

OUTLOOK FOR AUSTRALIAN POLITICS AND GOVERNMENT IN 2012

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Taken as a whole, the first full year of the Gillard government has been terrible. Julia Gillard has hardly taken a trick all year and her present standing in the polls is worse - much worse, consistently worse - than it was at last year's election, when she failed to attract enough votes to form government in her own right. Her present primary vote in the low 30s would give her zero hope of winning an election. Only if she could get it up to at least 40 per cent would she be in the hunt. This time last year - three years out from the next election, assuming the government runs full term - I fearlessly predicted Labor would lose it, because 'this generation of Labor is terminally incompetent'.

Having made that call, I'm sticking to it. I'm doing so even though I know full well how easily the political outlook can change over a period as long as a year, let alone two years. After all, who would have predicted in October 2009 that the election would be months early and fought not between Kevin Rudd and Malcolm Turnbull, but between Gillard and Tony Abbott, that Abbott would come within a whisker of winning and that Labor would be forced into an alliance with the Greens and rag-tag independents?

But I have to add that, at the end of her first year, Gillard and her government are looking in better shape than they did half way through it. The first point to acknowledge is that she's held her minority government and its alliances together for a year - longer than many people expected - and it's never seriously looked in trouble. The second is that it's been a year of great achievement. The opposition has frequently criticised Labor for being unable to actually do anything but, as was always Gillard's intention, this has been a year of ticking off items on the to-do list - in particular, the various items inherited from Rudd. Of the three big problems he left her, the carbon tax has been put to bed, the mining tax is well on the way and only the asylum-seeker issue remains chronically unresolved. Along with Gillard's opportunity to be seen looking like a leader on the international stage with other leaders, these runs on the board do much to explain her recent slow improvement in the polls, in the two-party preferred and, particularly, as preferred prime minister.

While the polls continue moving in the right direction - however slowly and with however far to go - Rudd is unlikely to mount a challenge. There's no reason to doubt his desire to return, and should the poll recovery falter, we're likely to hear from him. Would the caucus ever turn back to him? There is so much continuing dislike of him they'd have to be terribly desperate, but it's not impossible. Would it help? No. His grass-is-greener popularity in the polls would soon evaporate as voters were repulsed by this ultimate proof of Labor's disloyalty, ruthlessness and lack of principle.

Next year should be a year of consolidation and less frenetic policy making, with the government needing to be sure the introduction of the carbon price arrangements goes smoothly. Should the

world economy stay on track, the government will press on with its priority of returning the budget to surplus - as, in all the circumstances, it should. Should things go really bad in Europe, the primary response will be from the Reserve Bank, but the government will at least have to reverse its rhetoric and allow the budget's automatic stabilisers to widen the budget deficit, and may need to consider a new round of fiscal stimulus. For Abbott and the opposition it will need to be a year where, finally, they make their contribution more constructive, outlining their own plans for improvement - even if, as ever, they leave the revelation of their detailed policies until much closer to the election. The longer Abbott continues with his relentless negativity, the more he risks trying the patience of voters.

Can we be sure the minority government arrangement will hold together for another year? No. Just one death or resignation of a Labor member could bring it undone. But by now it ought to be clear to all that the independents on whose votes Gillard relies have much to gain by continuing to prop her up and much to lose by deserting her. It should also be clear that achieving continued co-operation from the people whose votes she needs is one of the things Gillard is good at.

Why Labor is so bad at it

I have no problem putting the boot into politicians who are flying high, but I don't enjoy kicking people when they're down. If for no other reason than that I prefer to be ahead of the conventional wisdom. But I can't take a look at the political scene and not address the obvious challenge for political analysts: why exactly is this version of Labor so bad at governing?

A host of explanations has been offered, many of which have only some degree of truth and some of which are more in the nature of excuses. One we can dispense with is that it's all down to the personal failings of Rudd. He had many failings and he left Gillard with a terrible inheritance of a far too long agenda of half-finished policy projects, but we've seen enough to know things didn't immediately look up after his departure.

A favourite excuse of Labor and its supporters is that it's been turned on by the Murdoch press. It's true *The Australian* has turned from being a newspaper to a product aimed at gratifying the prejudices of a particular segment of the audience, but it is - by commercial design - preaching to the already converted. Its influence is limited to those silly people in Canberra who continue to take it seriously, imagining it still to be a newspaper. As for the depredations of Sydney's *Daily Telegraph*, it was ever thus. That organ has been a vehicle for foisting the bosses' views on workers since it was owned by Frank Packer. It's true the radio shock jocks often take their line from those two outlets, but were they not available the jocks would just have to work harder to find their sources of daily indignation. So, sorry, but I think the Murdoch excuse is greatly overdone. It falls into a class of argument politicians trot out to sustain the faith of the party faithful, not because they believe it or expect the uncommitted to believe it.

