constructions sake.

This will, of course, require change. We'll need a new way of looking at cost-benefit assessments. We'll need politicians to look beyond the immediate electoral cycles,

and we'll need to work together – government, business and community – to translate this new mindset into a reality. Critically, we'll need to rethink historic spending patterns, so they meet both the needs of both today's urban communities and the communities to come.

It won't be an easy change, but it's one we can make if we are driven by a vision of a better future.

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