# Labor's dying art of masterful inaction

**Canberra observed**
Laura Tingle

What are $34 billion of tax cuts and a flummoxed opposition worth in the opinion polls? And, for that matter, what will be the opinion-poll measure of a successful campaign opening for the government?

The first of the major published opinion polls conducted after the calling of the election last Sunday are already whirring their way into print and they may be just as important for determining the history of this election as the tax cuts and Sunday's debate.

This is because so much of the first week of the government's campaign seems to have been about psychological warfare on Labor, as it has been about any communication with the public.

Just think about it: the coalition has rarely been off the air all week in its paid advertising campaign. But it has not used all that spending to sell its huge early spending on tax cuts. Instead it has concentrated its dollars in its more comfortable zone of negative advertising and its claims that the union-dominated Labor Party would end the world as we know it.

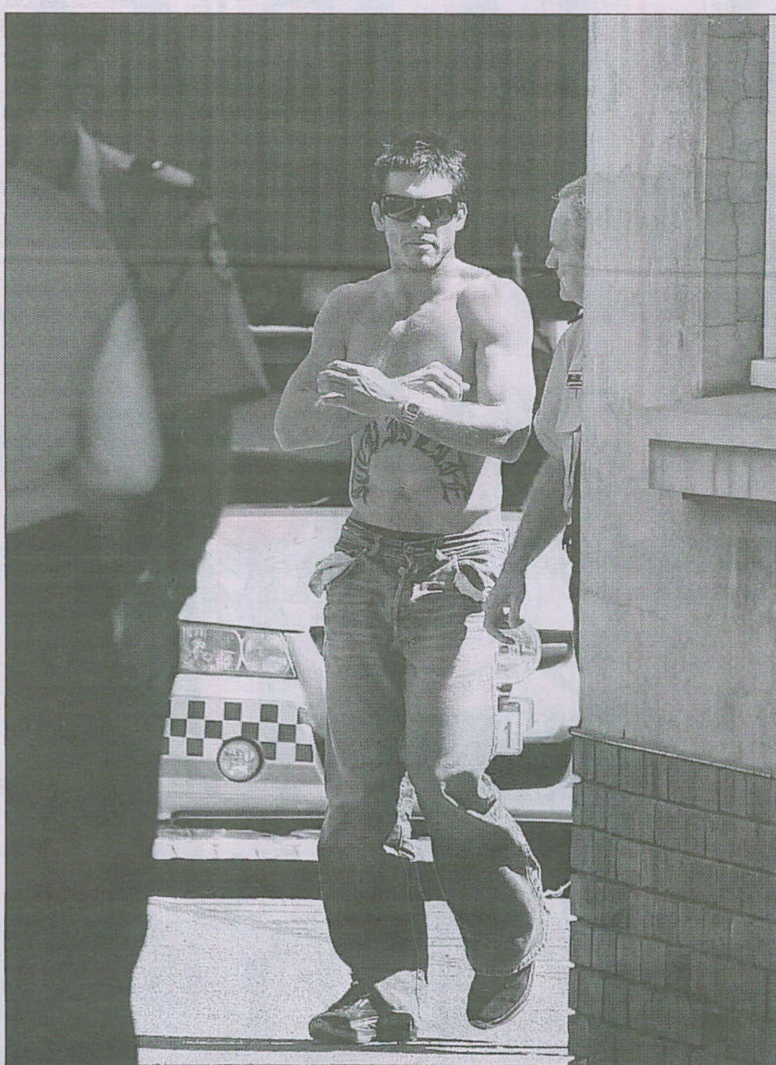
So just imagine what happens if such a huge spend ultimately had relatively little effect on either the voters or Labor?

Just imagine the panic in the coalition and the relief in the Labor Party as they go into Sunday's leaders' debate if the polls don't move significantly.

Few political observers believe the polls won't move at all from the 55 per cent Labor/45 per cent coalition pattern that has dominated the year, if for no other reason than the polls always adjust once the formal campaign is called. ANOP's Rod Cameron has long believed Labor's vote is overstated at 56 per cent and thinks it has been somewhere closer to 54 per cent.

But the desperation inherent in the government taking such a huge risk as it did on Monday with the tax policy means it knows it has to really get the vote moving early, and significantly, if it is to have any chance of success on November 24. The psychological victory over Labor this week would be diminished if the polls show only a small drift back to the government.

Howard's defensively driven but aggressive move on tax cuts on Monday has shown the new boy on the block a thing or two about why you should never underestimate the Prime Minister, why you should never be too smug about your grip on a political battle and why you should never underestimate the power of incumbency.



**Footballer Ben Cousins and drugs distracted voters from Labor's ills.** Photo: GREG BURKE

There was a story going around the public service late last week that the Howard government had been keeping open the option of bringing back federal parliament for one last legislative bang early this week.

It is fascinating to think that the legislation may have been for the $34 billion of tax cuts it instead simply announced on Monday and to ponder why it didn't pursue that path, which would have left Labor forced to back or reject the tax cuts on the spot.

As it was, for at least 48 hours the gamble seemed to have worked: Labor's Kevin Rudd and Wayne Swan looked shell shocked, Labor looked strategy-less and sick.

Then Ben Cousins went out for a good time, the tax story disappeared, the news cycle moved on and Labor was left to recover from its completely unconvincing "we'll do this in good season" response.

Since then Labor seems to have brushed itself off and regrouped a little, even if its daily campaign events continue to look a little Mickey Mouse and predictably like all the announcements before the campaign proper started.

The reasoning now is that Howard's move has not been all bad for the opposition: it's got the economic data it needs 10 days earlier than it expected; the government has shown its tax hand; the tax cuts are directed at the very place Labor has targeted in the past so it knows the ground; and more than anything else, six weeks is a long time in politics.