I think part of the problem attaches to Gillard herself. The brutal circumstances in which she came to power count against her in the mind of many voters. I don't doubt there's an element of misogyny in the electorate's failure to warm to her and that many people find her voice grates. But her deeper problem is her inability to come over on television as a warm and likable person. Some polities have that ability, others don't. Other politicians manage to substitute an air of paternal authority - don't

worry, father is in charge - for likeability (eg Malcolm Fraser, Maggie Thatcher), but Gillard can't manage that, either.

Lack of an air of authority - leaders who look like leaders and hence command respect and compliance; leaders who seem legitimate - has plagued the Rudd-Gillard government. I've come to the conclusion that - at the federal level, at least - the Liberals really are the natural party of government. That's what the electorate thinks, what business thinks, what the media think, what the Libs themselves think and what, deep down, even Labor thinks. On the central polling question of which party is best to handle the economy, the Libs always win. The Hawke-Keating government managed to out-poll the Libs for a while, but Rudd and Gillard never have. This is not a question of track record, but of long-held and deeply held stereotypes. The party of the bosses will always be better at managing the economy than the party of the workers.

This is what allows Abbott to turn opposition to outright obstruction without attracting criticism. It's what allows Abbott to take the support of business for granted, while Labor knows it must always be seeking business's approval. It's what has allowed business to conclude Labor is anti-business even while Labor modifies its policies - including Fair Work - to avoid offending business. It's what, in the battle over the mining tax before Rudd's overthrow, allowed the public to believe the foreign mining giants' ads claiming the tax would destroy the economy over their own government's ads assuring them the tax wouldn't be a problem.

It's what explains the Libs' ability to wind up the electorate over Labor's mountainous deficits and debt and why few economists intervened to dispel the nonsense. It explains why the opposition has had an excessive influence over the government's fiscal policy and why Labor is obsessed by returning the budget to surplus in 2012-13. It also explains why only at this point have economists entered the debate to attack the government's deficit mania.

Labor's universally assumed inferiority - combined with journalism's highly selective approach to quoting evidence - explains the success of *The Australian* in convincing almost everyone - punters, gallery journalists and even Labor politicians - that most of the money spent on Building the Education Revolution was wasted.

Associated with Labor's lack of apparent authority is the phenomenon of the slippery slope. When you're in power and on top you get a lot of co-operation, compliance and tacit support from interest groups and the public generally - all of which help you stay on top. These benefits of incumbency give you the strength to stand up to particular vested interests and tide you through the ups and downs of the polls. But when your weakness in the polls becomes sustained, you hit the slippery-slope part of the curve where it becomes a lot easier to fall further than to claw your way back up. Where things start to unravel as people who formerly accepted the reality of your continuing authority begin to wonder how long you'll survive, whether they should give you a push on your way and whether they should start cosyng up to your likely vanquisher.

Though she seems to have made a little progress back up the greasy pole in recent days, Gillard has spent most of her time as PM sliding down the slippery slope. It's a situation that emboldens your critics and opponents while making your supporters more cautious. So things have been unravelling. The denizens of the House with the Flag on Top - pollies on both sides, staffers and journalists -

revere success, fear the successful and despise failure. Lindsay Tanner says the press gallery is either at your feet or at your throat. It shifts when it sees you languishing in the polls, emboldened to be a lot more probing and critical and take a lot less on trust. The denizens take the polls so seriously that everyone starts expecting anything you do will fail, and their expectations tend to be self-fulfilling.

One interest group that's particularly susceptible to this behaviour is business. Business will live with a housetrained Labor government with a steady grip on power. But it does so against its natural preferences. Big business people expect Labor to court them, while quietly accepting it when the Libs choose to ignore or pressure them. Business is very unhappy with Labor and I have no doubt its disenchantment and its increasing willingness to make its unhappiness known is magnified by its perception the Gillard government is not long for this world. It's willingness to accept the carbon tax has been diminished by Abbott's success in turning public opinion against the tax. Its complaints against Fair Work - which don't seem to have great substance - are directed mainly at persuading the next government to shift the balance back in favour of employers. If this does collateral damage to Labor between now and the election, so much the better.

