

OUTLOOK FOR AUSTRALIAN POLITICS AND GOVERNMENT IN 2011

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Just as Glenn Stevens starts each appearance before the House economics committee by reviewing the fate of the forecasts he made at his previous appearance, so I have to start by reviewing the fearless forecasts I made this time last year. Usually Stevens can say his forecasts turned out pretty well, but I can't. Since I know you guys like people to make a clear 'call', I gave one. And as a well-trained journo I put it in the lead: 'it now seems clear the next federal election will be a double dissolution held not much earlier than normal - late September - with climate change and Work Choices as its main issues. It also seems likely that Kevin Rudd will win in a landslide'. Later, I referred to Tony Abbott, elected to be opposition leader just the previous week, as 'unelectable'.

Whoops. Every one of those judgments proved wrong. My key miscalculation was in assuming Rudd couldn't and wouldn't abandon his commitment to achieving his emissions trading scheme. The other errors I made flowed from that. Labor insiders tell me I was among the first outsiders to detect Rudd's feet of clay, but as it turned out even I overrated him. Had Rudd not lost his nerve on the ETS he would have had to hold a double dissolution, but the one he considered and eventually decided against would have been held early in the year, not later as I predicted. His about-face on the ETS started his precipitous decline in the polls which, combined with his difficulties over the mining tax, prompted his overthrow. But his brutal replacement by Julia Gillard did little to revive Labor's electoral standing. Clearly, I and other smarties greatly underestimated Abbott's powers as a politician, including his ability to largely defuse Work Choices as an election issue.

I've known for many years how foolhardy it is to make long-term political predictions - that is, predictions of events more than a year away - because events and attitudes can change so easily between now and then. But, for the sake of a fearless call (and also because the earlier you make your forecast the more time there is for people to have forgotten it), let me break my rule: I predict the Gillard government will run full term but, though that ought to give it plenty of time to lift its game, will lose the next election. I've come to the conclusion this generation of Labor is terminally incompetent.

Federal Labor's achievement this year has been nothing short of extraordinary. To quote Wayne Swan: 'We came within a whisker of losing government despite the best performing advanced economy in the world, despite substantially increasing the pension, despite fairer workplace laws, despite record investments in human capital, and despite cutting income taxes three times.'

I'm going to devote a fair bit of this talk to trying to explain why Labor stuffed up so badly, before looking to the future for politics and government.

The Demise of Rudd

The man who emerged from relative obscurity to become Labor's saviour in 2007 turned out to be deeply flawed. Matched against the ageing John Howard, he looked appealing - young, good looking, well spoken, well educated and articulate - and unthreatening. At the same time, he promised to end the unfairness of Work Choices and was judged the more credible of the two in his promise to take decisive action on climate change. But he didn't look particularly 'Labor'.

He didn't look it because he wasn't. He hadn't had to fight his way up through the party or the union structure, even though he - like almost everyone at the top of modern Labor - had cut his teeth working for state Labor, in his case as a politically appointed senior bureaucrat working for the Goss government. Labor's egalitarian ethos hadn't rubbed off on him, he held the unions in disdain, he was in a faction but not of one, he had little personal support within the parliamentary party and no mates. The main things that got him into the opposition leader's job were his sponsorship by the NSW Right and his deal with Gillard of the Left. He did deals with many party people, most of whom he stopped talking to after he'd attained the exalted heights of prime minister. He burnt up much goodwill by giving jobs for the boys to boys from the other side - something Howard would never have dreamt of doing. He failed my acid test for Labor ministers: his staff didn't love him (as most do).

He turned out to be all ambition and little principle. His overriding goal was to maintain his own popularity. He had little courage and was part of a cabinet that almost universally lacked courage. Everything started falling apart when he, after a long period of indecision, took the fatal decision to abandon the ETS because it had become too hard. To be fair, he took a lot of persuading to give up the ETS, but eventually those urging him to stick with it - Lindsay Tanner, Penny Wong and John Faulkner - were overwhelmed by those urging him to drop it: initially, Sussex Street (Mark Arbib and Karl Bitar) and then Gillard and Swan - the two whose careers benefited most from that fatal miscalculation, which in one blow destroyed the credibility of both Rudd and his government.

Despite his reputation as a policy wonk, Rudd turned out to be a hopeless administrator. He couldn't set priorities or delegate (meaning he had no intrinsic feel for opportunity cost). He moved from one enthusiasm to the next, wanting everything he touched to be the biggest and best ever (he was addicted to superlatives), but had great trouble making up his mind and would delay a decision by demanding more options and the answers to more and more questions. His personal staff and senior bureaucrats were treated very badly. People would work all night to have a response to his queries on his desk next morning, only to discover he hadn't found time to read it. They'd be summoned to a meeting with him several days later, where he'd flick through their paper, asking questions to which the answer was often 'on the next page, prime minister'. Papers piled up in his in-tray, everything ran late and often had to be thrown together at the last minute to meet some deadline. Bureaucrats who needed something ticked by the PM would save it till he was out of the country and then submit it to Gillard, who would turn it around in no time. Government decision-making became chaotic.

