

Kevin Rudd's darkest days

New evidence shows just how out of control the Rudd government actually was, finds [Sinclair Davidson](#)

Kevin Rudd spent a fair amount of his intellectual capacity drubbing Friedrich von Hayek. Two major speeches given to the Centre for Independent Studies put the boot into Hayek who had also featured prominently in Ruddite essays deploring free markets. If Rudd had spent more time reading and understanding Hayek his prime ministership might have been more successful. His was not even a one-term government. His leadership was brutally but efficiently terminated in a matter of hours.

Perhaps a greater understanding of Hayekian principles would have better prepared him for the trials of national leadership.

The failings of the Rudd government were largely economic; successes were symbolic. Rudd was a utopian—he had a vision

for Australia, but in the end the cost of imposing that vision was too high. The great English philosopher Michael Oakeshott argued political leaders should not impose their visions for a better world on the broader population, 'if it is boring to have to listen to the dreams of others being recounted, it is insufferable to be forced to re-enact them.' Rudd was insufferable and worse; his behaviour and temper

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tantrums had become more erratic and public over time. Oakeshott continues, 'We tolerate monomaniacs, it is our habit to do so, but why should we be ruled by them?' Indeed.

Hayek had written a chapter in his *The Road to Serfdom* entitled 'Why the worst get on top'. In that chapter Hayek had warned on expediency becoming a moral imperative. When the end justifies the means individuals are cut off from all moral moorings and any sort of poor behaviour is justifiable. Rudd was very expedient and this contributed to his government's greatest failure—the mismanagement of the so-called global financial crisis. But the pointers to that failure were clearly visible early in his term of government.

One of the first economic policies that the Rudd government attempted was a national FuelWatch scheme. The argument was that consumers would benefit by about two cents per litre of petrol and the government had some econometric modelling to substantiate their claims. As it turned out the modelling was based on non-transparent data

and had a number of fatal flaws that undermined the whole case for the scheme. It was eventually defeated in the Senate, but only after a bitter public debate. The refusal to consult and to make data and modelling results available to outside scrutiny was to become a hallmark of the Rudd era.

GroceryWatch was the notion that government could provide consumers with comparative price information that would allow them to make better purchasing decisions. Of course, many retailers already spend their own money and time providing consumers with price information in a process known as 'advertising'—yet the government persisted for some time before abandoning this project. It turned out that the data government had on prices was often out of date and highly aggregated. In other words, it was of little use in actual decision making.

These were early problems that the Rudd government encountered. There will always be some teething problems with a new government. It is clear, however, that any lessons that could have been learned from these instances went unlearned.

The defining feature of the Rudd government was the response to the global financial crisis. Rudd referred to this as being a 'shitstorm'. Obviously, this was an attempt at humanising the PM, who 'accidentally' dropped the word on national television when describing the crisis. What is important to remember is that the Australian shitstorm was more of a political crisis than an economic crisis.

Rudd had come to office in November 2007 passing himself off as an economic conservative and promising that 'this reckless spending must stop'. By the end of his prime ministership his government had never achieved a single budget surplus and public debt had exploded to 1996 levels. It is very unlikely that Australia will have much to show for all that

spending, but Australia did avoid a recession. The defining question of the Rudd era must be how much did his actions contribute to Australia avoiding recession? Or would Australia have avoided recession anyway? Was Rudd worth it?

In their new book, *Shitstorm: Inside Labor's darkest days*, Lenore Taylor and David Uren come to conclusion that Rudd wasn't worth it:

... it is hard to resist the conclusion that the government spent more than was needed, no matter how reasonable its actions appeared at the time ...

The government and Treasury had expected collapsing businesses to drag the economy into a long recession, but instead the shock caused by the collapse in world trade and the panic in financial markets passed after a few months, leaving the corporate sector largely intact. The government was left completing large stimulus projects that were no longer really needed ...

It is the opportunity cost—the things that cannot be accomplished by either this government or the next—that weighs heaviest as a result of the government's spending more than was needed. Had the economy behaved anything like Treasury's forecasts for it, no-one would have begrudged the money spent. But now \$75 billion has gone, with a negligible addition to Australia's productive capacity. The debt must be serviced and in due course paid back. In the context of a \$1 trillion economy, it is not a crippling burden, but there is depressingly little to show for it.

That is a fairly damning assessment from two journalists who would normally be somewhat sympathetic to the government's stance on the stimulus packages. Unfortunately, what isn't



quite clear, however, is how they came to that conclusion. They tell the story of the Rudd government and the events of the crisis, including the climate change debate, but do not really come to terms with why the stimulus had failed, or why Australia avoided the crisis. To be sure, the failure of the Australian stimulus package is a lesser problem than the failure of stimulus packages in other parts of the world. The US, for example, spent a larger fraction of GDP on stimulus programs and still experienced a deep recession.

