THE BRIEF

# Death of economists: Do they still matter, do we even listen to them?

Tuesday
29/05/2015
1:57:56 PM

**DOMINIC ROLFE**

*The GFC didn't just strip billions from share portfolios and the housing market. It might also have signalled the end of economists' princely status as forecasters of our financial fortunes.*

On the morning of October 12, 2008, the then Treasury Secretary, Ken Henry was woken by a call from his mother in Taree. It was the first time in his life she had telephoned before he had risen. She was worried. The fallout from US subprime mortgage defaults and the collapse of Lehman Brothers was washing through the world's markets. Credit markets had frozen and there was rising panic in the Australian community over the safety of their bank deposits. Henry's mother asked him if she should take all her money out of the bank. And his mother, as Henry noted, was a rational person.

Later that morning, Henry pulled Kevin Rudd aside before they walked into the Cabinet room where a response to the GFC was being thrashed out. He told the then Prime Minister that they needed to reach a decision that afternoon on guaranteeing Australia's bank deposits. Rudd would agree. The money in Henry's mother's account was safe, along with all other Australian account holders.

Rudd also asked Henry what else he should do. "Ken, to his great credit, distilled an otherwise complex message for us," recounted Rudd, "'Go early, go hard, go households.'" Rudd signed off on the first (and least controversial) of his stimulus packages - a $10 billion gift to Australians that put $1000 in their pockets just in time for Christmas.

It was a moment when economic thinking helped Australia avoid the recession that befell the rest of the globe. But would it turn out to be the high water mark for economists in Australia? While we turned to our economic gods at the height of the GFC as we might turn to religious leaders in times of personal crisis, some have since argued that they've been virtually stripped of their vestments by the very scenario that should have deified them. Yes, we still hear them but are they less likely to be dispensing sage and accurate advice?

"One factor that has made economists less interesting and less informative, is the way the entire economic environment has changed," says veteran *News Limited* business journalist, Terry McCrann. "In this extraordinary period since the GFC, the economic rule book has been thrown out the window and all the normal things that you would have expected governments and policymakers to do to fix problems no longer work and no longer seem to be relevant. Unpredictability is the new normal so it's much harder now for economists, in any sense, to add much to a meaningful discussion."

Even bank economists admit that the post-GFC world has changed. In early May, Ben Jarman, senior economist at JP Morgan, told *Saturday Extra's* Geraldine Doogue, that "[the RBA] and a lot of us in the forecasting world, have only gradually been coming to realise just how deeply the psychology of private citizens, corporates and households in the real economy have changed since the financial crisis in 2008. Monetary policy in particular doesn't work like it used to."

Before the GFC, the theory went that when you cut interest rates, the first signs of more economic activity would be in housing and that would then flow through to increased consumer and business behaviour. But those stimulatory effects in Australia have, in a major part, stopped at housing. After accounting for mortgages, consumers and business are saving more rather than spending, decreasing the flow of money in the non-housing sector economy. It is reigniting the question to which monetary policy - the raising or lowering of interest rates - works or not. "It comes back to the psychological scars of the financial crisis," Jarman told Doogue, "and one of the solutions to that is [for households] to just hold more cash. The problem that policymakers have had is that they can set the right preconditions, make money cheap through lower interest rates but you can't choose where people will push it."

There is another, related, reason why McCrann feels economists have lost their must-read allure. "The only thing that seems to matter to economists is what the RBA is going to do with its cash rate at their monthly meeting," he says, "The more meaningful, deeper, granular analysis of what's happening in the economy has disappeared."

So, in a world swirling with advice and comment about the future why even listen to economists? Should we sneer at recent headlines such as: "RBA unlikely to raise rates for years: economists"? Or are we so used to economic forecasts being so far off that we've decided to pay them little attention? Even when they're official Treasury numbers. As *The Australian's* economic editor, David Uren, pointed out in December last year, "Treasury first tried estimating the 2014-15 budget bottom line in December 2011; between budgets, updates and pre-election estimates, it has now had nine goes at getting the number right. The total downgrades due to the state of the economy now tally to $58 billion for that year alone."

At its heart, economics deals with the allocation of scarce resources. For Chris Richardson, the well-known commentator from Deloitte Access Economics and former Treasury economist, the two basic aims of society are fairness and prosperity. In other words, how big the pie is and how it should be sliced. "Everyone will have different ideas about that," he says, "but economics is about social contracts and how we do it better."

Economics is far from having an agreed system of analysis. And while it would be folly to reduce the dismal science to the decades old argument between Keynesians and Friedmanites, the economics landscape can be broadly broken into those who believe to varying degrees in the primacy of the free market and those who are more wary of it. It's a debate that is being rekindled as large government deficits and low (or zero) interest rates leave us with fewer and fewer stimulatory levers to pull.

The debate about the size and deployment of the GFC stimulus packages is a case in point. "The response," says Fairfax economics writer Matt Wade, "was a classic example of Keynesian economic policy and there's no doubt it stopped Australia going into recession and kept tens of thousands, if not hundreds of thousands of people from losing their jobs."