Rudd was also an autocrat. He didn't consult - not the unions, business, the backbench, the outer ministry or even the cabinet. Key decisions were made by the kitchen cabinet or Gang of Four, the strategic priorities and budget committee - Rudd, Gillard, Swan and Tanner - and even then there've been suggestions the other three were consulted rather than allowed to

decide. After Rudd was deposed because the government had 'lost its way', Gillard and others were often asked whether they'd done anything to warn or remonstrate with Rudd. The honest answer is: No, not really. People were afraid to speak frankly to Rudd for fear of incurring his (frequently displayed) displeasure and being cut out of the loop. Rudd lacked the courage to sack people, but would just stop talking to those - even those within his office - who'd lost his confidence. By the end, pretty much his only confidants were a couple of inexperienced 30-year-olds in his office. His fatal mistake was to stop talking to Mark Arbib.

Rudd returned from his failed attempt to broker an agreement at Copenhagen exhausted and dispirited. He seems to have gone into a funk of indecision. He balked at calling a double dissolution, then sought to distract himself with health reform, visiting about 40 hospitals around the country to 'consult'. Senior bureaucrats and ministers followed him around, hoping he'd make decisions and reach their agenda item.

Rudd's obsession with always trying to dominate the daily news cycle proved a snare and a delusion. His insistence on having ministers and departments come up with an unending stream of minor 'announceables' wasted their time and annoyed them while distracting them from more important matters. Worse, it deluded the government into imagining it was communicating effectively with the electorate. Labor's small army of young PR punks manhandled the press gallery more than it was used to, meaning the media were ready to turn on Rudd as soon as his dominance slipped. The notion that if you could dominate the news cycle every day for three years the election would be a pushover proved to be wrong. As soon as the decision to drop the ETS destroyed Rudd's credibility - among people who didn't fancy the idea, as much as those who did - all those days of media dominance counted for nought.

Rudd's backdown on the ETS weakened him for the next big battle, over the resource super profits tax. It emboldened the big three miners to seek to destroy the government rather than bargain with it, while reducing the government's creditability in defending the tax to the public and making the notion of reaching a significant compromise with the miners unthinkable. (What isn't widely known is that the big three's resistance was heightened because the tax would have cost them more than twice what Treasury had estimated it would.)

Rudd's losing fight over the RSPT proved the last straw for the spurned Sussex Street, which patched up its relations with the parliamentary Right in other states, gathered the numbers in caucus and made a last-minute offer to Gillard she couldn't resist. The former Hawke minister Neal Blewett has expressed surprise at how quickly the party panicked. All successful governments go through periods of being behind in the polls. The explanation is partly that modern Labor is more committed to power than principle, but also that, by then, the entire party was so fed up with the chaotic, authoritarian Rudd. The night the bureaucrats learnt Rudd was being replaced by Gillard there would have been dancing in the streets.

The unlosable election (just)

It's remarkable that a first-term federal government - particularly one that had performed so well in managing the economy - failed to win the election and went so close to losing it. We'll never know whether Labor would have done better at the election had Rudd been allowed to stay on. We do know the election would have been held in October rather than brought forward to August. It's clear the brutality of Rudd's overthrow would have cost Labor votes - more than the conspirators ever bothered to imagine it might. But it's doubtful Rudd would have been able to reach a compromise with the big miners over the resource tax, so one

imponderable is how well he would have withstood the continued onslaught, including a massive ad campaign and funding of the Liberals.

On the other hand, Rudd's overthrow robbed Labor of the ability to boast about its various achievements (paid parental leave is one Swan didn't mention in that earlier quote). How could you justify Rudd's ousting as necessary because the government had 'lost its way' and then praise his performance? Thus did Labor forfeit much of the benefits of incumbency - another price I doubt the conspirators thought about before they acted. But most Labor insiders are saved from worrying about what might have been by their conviction that, one way or another, Rudd had to go.

I think it's now clear Gillard's strategy of reaching a quick fix on the government's three most pressing problems - reaching a compromise on the mining tax, doing something about asylum seekers and filling the vacuum on climate change - then rushing to an early poll while Gillard was still enjoying her honeymoon with the electorate was a costly miscalculation. The honeymoon quickly evaporated, leaving a woman with blood on her hands rushing to the polls before the dust had settled and people had got a chance to get to know her. Unsurprisingly, they weren't greatly impressed.