Both the Rudd and Gillard governments seem remarkably inexperienced. This shouldn't be an excuse because it's unusual for incoming federal cabinets to have many members with previous ministerial experience. Labor doesn't seem to realise that maintaining good relations with business isn't just a matter of senior ministers trying to fit in as many boardroom lunches as possible, or even keeping in touch with the business lobby groups. It means having big business chiefs feel they can ring the PM about a problem and their being on the receiving end of calls from the PM to inquire about their views on relevant matters. The main union leaders would have such a relationship with the PM, but I doubt the business chiefs do. They'd know this and would feel alienated from Labor, especially because Howard was such a great private phoner of power-holders.

Similarly, Labor's failure to make sure the big miners knew what to expect well before the unveiling of the resource super profits tax is a sign of inexperience. The name of that tax - chosen by Labor's spin doctors - did much to convince the rest of the business community Labor was anti-profit and anti-business, without doing much to arouse the punters' resentment of foreign mining giants. Labor's PR people have been far too young, lacking much journalistic experience, let alone political experience. It should have recruited some old hands. Rudd treated his staff so badly he burnt through a generation of good advisers.

But Labor's chronic inability to sell its policies to the electorate can't be explained simply in terms of the inexperience of its spin doctors. It isn't primarily about spin doctors. I think the root of this generation of Labor politicians' problem - the key reason they're so bad at governing - is their background. Unlike earlier generations, almost all of them are apparatchiks; they come from Labor's professional political class: people who start working for ministers or unions straight from university and climb the Labor career path, never making a success of a career in the outside world or even spending a lot of time as an on-the-ground union official dealing with ordinary workers and disparate employers.

The trouble with this system is that it seems to be breeding a generation of politicians who don't have a good feel for human nature and, above all, don't give up their profession and enter parliament with a burning desire to make the world a better place. Their burning desire is to make

cabinet minister. Their entry to parliament is a promotion and a pay rise, not any sacrifice. These guys don't have deeply held values and convictions they're prepared to fight for and run risks for. Their lack of conviction robs them of the ability to explain policies that arise from their framework of belief. They can't fashion a compelling narrative of what drives them and where the government wants to take us. They lack the missionary zeal of someone like Paul Keating; they have no desire to convert. They think 'selling' policies is a matter for spin doctors and advertising agencies, not of working tirelessly to help people understand the vision and see why it's so important. When you're not passionate about explaining your policies, when you're just a political player, you do what Labor has done from the moment it took office: focus on attacking your opponents, thus conferring them and their criticisms a status they wouldn't otherwise have. When you're not a passionate explainer, you avoid answering questions and merely repeat prepared lines.

The problem with all this isn't just that you fail win public support for your policies, it's also that the public can sense your lack of commitment and conviction, your preference for self-preservation over leadership, your interests over theirs. You lose authority and respect in the eyes of voters. Courage comes from convictions; public confidence in governments comes from people's perceptions of your courage and conviction. As John Howard demonstrated with the GST, voters are perfectly capable of giving you grudging respect for pursuing a policy they don't like the sound of.

Minority government may be the making of Gillard

But having said all that, I now have to highlight a qualification. At the end of its fourth year, Labor has now amassed an impressive list of achievements. Leaving aside its remarkably effective response to the global financial crisis, we have: paid parental leave, equal pay for community workers, plain packaging for cigarettes, the foundations for a national disability insurance scheme, a price on carbon, the likely passage of the minerals resource rent tax, and the continuing pursuit of compulsory pre-commitment on poker machines. (Admittedly, the mining tax was butchered and Labor's health and hospital changes fell far short of their billing.)

Some of the items on that list may not greatly appeal to you, but they would to the Labor heartland. And it's noteworthy that some of the items wouldn't have been there had it not been for the insistence of those whose votes Labor has depended on to stay in government. On the carbon price, in particular, Gillard had no choice but to press on with its early introduction. See what's happened? The circumstances of minority government and the ferocious opposition of Abbott have left Gillard with no option but to take principled positions and stick to them through thick and thin. If her improvement in the polls proves lasting, it will be because her failure to win a majority has forced her to exhibit all the impressive qualities she seemed not to possess. Her steadfastness and ultimate achievement may be we winning her the grudging respect of the electorate.

Provided she can hold the numbers in the House for another two years, Gillard should benefit from the effluxion of time. It will give people more time to get used to her idiosyncrasies and more time to tire of Abbott's. And there'd be something very wrong if more than a year of living under the carbon tax didn't cause people to lose their fear of it.