But on the effectiveness of the packages, there's no consensus. "It's still being debated," says Wade, "It's wrong to portray economics as this monolithic profession where they all use the same methodology and come up with the same conclusions and have the same ideas - it's complete rubbish."

And just as there are myriad economic viewpoints, these opinions emanate from countless sources. Economists such as John Quiggin and Warwick McKibbin, come dressed in academic garb, some such as McCrann, Wade, Alan Kohler and Ross Gittins, have morphed into journalists, while others such as Judith Sloan and Henry Ergas straddle both divides. An army of mostly publicly silent economists reside inside government departments and the Reserve Bank of Australia, others advocate loudly for lobby groups and think tanks. Yet another battalion crunch numbers for private enterprise.

Adding to the intrigue is the fact that many economists work on subsets of industry, the labour market or financial markets. This makes a model of precisely how everything fits together difficult to specify. When you fold in demographic change, technological innovation, globalisation and ideological allegiances to the mix, simple, linear analyses of such a monstrously dynamic system make numbers rubbery if not completely impossible.

So given all of that, who should we listen to? Does inaccuracy make the soundest voices even more important? Sheryle Bagwell, the business editor for ABC's RN Breakfast, says while a lot of economics is essentially a guessing game, veterans of the game are those worth listening to the most. For her, the economists she gives most credence to have built their influence and respect through the weight of experience and being seen to hold balanced views. "Not a lot of them have great track records because it's all about forecasting and looking into a crystal ball," she says, "Among most journalists, Bill Evans and Saul Eslake are the most respected of private sector economists because they have been around for a long time, and have seen it all."

Eslake, from Bank of America Merrill Lynch, is one of few names across the Australian economic landscape that most agree commands economic gravitas. Kohler says that Eslake's influence is clear through the speeches and reports that he puts out. In a 2013 submission to the Senate Economics References Committee, Eslake's submission titled "Housing Policy: 50 Years of Failure" addressed the twin failed policies of both first home owner grants (that Eslake had been arguing against for over 30 years) and negative gearing. In most states, those grants have been substantially reduced and Eslake continues to keep negative gearing in the policy spotlight.

More recently, Fairfax's Peter Martin says that Eslake's influence has crystallised around mooted changes to superannuation legislation. "Because Saul and John Daley from the Grattan Institute have been banging on about superannuation tax concessions favouring the wealthy, the government came very close to doing something earlier this year before it backed away for political reasons. Labor has been won over," says Martin.

Eslake's influence, says Martin, seems to emanate as much through his willingness to drive public debate as his perceived independence. "If a peak body or lobby group produces research and then they get an economist to pour holy water over it to make it look ridgey didge, no-one's going to pay attention to them. In the case of Eslake and Daley, they're not representing anyone so they're much more listened to."

So what does Eslake himself think of his perceived influence? "I would say that economists like myself have virtually no power at all," says Eslake. "When I was chief economist at ANZ, I would find myself saying to people, don't confuse visibility with influence. The most powerful economists are people like Glenn Stevens or John Fraser. The vast majority of the ones you see on TV, we've no power at all."

It's worth noting, however, that according to Martin, one of the most influential economists is the one the Prime Minister keeps closest. "David Gruen used to be head of macroeconomics in Treasury," says Martin. "Now he's Deputy Secretary, Economic in Prime Minister and Cabinet. He's the one who whispers in Abbott's ear. Gruen looks at all the relevant cabinet submissions and says, 'don't do this,' 'caution', 'yes to that, tick.'"

Eslake also nominates former RBA and Treasury official, Andrew Stone, as having strong political influence with Abbott. "Stone has been with Abbott since he was in opposition," says Eslake. "You wouldn't know it because he's almost invisible but he's probably a powerful economist."

While Eslake seems to be the most dominant public economic voice in the country, a quiver of big bank economists follow closely. In terms of economic influence (or, perhaps, visibility), it's more diffuse starting with Westpac's Evans, Alan Oster from NAB and Steven Walters from JP Morgan.

McCrann argues that the big bank economists, backed by their large teams of numbers wonks, are the closest things to an economist's economist, with Evans and Oster the stand-outs. "The bank economists can tell you what the data - retail sales, investment, construction, exports numbers - is showing so we can trust them." But, he adds, "it's not that helpful in anticipating what is going to happen next year or in a couple of years' time."

A more sceptical view of bank economists, according to Wade, "is that while they do provide analysis, for some, the job seems to involve a lot of public relations." Eslake agrees: "I would argue that economics was the only reason that [ANZ] got favourable coverage in the media," he says of his time at the bank, "instead of coverage for the CEO's salary, huge profits or charging fees. I used to argue internally that that's where us economists add some value to the organisation."

Ultimately, tracking the numbers and making market calls is a post-facto game. The economists, then, who wield the greatest clout are perhaps those who hold the jobs that demand they actually man the tiller. If you're looking at real power and influence, the two who exert real pressure on the Australian economy are Reserve Bank Governor Glenn Stevens and John Fraser, head of Treasury. Stevens is "ultimately responsible for the setting of monetary policy which is the key lever of economic management in Australia," says Wade. "And the RBA is an independent institution."