The campaign was surprisingly badly run, and was marred by several damaging leaks, which party insiders are convinced came from Rudd. Before the election we were told a uniform swing of just 1.7 per cent against Labor would be sufficient to tip it out, but it actually suffered a two-party preferred swing of 2.6 per cent and still ended level pegging with the coalition on the number of seats. Why? Because the swing was far from uniform, varying greatly between states: down 5.6 per cent in Queensland, 4.8 per cent in NSW and 3.2 per cent in Western Australia, but up 4.4 per cent in Tasmania, 1 per cent in Victoria and 0.8 per cent in South Australia. And because swings aren't uniform even within states, they don't translate evenly to seats. In net terms, Labor lost seven seats in Queensland and one each in NSW, WA, Tasmania and the Northern Territory, gaining a net one seat in Victoria, to lose 10 seats in total, eight to the coalition, one to the Greens and one to an independent in Tassie.

On first preference votes, Labor lost 5.4 percentage points, though only 1.5 percentage points of this went to the coalition, leaving almost 4 percentage points going to the Greens. The Greens' two-party preferred vote in the Reps rose to 11.8 per cent (with 79 per cent of their preferences going to Labor). This was Labor's fourth lowest primary vote since the beginning of the two-party system in 1910.

Breaking up Labor's vote by region, its two-party preferred vote fell by 3.3 percentage points in inner metropolitan seats, by 3.1 points in rural seats, but by only 1.8 per cent in outer metropolitan and provincial seats.

On a depressing note, both sides judged it easier to scare people into rejecting the other side than to inspire people to support them. On an encouraging and remarkable note, because both sides were so anxious to claim they'd be better at eliminating budget deficits and debt, both felt they had no choice but to nominate offsetting savings to cover the cost of their election promises (although the Liberals' costings were deceptive).

Gillard's strengths and weaknesses

As Peter Hartcher has pointed out, Gillard has one thing in common with Abbott: both seized their party leadership as part of a reform panic. Abbott: the coalition's panic over Malcolm

Turnbull's commitment to the ETS; Gillard: Labor's panic over the opposition to the mining tax. Not an auspicious beginning for either of them. I don't believe Gillard undermined or plotted against Rudd but, even if she didn't, it looked bad and she has had no honeymoon with the electorate.

She isn't able to appear warm and likable on television, which means she lacks charisma. She isn't disliked, but she isn't liked either. A substitute for likeability (eg Bob Hawke) is being respected - seen as a strong and capable leader (eg Howard, Malcolm Fraser), but she doesn't have that either. Since the election she and Labor have been flat-lining in the polls, making no progress from their perilous position at that time. You can see this as a sign she's failed to impress the electorate or that it's suspending judgment - both, probably.

One of her strengths is she's a highly capable administrator (notwithstanding the exaggerated problems with the schools halls building program). She's smart, she works hard, turns the paper around and chairs a very disciplined meeting. Another great strength - much in evidence in the 17-day period between the election and Labor's confirmation it had the number to continue in government - is her ability as a negotiator and deal-maker. She can give you little, but send you away happy. A third great strength is her willingness to listen, consult and include. All leaders learn from the mistakes of their predecessor, but she would have been inclusive anyway. Cabinet is back to functioning normally. Even if her polling doesn't improve, it will be a long time before the caucus can be roused against her. And she has had the sense to abandon Rudd's obsession with dominating the daily news cycle.

Her great weakness is her lack of belief. She's hugely ambitious, but doesn't seem to have a deep commitment to Labor's traditional preoccupation with fairness and redistribution, equality of opportunity, social justice and compassion. She came to power via the Left faction, but shows no sign of having left-wing values. Indeed, I suspect she's trying to live down her left-wing label by erring on the conservative side. She does keep saying what her values are: she believes in hard work, a fair go through education, and that we're all equally worthy of respect. That's fine, but it doesn't get us far. And though she and her cabinet colleagues keep stressing their belief in 'a strong economy', that doesn't mean she's an economic rationalist - just a politician who's concluded a growing economy is essential to staying in office.

Laurie Oakes says Howard made every mistake in the book in his first term, but he only made them once. My big question about Gillard is the steepness of her learning curve. If you learn from your stuff-ups, your chances of survival and success are greatly improved. I concluded Rudd didn't have a learning curve, so wasn't sorry to see Labor bundle him out. Gillard was at the fore in persuading Rudd to abandon the ETS, which proved a disastrous mistake, but her decision to fill the vacuum with a citizen's assembly suggests she was very slow to see the error and start getting back into the carbon-price game.

One of Rudd's failings was his hankering after the biggest and best in everything, regardless of whether all his grand projects were consistent with his (utterly genuine) commitment to returning the budget to surplus ASAP. This says Gillard should have seen the gold-plated national broadband network coming and taken quite steps to tone it down, but she didn't.

Tony Abbott and the Libs

Abbott has proved a far more disciplined and successful politician than I ever imagined he could be. He got the job because of his willingness to switch to implacable opposition to a

price on carbon (that is, to a policy on climate change that's less rational than the Greens'), but also because the Libs, expecting a drubbing in the election, wanted him to minimise the loss of their base vote. He not only held the base, he gained almost enough of the middle ground to win. He just kept punching away during the election campaign, kept his foot out of his mouth, and did far better than anyone expected.