To understand the failure of the Rudd government we need to consider an argument made by US blogger Arnold Kling in his recent book *Unchecked and Unbalanced*. He makes the argument that knowledge is becoming more specialised and diffuse while political power is becoming more concentrated. The fact that knowledge is unevenly distributed across the economy is Hayek's great contribution to economic analysis. Kling argues persuasively that knowledge is becoming more diffuse over time. This trend, however, interacts very poorly with the fact that political power is becoming more concentrated. Kling's argument is that the same forces that ensure greater diversity in knowledge are concentrating political power. These forces occur anyway, but when combined with activist government they are a recipe for disaster.

The government's ability to successfully micromanage ever sophisticated aspects of the economy declines as knowledge becomes more diffuse. Government are still able to provide one-size-fit-all policy solutions at a time when consumers expect business to provide tailored micro-solutions. This, of course, leads to greater dissatisfaction with public services. The great irony of this is that government has never been better at doing what it does. Nonetheless, public dissatisfaction with government services seems to be on the



Shitstorm:
Inside Labor's Darkest Days
by Lenore Taylor and David Uren
(Melbourne University Publishing,
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rise as expectations grow faster than government can deliver. Rudd came to power promising to deliver more. Over time he gained the reputation of over-promising and under-delivering. As Taylor and Uren argue:

Even before the global meltdown, the government was struggling with the gap between what it was trying to do and what it could explain in its hyperactive drive to control the 24-hour news cycle.

The point here is that even before we get to the personal failings of the individuals involved, the Rudd government was always going to struggle to meet the lofty goals it had set for itself.

It seems Rudd had a natural inclination to micromanagement and an exaggerated opinion of his intellect. Confidence in your own opinions and views is a necessary trait in any leadership aspirant—so too is the wisdom to recognise limitations. Many organisational constraints exist to temper the strongly held views of leaders. The separation of powers within government exists for this very reason—to make it difficult for charismatic individuals to accumulate large swathes of power. One of the failures of the

Rudd government can be attributed to the failure of institutional constraints on government. Cabinet meeting where policy is debated by senior ministers of the crown having been fully briefed by their staff simply did not occur. Why so many safeguards in the Westminster system of government failed to work, or even sound any alarm, before Rudd was deposed as prime minister is an open question.

The argument that the government had to react quickly to the economic crisis and had insufficient time to gauge the opinions of the full cabinet simply does not hold. Taylor and Uren make the point, 'The Rudd Government saw the global economic storm coming'. Rudd had asked Ken Henry—Secretary of the Treasury—for some worst case planning in February 2008. By the time the government felt the need for an active fiscal response to the crisis in mid-October those plans were well advanced. Yet only Rudd and Treasurer Wayne Swan knew of the planning. Uren and Taylor report that Julia Gillard and Finance Minister Lindsay Tanner first heard of the plans on October 7, 2008. This represents an extraordinary process failure in government policy formulation. The Minister of Finance discovered a plan that would eventually spend half the nation's budgeted surplus a few days before the decision was made.

Tanner had been on the back foot throughout. He left the Brisbane meeting unconvinced of the need for a package and it was only on the Thursday [October 9] that he'd been informed by his department head, Ian Watts, that it looked as though one was going to happen away.

When that decision was eventually taken Tanner wasn't even there—he was on a phone hook-up from Melbourne, babysitting his children.

Swan wasn't at the meeting either.

He was in Washington D.C. at the IMF meetings. Swan clearly had been terrified by what he had heard in the US and it is clear that he over-reacted to the news. That is unsurprising. The US Administration had struggled to pass its TARP legislation through the Congress. Treasury Secretary Henry Paulson had employed much stronger rhetoric than circumstances indicated to promote his bailout package. Roger Congleton, professor of economics at George Mason University, argues that prior to this point the US had been experiencing a standard recession but government rhetoric of a new great depression was ‘news’ to many investors and believing that the government had superior information they immediately responded to that information. Panic from the US infected the Australian decision makers.

It was over the weekend of October 11 and 12 that the Rudd government made the decision to spend \$10.4 billion—half of the budget surplus. It was at this meeting that Ken Henry coined the phrase ‘Go Hard, Go Early, Go Households’. Apparently this was the distillation of Henry’s views of how to respond to an economic crisis. But Uren and Taylor suggest there is more to the Treasury involvement than simply giving disinterested advice. Henry had previously workshopped responses to an economic crisis. As he told Uren and Taylor:

The view we came to out of both those workshops was that, in periods of serious economic weakness, we in this department should be the first to say to government ‘do something’; we shouldn’t be the last’, he says.