Richardson sees the influence of Stevens and Fraser in a slightly different way. "Yes, the earth moves when the RBA makes comments about the budget," he says, "but the RBA job has much less policy power than for John Fraser or the heads of treasury at state governments, or the heads of Prime Minster and Cabinet. These people bust a gut to give the best advice possible while taking stunning criticism from the public or politicians."

Policy influence resides in a major sense with Treasury, notwithstanding PMC, which Martin says is now full of economists, too. And it's as much the policies that filter through as those that don't. "The actual decisions, the choice of spending money here or there," says Martin, "involves comparing the differing outcomes and that's what economics and economists do." Richardson agrees. "Some of the most vital things Treasury economists can do," he says, "is stopping dumb decisions. It's harder to undo policy that has been implemented." Eslake, however, thinks that this argument is undermined by reality. "I'm not sure economists have been all that good at stopping dumb policies because there are so many examples of dumb policies happening."

A former senior RBA and Treasury official says that the major difference between the economic influence that flows from those two organisations reflects the legislative and bureaucratic environment they operate in. "If you have a statutory charter, such as the RBA Act, that gets you focused on what you have to judge and the call you make," he says, "In the Treasury it's a bit different. One has to make up their own benchmarks. It's harder because you give your frank and fearless advice once, if it's not taken up you put it again and then it's time to go with a compromise."

The problem in Treasury, he says, is that economists are increasingly under pressure to deliver politically palatable policies, not independent advice. "Unfortunately, in the last decade or so, if you're not working for the minister of the day of whatever political persuasion, and you're not delivering what they might want rather than what the public might want, then you're sidelined," he says, "These days it's harder for good economists to get their advice through and have it discussed and understood because so much of the power resides in ministerial offices rather than government departments. And those in ministerial offices are rarely good economists - they're often aspiring politicians."

As ministers and governments change, then, economic policy reflects both the advice they're receiving and as importantly, the advice they're rejecting. Alan Kohler says that politicians are now aggregating their economic information from a larger number of sources than before. "I don't know who they are, but [the Treasurer Joe] Hockey would clearly have his favourite economists."

Bagwell believes that Hockey would always take the advice of Treasury "but Hockey is closer to the private sector than say Wayne Swan," she says. "Hockey should be out there talking to everybody. That's [RBA Board member] John Edwards' line, that a good treasurer doesn't get led by the nose by Treasury because they are in an ivory tower and they often get things wrong - they usually go harder in terms of cuts and that sort of thing. Maybe [with the new Treasury chief John Fraser being a former UBS executive and economist] Hockey is hedging against that, which is good."

For punters trying to read the economic tea leaves and make sense of the column inches and branded interviews, a handful of economic writers and researchers stood out. For McCrann, economists such as John Daley from the Grattan Institute and those at the Centre for Independent Studies are worth listening to. Though, he cautions, "you don't take what they say as being innately true, you need to take them on the merits of their argument and the foundations they base it on." Long time Fairfax writer, Ross Gittins, was lauded by many for conveying complex ideas in simple terms. Eslake religiously reads Ross Gittins, Peter Martin and Alan Mitchell, among others. Richardson is another that many see as being a strong communicator of important economic thinking.

Richardson himself nominates Gittins, Ross Garnaut, Henry Ergas, Warwick McKibbin, John Quiggin and Ian Harper as his significant six. "It's an eclectic group," he says. "All six are superb economists and all tell it as they see it. I'll often disagree with them but if I'm going to [disagree with them] then I need to have good reasons." Martin meanwhile, says that along with Eslake and Daley, Richard Denniss and John Edwards are those that exercise the most influence.

Richardson, however, notes that one of the big failures is the economists' lack of communication skills. "We have great ideas but perhaps don't get them across as well," he says. "We've had heads of Treasury who, if they had to make a speech, took joy in making sure no one understood what they said. It seemed at the time like the right thing to do as a public servant."

McCrann agrees. "Given that the economics profession isn't very good at explaining what's happening, I don't think the general public would have a great deal of confidence in economic analysis and predictions."

But with all the economic sound and fury that fills our papers, radios and TVs, Richardson offers perhaps the most subtle and powerful argument for the high-profile, opinionated economists to keep doing what they're doing, even if their ability to forecast is circumspect. "In politics at the moment it's hard for either side to achieve anything," he says, "because over the past 20 years both sides in opposition have been increasingly likely to oppose and that's killing public policy.

"Talking to the public via the media about policy means you can then have a debate around that. And, in a way it's giving politicians cover for things that they know they should do but won't because of the political environment."

So perhaps what we need is not economists who can make predictions from wildly variable data - instead, we need bold, non-partisan economic thinkers who are able to advocate smart policies both behind closed doors but more importantly in public forums. "The economists that have the most influence, have gained that influence not by whispering in the government's ear but by filtering things into the public debate," says Martin, "It's the media that acts on the public and also acts on the politicians. And then the public acts on the politicians."