Abbott is a contradiction: intensely personable in the flesh, but capable of coming across as a crazed zealot in the media. But after a rocky start he kept all his zealotry well controlled. He can say stupid things (eg that this was the worst Labor government ever) but also things that are charming and disarming (eg that Gillard's success with the independents showed her to be a talented negotiator).

The Libs are the natural home of economic rationalism, starting with Bert Kelly, The Modest Member, John Hyde and the Dries, and the pre-PM Howard, who once fairly dubbed himself the father of economic rationalism. But rationalism is out of fashion today; Abbott's not interested in economics and is happy to argue that putting a price on carbon is crazy and pretend that 'direct action' will fix climate change rather than just waste money. There are no rationalists left in the party bar Turnbull (and maybe Joe Hockey), though Hockey is regarded as lazy and has two people after his job (Andrew Robb and Turnbull). But Robb's credibility has been damaged greatly by the disclosure after the election that his policy costings - which he refused to submit to Treasury and Finance - were flawed to the point of fraudulence.

It took Abbott too long to realise he'd lost the election and that the government was unlikely to fall any time soon. He should assume the election will be in three years' time. If so, it doesn't follow that just because he almost won this time he's sure to win whenever the next election's held. As I've been reminded to my cost, the political world can change dramatically within a year, let alone three. One thing that could change is that three years of Abbott's unrelenting opposition to everything - punch, punch, punch - could wear very thin with an electorate that gets terribly tired of seeing politicians perpetually arguing with each other. You get the feeling Abbott would oppose the Second Coming if it was Labor policy. Smart oppositions avoid appearing excessively negative by being more selective in what they oppose and drawing attention to the things they support. Abbott has indicated he understands the Libs' need to do more to articulate their own positive policies, but whether he can force himself to be more positive and less relentlessly negative remains to be seen.

Labor and the economy

The more loudly Labor proclaims its fealty to 'a strong economy' the more you realise there's something amiss. These days, it's virtually compulsory for governments to claim to be committed to economic reform, though they have considerable latitude in what they define as reform. With the retirement of Tanner, Labor's down to just one avowed economic rationalist, Craig Emerson, who's sidelined in Trade. It will take some time for Labor's new economics professor, Andrew Leigh, to progress from the backbench to the front. I don't regard Swan as a true believer, though I have hopes for Wong. She did, after all, spend Labor's first three years trying to introduce market pricing to carbon emissions and water. No, these guys are just politicians, first and foremost, who realise the political importance of good economic performance, but don't have a deep understanding of, respect for and belief in the power of market forces. They are dogged by an inferiority complex in the economic area, born of their knowledge that they're only faking it as economic rationalists and of Peter Costello's decade-

long success in reinforcing the electorate's instinctive belief that the party of the workers couldn't be any good at managing the economy, whereas the part of the bosses obviously would be.

Rudd and Gillard happen to have done particularly well at macro management, as well as it's reasonable to expect flesh-and-blood politicians to do. They've left the Reserve Bank alone and uncriticised as it's done its job; they stimulated the economy vigorously at just the right moment, they managed business and consumer expectations brilliantly, and they've imposed budgetary strictures on themselves from the off (starting with the requirement that all stimulus spending be temporary and moving to the restrictions on tax cuts and real spending growth till the surplus is back to 1 per cent of GDP). I have no doubt they'll do 'whatever it takes' to get the budget back to surplus in 2012-13. I don't regard this performance as having been seriously marred by the problems with insulation and school building. It has suited the opposition and sections of the media to leave us with a greatly exaggerated impression of the extent of waste, and to deny the very real trade-off between macro-economic timeliness and value-for-money.

It's on the micro side that Labor's performance has been weak, with its wasteful spending on industry assistance, cash-for-clunkers and the like, its inadequate rollback of Howard's extensive middle-class welfare, its excessive compensation to polluters under its ETS and then its abandonment of that scheme when the going got tough, and finally its mishandling and ultimate butchering of the minerals resource rent tax.

Throughout its life the government has exhibited three related deficiencies: a lack of values, a lack of courage and a lack of skill in managing its relations with the electorate. It's mainly because of Labor's lack of deep belief in rational policies that it lacks the courage to fight for them when an unprincipled opposition exaggerates their cost to the electorate. And it's the same lack of genuine belief and understanding that leaves ministers unwilling or unable to explain and defend policies whose short-term costs will be outweighed by longer-term benefits.

Labor's explanatory powers and its belief in its own ability to exercise those powers have atrophied through lack of use. It's relied too long on spin doctors, whose stock in trade is to conceal, confuse and distract rather than explain. People who should be being paid to find effective ways to explain complex and unfamiliar concepts put their effort into trickery, such as announcing backdowns late on Friday afternoons, or bullying journalists. Ministers agree to the public's self-pitying misconceptions rather than explain complex truths. We didn't have a recession because we didn't have two successive quarters of negative growth - what a way to denigrate your own success! Any change in mortgage interest rates not in lock step with changes in the cash rate is profiteering. If power prices have risen a lot the cost of living has gone through the roof and you're right to feel impoverished.