It's interesting to observe the way conservatives have transferred the mantle of bogymen from the ALP to the Greens. Labor's greatest crime is not being typically wrongheaded Labor, but falling under

the spell of the demonic Greens. Exhibit A would have to be the carbon scheme. But, apart from its higher levels of compensation to industry, it was little different from Rudd's carbon pollution reduction scheme, which the Greens rejected out of hand. It's not politic to say so but, in the end, it was the Greens who changed their tune, much more than Labor did.

The prospect of Abbott

Abbott has been far more effective as opposition leader than I and other smarties expected. He quickly learnt to keep disciplined and avoid putting his foot in his mouth, and quickly displayed his greatest, most enviable strength as a politician: an ability to 'cut through' - to have the things he says noticed and broadcast by the media.

His policy of blanket opposition to all the government's policies has served him well. Many expected the electorate to tire of his relentless negativity, but it hasn't happened yet. Even so, some strains are beginning to show. His autocratic style has put noses out of joint within the party and, should his standing in the polls ever slip, we will hear from his detractors. There is much discontent within the party and in business over his refusal to criticise Fair Work and propose any changes that could reawaken the spectre of Work Choices.

Despite the opposition's remarkably strong standing in the polls, Abbott is not personally popular. He has a 55 per cent disapproval rating for his job as opposition leader. And the authoritative Australian Election Study, in which ANU political scientists surveyed voters soon after the last election, found that Abbott's unpopularity was the main reason he failed to win enough seats. Though Gillard's popularity rating was low, Abbott's was a lot lower - lower even than Keating's in the 1996 election.

Abbott has little interest in economics and no commitment to economic rationalism. His policy positions reek of populism, protection and direct controls. His solemn promises to roll back the carbon and mining taxes, but not reverse the goodies they will be paying for, leave him with a funding gap of many tens of billions he has, as yet, made no attempt to fill. How such a man could bring himself to outline the sweeping spending cuts needed to make good his promise to return the budget to surplus without delay is hard to imagine. He has, however, taken the precaution of refusing to use the services of the new Parliamentary Budget Office to cost his promises. There is no precedent for parties promising to abolish major new taxes already in operation, nor for governments actually doing it. I find it very hard to believe it would happen.

Should Abbott be elected, we face either a monumental breaking of promises or a government totally consumed by the effort needed to turn back the clock. Why the part of the electorate that cares most about good macro management and micro reform has had so little to say about Abbott's incredible performance I don't know. Perhaps they'll have more to say as the reality of an Abbott-led government draws closer.

Observations on monetary policy

I normally begin this section observing that the market and the business economists have had another bad year in their efforts the second-guess the Reserve Bank's moves in the cash rate, but this year I have to declare the second-guessers to be ahead on points. The notion that the Reserve

might cut rates entered the futures market's head a lot earlier than it entered the Reserve's head, so the market has to get credit for that. I'm not sure the market was particularly prescient on size and timing - suggesting it might have been right for the wrong reason. I suspect the market was dominated by foreign players who merely projected North Atlantic conditions onto the Antipodes, making insufficient allowance for local conditions. But, as all of us in the prediction business know full well, a win's a win. I wouldn't make those criticisms of the other great hero of this episode, Bill Evans. He stuck his neck out ahead of all of us, we marvelled at his folly, but he turned out to be right and he deserves all the accolades he got.

From where I sit it's clear to me that to make a legendary call like Bill's you have to get well ahead of the game, well ahead of the data - and you have to be right. When I saw Bill make his call I thought, that's not in the Reserve's plan, so he'll only be right if he foresees developments the Reserve doesn't foresee and those developments are big enough to change the plan. He did and they were.

The Reserve begins each year with a view of how the year's going to pan out and a rough idea of the policy adjustments the outworking of that view will necessitate. It must have such a view because it has an on-the-record forecast, and that forecast is its view. The trick for you guys is to work out what its forecast tells you about the policy adjustments needed to bring the inflation forecast about, given the growth forecast.

This year the Reserve was expecting growth to accelerate as the effects of the resources boom spread through the economy, adding to inflation pressures at a time when we were already close to full employment. It was therefore expecting to have to tighten a few times as the year progressed. But here's the point: it's continuously testing its forecasts and its expectations against the data as they roll in. And it makes its judgments about whether policy needs to be adjusted one board meeting at a time. As events unfolded, the economy didn't accelerate in the way it had been expecting, and so the Reserve never reached a point where saw the need to act on its 'bias to tighten'. At first there was the temporary setback of the Queensland floods - which proved less temporary than first thought - and then there was the backwash from the growing sovereign debt problems in Europe, mainly on business and consumer confidence. By November it was clear the economy wasn't taking off the way the Reserve had expected - mainly because of the confidence backwash from Europe - so the Reserve wasn't going to have the trouble keeping inflation within the target range it had expected to have, thus allowing it to make what it expects to be a once-off reduction in the cash rate to get it back to neutral. It's worth noting that part of the scope for this move came not from the effects of Europe but from the past and future revisions to the underlying inflation figures arising from the Bureau's reweighting of the index.