In other words, Treasury had abandoned any pretence of an orthodox economic response to a downturn. Furthermore, Treasury would now have to be in the market timing business. Being able to accurately predict turning points in the economy is a remarkably rare, yet highly profitable, skill. Yet that is precisely what Treasury thought they could do. *Shitstorm* continues:

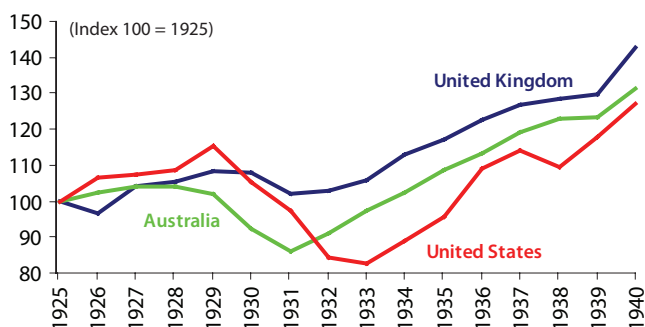
David Gruen, who was part of the 2004 workshops, saw the problems of using government spending to cushion an economic downturn as essentially prac-

Fear of Scullin: Learning the wrong lessons from the Great Depression

The spectre of the Scullin government haunted Kevin Rudd and Wayne Swan during 2008. James Scullin was a one-term Labor prime minister during the great depression. It was during his term of office that Australia accepted the advice of Sir Otto Niemeyer to cut government spending. There is great deal of controversy as to whether that advice was wise or not. It is certainly inconsistent with the Keynesian views that came to dominate mainstream economic thinking after the Great Depression had ended.

In *Shitstorm*, Taylor and Uren quote Swan as saying, ‘The abiding lesson of the Great Depression was that governments when they could have acted didn’t and the consequences of that were incredibly destructive’. That reading of history, however, is not consistent with actual events.

GDP Growth, 1925-1940

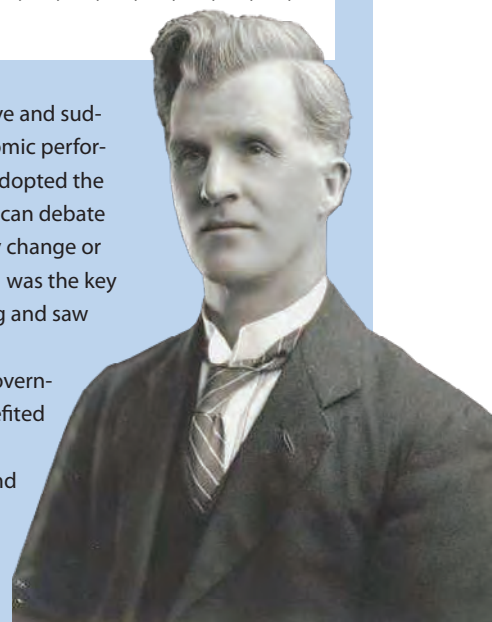


Source: Angus Maddison

Historical GDP figures show a decisive and sudden turn-around in Australian economic performance in 1931—the year Australia adopted the Niemeyer plan. Economic historians can debate whether that was the decisive policy change or whether going off the gold standard was the key to recovery. Britain also cut spending and saw economic improvements.

But it is clear is that the Scullin government made tough choices that benefited the Australian economy. The highly praised ‘New Deal’ led to a deeper and longer US recession.

– Sinclair Davidson



James Scullin, 9th Prime Minister of Australia

The prime minister, the treasurer and Treasury organised and coordinated the response to the crisis. Kevin Rudd has subsequently lost his job—his government had ‘lost its way’. It seems clear that Treasury has lost its way too.

tical. To avoid the problems of Keating’s One Nation package, Treasury had to be quick to recognise that the economy was in a downturn, and the government had to be quick to start spending. If these conditions were met, Gruen believed an increase in government spending could deliver a much faster-acting and more direct boost to the economy than a rate cut.

This view invites us to imagine that fiscal stimulus has never worked in human history simply because government can’t spend money fast enough. Gruen, we are told, was also unimpressed by the theoretical arguments against stimulus spending.

The most famous argument against stimulus spending is a theory known as Ricardian equivalence. This argument suggests that most people will save a cash handout on the basis that future tax liabilities will increase. There is a huge academic debate as to whether this theory is correct or not. Yet Gruen, as a doctoral student, had surveyed ANU students on public debt and compared that to ANU academics’ expectations of student knowledge of public debt and had ‘concluded the theory was an economists’ fantasy’. Perhaps it is. A dodgy experimental economics exercise on ANU staff and students is hardly authoritative and insufficient grounds to spend half the budget surplus.