Why do ministers perpetually attack the opposition rather than explain and defend their policies? Because they're politicians doing what politicians do, not economic believers doing what believers do. You've got to build support for reform - even if only among opinion leaders - but you don't do it by attacking your political opponents, you do it by unceasing explanation and persuasion.

Why Labor's so bad at it

In watching the government's performance over the past three years - but particularly over the past year - I've come to the startling conclusion that federal Labor has lost its race memory of how to govern. The Hawke/Keating government knew how to do it, but after 11 years in the wilderness Labor has lost the knack. These guys are amateurs. Many of the ministers and their advisers had experience in government at the state level, but it hasn't successfully translated to the federal level.

One sign of amateurism is that Labor is still talking and acting like an opposition. Not being in power, oppositions do little other than criticise the other side, leaving it until close to the election to produce positive policies. Sensible governments ignore their opponents as much as possible, exploiting the advantage of incumbency to deny them air. Responding to opposition criticism gives that criticism legitimacy in the eyes of the media and the public. Labor spends all its time attacking its opponents. The electorate finds this far more alienating and confusing than convincing. Those who aren't one-eyed for one side or the other don't feel equipped to adjudicate the debate and so are likely to conclude 'they're all liars'. In other words, attacking the opposition isn't persuasive. It's a sign Labor is confusing scoring points inside parliament house with scoring in the electorate. But the other disadvantage of perpetually disagreeing with the opposition is that it crowds out what the government should be doing: explaining its policies and expounding on their many virtues.

Another sign of opposition thinking is the way Labor keeps expressing sympathy for punters' complaints that it picks up from its focus groups eg the cost of living, the greedy banks, executive salaries. Oppositions can get away with this, but governments can't because they're expected to act on their expressed concern. Governments are unable to do much to fix most of these complaints, many of which are ill-founded. By sympathising with these whinges rather than making the counter points, governments foster the belief that they can and should solve all the problems of individuals, a recipe for voter disenchantment.

If there's one thing you'd expect Labor politicians to understand it's the need to 'do the numbers' - make sure you have enough support for a proposal before you make it public and risk losing face if you then have to seriously modify or even abandon it in the face of vigorous opposition. Partly this is about pre-marketing controversial ideas to find small modifications that could significantly reduce opposition, without any loss of face. Partly it's about conditioning people's expectations and also allowing the leaders of key interest groups to condition their supporters' expectations. Everyone appreciates a heads-up; no one enjoys being caught by surprise. Consulting before announcement rewards and encourages loyalty among natural supporters eg the unions, and builds trust with non-supporters eg business.

The sad story of the resource super profits tax is a case study. The tax was intended to be no more burdensome than the miners would reluctantly accept, but in the event the big three objected so strongly they declined the opportunity for post-announcement consultation and set out to bring about the government's electoral defeat. The miners had signalled their willingness to accept a profits-based tax, but seem to have been expecting an extension of existing petroleum resource rent tax (which is roughly what they ended up with). The only warning the miners had was being told of the government's plan the day before it was announced. The proposed tax was in a highly sophisticated form unfamiliar to the miners (and their financiers), but the bigger problem was Treasury's gross underestimate of the revenue

the tax would raise. When, after weeks of public battling, the government finally realised the extent of this miscalculation, it soon agreed to change the tax in ways that reduced its revenue-raising potential to about what had been originally intended. This was seen by the public as a huge backdown in the face of opposition from a powerful foreign interest group. But worse, in the process the tax was butchered, greatly reducing its intended efficiency benefits. Had the government known the tax's true revenue-raising power beforehand, it would merely have halved the rate at which it was imposed, from 40 per cent to 20 per cent. Had that happened, the miners' opposition would have been greatly reduced and no one would have thought any the worse of the government. And the government would have been much better informed in advance of any announcement had it released the Henry report for public comment soon after receiving it, rather than releasing it simultaneously with the announcement of its response. The miners would have known what was being proposed, could have done their sums as to its effect on them and privately warned the government about their misgivings. Taking another example, I believe the controversy over the government's reservations about the budgetary cost of equal pay is another case where pre-consultation could have saved the government a lot of skin.

This government lacks the confidence that should come from incumbency, that should embolden it to take calculated risks in support of good policy and should, in turn, foster the electorate's confidence that the country is in safe and competent hands. This is a circular process: acting confident makes the electorate confident in you, which justifies and reinforces your own confidence. Instead we find a government with an economic inferiority complex, always trying to hide behind the authority of others: the allegedly 'independent' Treasury, the Henry report, the Murray-Darling Basin Authority, the NBN business case etc. Rudd would also have co-opted the Reserve Bank to his management team had the (genuinely independent) Reserve not politely declined.