I don't think the Reserve has very firm ideas about where the stance of policy goes from here. The economy is pretty much in equilibrium, policy is set at neutral, so the rate will stay where it is until developments occur that knock the economy off its equilibrium path - and off the Reserve's forecast - in one direction or the other and require a policy response. Clearly, the balance of risks is very much to the downside.

But Bill has made another call and, as I understand it, is predicting another three cuts -presumably 25-basis-point cuts - next year. Here again you see him getting well ahead of the game; well ahead of the Reserve's thinking, as expressed in its forecast. He can see something coming down the pike the

econocrats can't, and he may again prove himself to be more prescient than them. What would fit Bill's call of three further cuts over the course of 2012 would be for the economy to slow down rather than speed up as forecast - for it to run out of gas, presumably because of growing caution and uncertainty on the part of business and consumers in response to continued turmoil in Europe. This would be manifest in a continuing rise in unemployment and an inflation outlook that was even more benign, thus allowing the rate to be lowered another click. Of course, were Europe to turn into the full catastrophe, we all know from the events of late 2008 how the Reserve would react. In that case I wouldn't be surprised to see three cuts next year, but they'd probably come thick and fast, and each be nearer 100 points than 25.

I remarked in my column last Saturday that when the news is full of stories about some economic issue and the authorities pop with a policy change, all the instincts of the media and the punters are to assume that A caused B. In this case, we hear all this bad stuff from Europe, which makes us think the European economy is stuffed, therefore we must be stuffed and that must be what caused the Reserve to slash its forecast and cut the rate. I think all humans have a tendency to string together chains of cause and effect in this way and for our thinking to be unduly influenced by those events that have 'salience' (prominence in our consciousness) because they are so dramatic, so highly publicised or so recent.

My point is that this defective reasoning may be very human, but economists need to do better. Because the markets and business economists spend so much time studying developments overseas - usually the US, but these days, Europe - and they do that because national financial markets are so highly integrated - these developments have great salience in their minds, which can tempt business economists to over-weight them when forming views about likely developments in our economy - our real economy.

We need to remember that overseas events may be very exciting and very important, but they're only relevant to us, our forecasts and our policy stance to the extent that, by some clearly identified channel, they have an effect on our real economy. They may be big in Europe, but are they still big by the time they reach us? Our real economy isn't nearly as well integrated with the world as our financial markets are. Our domestic demand (GNE) accounts for almost all of our aggregate demand, sometimes more than all. As I keep reminding my readers, roughly 80 per cent of what Australians produce they sell to other Australians and roughly 80 per cent of what they purchase they buy from other Australians. Of course, the sharemarket is a more important channel than it used to be, and so - thanks to an ever-more globally integrated media - are confidence effects. I say all this simply because I keep hearing business economists making predictions about what the Reserve will do, and explaining why it's done what it's done, much more in terms of overseas development than I see in all the Reserve's detailed exposition of why it did what it did. You've got to get your direction of causation right. The Reserve is managing our economy, it's responsible for our inflation rate. Its highest consideration will be what's happening in our economy and its interest in what's happening in other people's economies is limited to assessing the extent to which those events impinge on our economy. That's obvious, but people who know a lot about what's happening in other economies seem to keep forgetting it. Sometimes I think the traditional order in which the econocrats set out their analysis - start with the world, then move on to the domestic - may confuse people as to which is the more important.

Last year I advanced my theory that the timing of rate changes is influenced by 'bureaucratic neatness'. At the time I said:

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.

That was a year ago. What's happened since then? We've had just one rate move and it happened on . . . Melbourne Cup Day, making it the sixth cup day move in a row. Still think it's mere coincidence? Last year when I advanced my crazy, utterly economics-free theory, my mate Rory Robertson was the first to express his scepticism. So I asked some relevant econocrats what they thought of it. They thought it had some validity. Provided the Reserve hasn't got behind the curve, and thus needs to catch up ASAP, it will be more inclined to move in those months that fit its carefully constructed reporting cycle.