Ken Henry apparently had wanted to commit \$5 billion to the first stimulus package. By the end of that fateful weekend Rudd had decided to spend \$10.4 billion. The cabinet rubber-stamped the decision the following Tuesday after the press

releases had already been printed. To sum up what had happened; Rudd and Swan had been worried about the economic crisis since early in the year. They had consulted with Treasury about a worst case scenario—a Treasury that unbeknown to anyone had an activist non-orthodox economic mindset—but had not advised any of the rest of the government, including the other two members of the gang of four. To compound the problem the opposition under Malcolm Turnbull offered bipartisan support and, with one honourable exception, did not subject the government, or Treasury, to any much needed scrutiny.

There has been debate as to whether the first stimulus package was successful or not. Ashton de Silva and I have argued that most of the money was saved and not spent. In contrast the government and its media allies have pointed to retail sales over Christmas 2008 to argue that it was a success. Of course, the biggest argument against the first stimulus package being successful is the fact that the Rudd government immediately unleashed a second stimulus package of some \$42 billion. Here the Rudd government intended only to save jobs.

The mathematics behind the massive outlay—and the total preoccupation of the prime minister—was how much money the government needed to spend to make up for the collapse in demand; it was how many jobs each component would create in each sector of the economy, and how that measured against Treasury’s predictions of the damage likely to be caused by the global

recessions.

One of the major problems with the second stimulus package is that the Treasury massively over-estimated the impact of the global financial crisis on the Australian economy.

The other problem is that an extraordinarily large amount of money needed to be spent in a very short period of time.

It would also turn out that no system on earth could deliver promised spending of almost \$60 billion in just four months without hitting some big implementation snags.

This must be one of the greatest understatements in Australian history. The home insulation scheme that the government had introduced to provide employment to low-skilled individuals led to four deaths and over 180 house fires. As much as the government has tried to argue that individuals and householders and the states should take responsibility for the debacle, the public have been clear as to where the lay the blame. The Building the Education Revolution expenditure has also proven to be controversial with The Australian newspaper running stories about waste almost every day.

What is missing from the Taylor and Uren account is any of the economic debate that occurred within Australia. They discuss the government and Treasury views and much about the opposition, yet there is no mention of economists outside those circles. The fact of the matter is that the government was unwilling to listen to any opinions it didn’t like. In the discussion of Malcolm Turnbull’s advice, Taylor and Uren argue:



Kevin Rudd and Wayne Swan enter a press conference with Treasury Secretary, Ken Henry | © Newspix

With the benefit of hindsight, his ideas may have avoided a lot of the government's subsequent problems, but the government rejected them entirely. Its reaction was immediate and scathing.

They are being far too generous—the Rudd government was too arrogant to accept any advice. When individuals make specific predictions that subsequently come true, hindsight has played no role in the analysis.

Two government ministers—albeit the prime minister and the treasurer—and Treasury organised and coordinated the response to the crisis. Kevin Rudd has subsequently lost his job—his government had 'lost its way'. Yet it does seem clear that Treasury has lost its way too. Ken Henry was able to opine that:

History may judge that first stimulus package as too early, too large or the configuration of it was wrong, but my view was that we needed to do something big and do it quickly.

There has been no public debate or scrutiny of that comment. Taylor and Uren tells that after a series of workshops Treasury had decided that it was always going to do—should that be 'recommend'—something big and quick. This raises the question about the brand of economics practiced in Treasury. As Henry told the Senate last year

whilst being very aware of those issues for many years, I can tell you that, confronted with the crisis that the world has been dealing with these past 12 months or so, those few quibbles with the use of expansionary fiscal policy—or expansionary monetary policy, for that matter—or other actions of governments to prop up credit markets are not ones that I considered should detain us for too long. They were rather quickly put aside.

In other words Treasury practices a brand of economics that is unknown to

the economic profession. They make it up as they go along. Small wonder that Henry was recently advising economists to shut up and support government policy.

As Taylor and Uren admit, a large sum of money has been spent with little to show for it. There was no rush—Rudd and Swan and Henry and Gruen had planned for a long time before they felt the need to spend—yet in that time they consulted with no-one and didn't even advise other elected representatives. They thought they could manage an economic crisis simply by spending, that they knew enough to replace private spending, and that they could save Australia from recession. Yet we know from the FuelWatch and GroceryWatch debacles that government had little understanding of markets and poor data. It is implausible to believe that they could get to macro-details right, when they had failed in the smaller aspects of their policy.

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