Because of the human fallibility of the electorate, politics abounds in paradoxes. But Labor has no instinctive understanding of paradox. When you're not conscious of paradox - when you don't realise the public is perfectly capable of holding logically inconsistent attitudes - you're easily misled by focus groups. One paradox is that though voters don't welcome hip-pocket pain, they want to be led by someone with the strength and confidence to inflict pain when he or she believes it to be in the nation's best interests. This explains why even those who feared the hip-pocket cost of the ETS reacted with disillusionment to Rudd's decision to ditch it. From all he'd said, we really needed it, but he was willing to shirk his leadership responsibility to avoid unpleasantness. What's particularly worrying is that none of those still at the helm of the post-Rudd Labor Party foresaw the price this expediency would extract. By contrast, Howard pressed on with his far more unpopular 'great big new tax on everything', the GST, and (narrowly) survived. What got him over the line was the public's grudging confidence that he must be doing this unpleasant thing because the country really need it to be done.

Another paradox is that the more concessions you make to interest groups, the more you stimulate rather than satiate the demand for concessions. Show me you're a soft touch, and I come back for more. Let me see rival interest groups getting in for their cut and I'll hasten to join the queue. But let me see that nobody else is getting much and I won't feel bad about getting little myself. The Hawke-Keating government had an objective of trying to stamp out the rent-seeking culture. It wasn't always honoured, but it served the government - and good policy - better than what we have now.

Another paradox is that the public will overlook individual bad practices for a long time, but eventually the smell will reach a point that registers with the electorate and causes it to turn away in disgust. Individual controversies over conflicts of interest - failure to declare interests; politicians taking jobs with interest groups soon after leaving parliament - don't excite much interest in the electorate, but if there's sufficient controversy over time to convince people a government is merely feathering its own nest, it's in trouble. Politicians devote much time to crafting arguments - often using statistics - designed to mislead without actually lying. People haven't the knowledge, time or interest to get to the bottom of arguments of this type. They just conclude both sides are lying. It took a long time for politicians to break sufficient promises for the public to conclude that all politicians break almost all promises. I doubt it's possible for governments to keep a high enough proportion of their promises for sufficient years as to turn that perception around.

One paradox most politicians do understand is that, in this big and complex world where no one has the time to pay the attention they should, voters' perceptions about things are more important than the reality of those things. Indeed, as the pollies say, 'the perception is the reality'. There's much truth to this. But you can push it too far. Neglect the underlying reality of effective service delivery badly enough for long enough and no amount of effort to manipulate perceptions will hide the unacceptable reality. Once you reach that point, nothing you say will be listened to and nothing you do to remedy the situation will help you. This is the story of the long demise of the NSW Labor government.

A final paradox is that when you're surrounded by risks whichever way you turn - when you're a minority government, for instance - and are most inclined to proceed cautiously, that just when you need to be bold. Why? Because the public's reaction to leaders is instinctive and unconscious. They're impressed by confidence and courage and unimpressed by uncertainty and timidity. They can tell when you're faking it.

Gillard says she must 'govern from the centre' if she's to win sufficient votes to hold government. This attitude is based on the notion that each side has core support of about 40 per cent, leaving them battling to attract a majority of the remaining 20 per cent of uncommitted, swinging voters in the middle. Market research reveals the uncommitted middle to be social conservative, uninterested in politics and very hip-pocket in its attitude to economics.

But in this, too, Labor is showing signs of amateurism - and being a slow learner. It's true you can't get too far from the centre, but it's not true you should be right in the centre. If you're Labor you have to govern from left of centre just as, if you're Liberal, you have to govern from right of centre (as Howard did). You can't get too far from the Left (or, for the Libs, the Right) or you'll lose too much of your base, your core support. If you're right in the centre - neither Left nor Right - you lose your identity, your defining characteristics. Apart from your party name, you don't look like anything in particular and who wants to vote for you? Not a lot of your base vote and not a lot of the swinging middle.

This, of course, is the story of Labor at this year's election. It lost a lot of its base to the Greens, but at the same time failed to attract many in the middle, meaning its primary vote fell 5.4 percentage points to 38 per cent - as we've seen, federal Labor's fourth lowest primary vote since the beginning of the two-party system in 1910. In Western Australia its primary vote got down to 31 per cent, in Queensland, 34 per cent. NSW was a fraction below the national

average. Humans are meaning-seeking animals. They want to know what leaders and their parties stand for and be able to put them in one box or another. Particularly because of its inferiority complex on economic management, Labor tried to turn itself into a pale imitation of the Liberals and, unsurprisingly, not enough people wanted to vote for it. If that sort of thing appeals, why not vote for the real thing?

Particularly because of its decision to abandon the ETS, Labor lost a lot of its primary vote to the Greens, and also Tanner's seat of Melbourne. Does this matter if it all comes back in preferences? Yes. Not all of it comes back and, in the Senate, it doesn't come back. In those state elections with optional preferential voting it may not come back. In a growing number of inner-city seats it doesn't come back if the Greens come second, the Libs come last and the Libs preference the Greens. The Libs didn't do that in the recent Victorian election, but this just puts Labor at the mercy of the Liberals' goodwill. It's clear that, had the Libs preferred the Greens, Labor would have lost three seats in Victoria. It may well lose some at the coming NSW election.

Experienced politicians know that first you hold your base vote, then you attract enough of the middle. Howard was always rewarding the Liberal heartland with baubles: a tax rebate for private health insurance, a school grants formula biased in favour of elite private schools, concessions for self-funded retirees and so forth. As Costello has said of Labor, 'a party that can't hold its base is heading for long-term decline'. One of the great lessons of economics is that we rarely face either/or choices. Rather, the trick is to find the best trade-off between conflicting objectives. To say Labor has no choice but to govern from the centre is to pick one extreme over the other. Labor needs to look like Labor and do enough to satisfy its base while also finding policies that will attract sufficient of the swingers.

Howard has said, 'you have to spend political capital on reforms'. Labor ministers often decline to adopt worthwhile but difficult policies, privately telling supporters 'we can't sell that'. My response is: Then when are you moving to a profession to which you might be more suited? Politicians who can't sell good policy can't do their job.

The year ahead

Right now, five out of nine parliaments in Australia are hung. Someone has calculated that 15 of the 16 minority (state) governments in Australia since 1989 ran their full term. The reason for that isn't hard to discover: the independents who prop up those governments have no desire to risk bringing their positions of prominence and power to an early end. So I think it's reasonable to assume there'll be no federal election in 2011.

Gillard would no doubt like to be able to put her own stamp on the government's agenda, but she'll have quite a wait before she can because Rudd left her with a long list of unfinished business. She says 2011 will be 'a year of delivery' and 'a year of decision'. Anything she wants to put through the Senate before July 1 will need the support of Fielding and Xenophon and the Greens if it's opposed by the opposition; anything after then will just need the support of the Greens.

Gillard needs to resolve the ambiguity in her deal with the big three miners on the minerals resource rent tax concerning whether the feds will cover the miners for future increases in state royalties (which would be equivalent to writing the states an open cheque) and also decide on any modifications to accommodate the smaller miners excluded from the election-

eve deal. Enacting the mining tax will allow the government to legislate for the rest of the tax package: the phasing up of compulsory super contributions to 12 per cent by 2019, cutting the company tax rate by 1 percentage point to 29 per cent, and so forth.

The tax summit will be held in the middle of the year, but I'll be surprised if much comes of it. The Henry report was commissioned before the global financial crisis, when the government believed it would have a big budget surplus and plenty of spare revenue to compensate the losers from reforms to be announced before the 2010 election. The budget deficit has put paid to all that, with the government committed to bank all revenue growth and avoid tax cuts until the budget surplus is back to 1 per cent of the GDP. If the economy is booming at that time it will be under pressure to continue avoiding measures that could make fiscal policy pro-cyclical. This greatly reduces its scope for significant reforms.

The more health economists and others have studied Rudd's reforms to health and hospital funding the less enthusiastic they are. The growing number of Liberal premiers is also unenthusiastic about giving up 30 per cent of their GST revenue, but Gillard will have to get on with legislating the deal that the feds take over 60 per cent of hospital funding, which is supposed to start in July.

The government will keep working on its decision about the plan for the Murray-Darling Basin. The early signs are that it won't have the courage to adequately increase environmental flows. It will also keep working on the search for a regional solution to its asylum-seeker problem.

Ross Garnaut will release his updated report on climate change in May and the Productivity Commission will publish its advice on the measures being taken by our trading partners and on the impacts of a carbon price on our international competitiveness. Gillard announced recently that the government will decide by the end of the year on the way it will price carbon. This is likely to be a carbon tax - at least initially - rather than an ETS.

Looking further into the future, if the Gillard government runs full term she's likely to find that, by 2013, the present coalition governments in Western Australia and Victoria will have been joined by coalition governments in NSW and Queensland. This may make COAG meetings more difficult, but it's likely to improve federal Labor's chances of re-election. Many voters like the idea of an each-way vote between federal and state, just as many like the idea of federal governments not having a majority in the Senate. Even so, Labor will need to become a lot canner and a lot more courageous if it's to win re-election. From her performance so far, I'm not confident Gillard will pull it off.

Observations on monetary policy

It's been another bad year for business economists and markets in their attempts to second-guess the Reserve Bank's rate adjustments. I said that last year but - though I haven't counted up - this year has been a lot worse, with the ratio of misses to hits way up. It's become a lot harder for you guys to predict now the nation's economics editors have retired from the prediction game. But that's the way the more loud-mouthed of your brethren seem to have wanted it.

I should say, however, that market economists' predictions have been closer to the mark - or less far off the mark - than market pricing. Why? Because the markets are still too focused on what's happening in the US, whereas the economists have twigged to how heavily the Reserve's thinking is influenced by developments in the Chinese economy.

I've said many times that monetary policy is as much an art as a science and that it's set in the governor's gut. All I'd add this year is that this governor's gut decides which way it's jumping at the last possible moment. So if he has so much trouble making up his mind, it's hardly surprising you guys have trouble second-guessing him.

You guys generally get the direction of changes right, and you seem to have figured out that, in all but exceptional circumstances, the size of moves is 25 basis points, but you have a lot of trouble picking at which meeting the change will be made. I guess because you rely on fundamentals rather than chartism, you don't seem to have explored one potential guide to the timing of moves: bureaucratic neatness. This idea occurred to me when I realised we'd had a Melbourne Cup day rate change for five years in a row. Could this be purely by chance? I decided to do some arithmetic. Over the past five years the Reserve has changed rates 20 times. Since there are 11 meetings a year, if decisions to change rates occurred at random, each month would have a 9 per cent chance of being chosen for a rate change. The four meetings a year that are preceded by the release of the CPI and followed immediately by the release of the statement on monetary policy, would account for just over 36 per cent of random chances. But, in fact, the SoMP months - February, May, August and November - accounted for 65 per cent of rate changes, with November alone accounting for 25 per cent. The point is that the Reserve has set up a pattern in which the SoMPs come soon after the meeting that comes soon after the CPI release, and two of the SoMPs come not long before the Reserve's twice-yearly appearance before the parliamentary committee. Remember, too, that the release of the CPI is a key influence on the revision of the Reserve's inflation forecasts, which are published in the SoMP and which heavily influence decisions about rate changes. The SoMP serves as the main vehicle the Reserve uses to explain and defend its rate decisions. Is it surprising that, having carefully set up the timing of its key publication and parliamentary appearances, the Reserve is more inclined to fit its decisions into that timetable?

But why in the past five years has the November pre-SoMP meeting had more than twice the hits that the other three pre-SoMP meetings have had? Perhaps because of an unconscious desire to get the books straight before the end of the year and the knowledge that what you've done has to tide the economy over until February.

Glenn Stevens offered some cryptic clues to his thinking and behaviour in his recent parliamentary testimony. He noted that decisions at particular meetings are often finely balanced. When you're moving in baby steps of 25 points, it's hard to believe that going now or waiting a month for more data will make much difference to ultimate macro outcomes. If the decision isn't finely balanced - if it's quite clear what you need to do - it's a sign you've got behind the curve.

Stevens tacitly admitted that monetary policy isn't as forward-looking and pre-emptive as it should be. He couldn't think of any time when it later became clear the Reserve had tightened too soon, but he could think of 'several times' when it should have tightened earlier. This is a reference to the first half of 2007, when the Reserve should have tightened further but didn't because of two successive CPI results that were falsely reassuring, and ended up having to tighten before and during the election campaign. The proposition is that the more timely your tightening, the less you end up having to do. The lesson from this episode is that you have to trust to your judgement of the big picture - which embodies your core beliefs about how economies behave - and not be too swayed by bits of data that don't fit.

I think Stevens' remarks alluded to two different circumstances: when you know you're behind the curve and when you know you're not. When you're not behind the game - which should be most of the time - increases are likely to be 'only fairly gradual and not very close together'. (Say, before each quarterly SoMP?) When you believe you are behind the game, however: 'I think it is better really to move in a reasonably timely fashion to a point where you might be able to rest for a while. That is a better position to be in.' I think this explains Stevens's behaviour between October last year and May this year. He kept saying he was going to move 'gradually' towards 'normal' (neutral), but in fact he moved at six meetings out of seven (with only two of them SoMP meetings). Why? Because he knew he was behind the game: he'd cut like mad fearing a severe recession but the recession was proving to be remarkably mild so he was anxious to get back to neutral without delay. He eventually decided the banks' extra rate rises had shifted neutral down from 5.5 per cent to 4.5 per cent, and once he reached that point in May this year, he rested for six months before deciding it was time to start gradually tightening into the restrictive range.

Looking to the monetary policy outlook for 2011, at the parliamentary hearing Stevens gave a lot of hints about the timing of his next move. Quote: 'What it means is that for the period we are going into in the near term I think this is about the right level. At the moment most commentators do not anticipate and market pricing does not anticipate any further near-term change by us for quite some time. I think that is probably a reasonable position for them to have based on the information we have now.'

But exactly how long is 'in the near term . . . for quite some time'? I think it's a guarantee that's already expired: it applied only to the December meeting - and so, of course, will carry us through to the February meeting. But it leaves the February decision an open question. So if you rule out a February rise you're doing so on the basis of your own judgment, not a clear indication from the boss.

My call for next year is that, assuming the economy continues to strengthen as forecast but there's no rapid build-up of inflation pressure, we'll see another two or three tightenings, well spaced over the course of the year.