In other words, there is a virtue in doing nothing with purpose rather than doing nothing without purpose.

Of course, there is the small, Howard-designed and Howard-built hurdle to overcome: Sunday night's debate, clearly timed by the Prime Minister to both force Rudd to release his tax policy early and to maximise the pressure on him if he doesn't.

It seems highly unlikely that the Opposition Leader won't try to influence the debate on Sunday by releasing some major new policy beforehand, even if it isn't tax.

In fact, the best thing he could do is to try to get the debate back onto his ground.

But election campaigns constantly produce the unexpected – such as the International Monetary Fund statement on Wednesday night reigniting warnings about the risks of a spending bonanza.

Kevin Rudd and Wayne Swan were working yesterday to capitalise on this to make their relative restraint a virtue.

And, of course, the big economic test for the government will come next Wednesday when the consumer price index number comes out and we know whether the government will have to explain away a high inflation number and a November interest rate rise – a really good reason for Labor to wait before it releases any big spending policies.

Despite all the apparent political mastery of the coalition's move this week, its campaign is cluttered, stuffed to the gunnels and almost tripping over itself with negative messages: beware the dangers of wall to wall Labor; beware the dangers of wall to wall trade unionists; beware the dangers of inexperienced people wanting to run the country.

Perhaps its own lack of confidence that the "L-plate" campaign it ran so successfully against Mark Latham will work quite as well against Kevin Rudd is confirmed by the fact it is doubled for Wayne Swan and then "anti-business trade unionist" Julia Gillard in all its ads.

> **"Swan looked shell shocked, Labor looked strategy-less and sick."**

Negative campaigning has won elections for John Howard in the past but it remains the case that the negative arguments aren't quite as clear of hazards as they have been previously.

Even its anti-union ads only subliminally remind people that there is a difference between the parties on industrial relations and therefore of the coalition's own unpopular policies.

It's not clear that negative campaigning will be enough on its own at a time when Labor got out early in defining the race as being about an old and tired government versus a new and energetic alternative. That implies a discussion about new issues.

For the coalition, that means really looking like you do have a new agenda. And for Labor it means dropping the "me-tooism" with which Rudd is increasingly being ridiculed and re-establishing the points of difference.

■ *Laura Tingle is the AFR's chief political correspondent.*

# Securitisation: a vicious cycle comes full circle

You can only pass the buck for so long – and the same is true for packaging and passing on risk, writes **Nouriel Roubini**.

The recent turmoil in global financial markets – and the liquidity and credit crunch that followed – raises two questions: how did defaulting sub-prime mortgages in California, Nevada, Arizona and Florida lead to a worldwide crisis? And why did systemic risk increase rather than decrease in recent years?

Blame should go to the phenomenon of securitisation. In the past, banks kept loans and mortgages on their books, retaining the credit risk. For example, during the housing bust in the United States in the late 1980s, many banks that were mortgage lenders went belly up, leading to a banking crisis, a credit crunch and a recession in 1990-1991.

This systemic risk – a financial shock leading to severe economic contagion – was supposed to be reduced by securitisation. Financial globalisation meant banks no longer held assets like mortgages on their books, but packaged them in asset-backed securities that were sold to investors in capital markets worldwide, thereby distributing risk more widely. What went wrong?

The problem was not just sub-prime mortgages. The same reckless lending practices – no downpayments, no verification of borrowers' incomes and assets, interest rate only mortgages, negative amortisation, teaser rates – occurred in more than 50 per cent of all US mortgages in 2005-07. Because securitisation meant that banks were not carrying the risk and earned fees for transactions, they no longer cared about the quality of their lending.

Indeed, a chain of financial intermediaries now earn fees without bearing the credit risk. As a result, mortgage brokers maximise their income by generating larger volumes of mortgages, as do the banks that package these loans into mortgage-backed securities (MBSs). Investment banks then earn fees for repackaging these securities in tranches of collateralised debt obligations, or CDOs (and sometimes into CDOs of CDOs).

Moreover, credit rating agencies had serious conflicts of interest, because they received fees from the managers of these instruments. Regulators sat on their hands, as the US regulatory philosophy was free-market fundamentalism. Finally, the investors who bought MBSs and CDOs were greedy and believed the misleading ratings. Nor could they do otherwise, as it was nearly impossible to price these complex, exotic and illiquid instruments.

Similar reckless lending practices prevailed in the leveraged buyout market, where private equity firms take over public companies and finance the deals with high debt ratios; the leveraged loan market, where banks provide financing to private equity firms; and the asset-backed commercial paper market, where banks use off-balance-sheet schemes to borrow very short term.

> **"Reckless lending practices occurred in more than 50pc of US mortgages in 2005-07."**

Small wonder that when the sub-prime market blew up, these markets also froze. Because the size of the losses was unknown – sub-prime losses alone are estimated at $US50 billion ($56 billion) to $US200 billion, depending on the magnitude of the fall in home prices – and no one knew who was holding what, no one trusted counterparties, leading to a liquidity crunch.

But the liquidity crunch was not the only problem; there was also a solvency problem. Indeed, in the US today, hundreds of thousands of households (possibly 2 million) are bankrupt and thus will default on their mortgages. About 60 sub-prime lenders have already gone bankrupt.

Many homebuilders are near bankrupt, as are some hedge funds and other highly leveraged institutions. Even in the US corporate sector, defaults will rise, owing to sharply higher corporate bond spreads. Easier monetary policy may boost liquidity, but it will not resolve the solvency crisis.

There are two reasons for this: First is uncertainty about the size of the losses. In part, the size will depend on how much home prices fall. Moreover, it is hard to price losses on exotic instruments that are illiquid.

Second, thanks to securitisation, private equity, hedge funds and over the counter trading, financial markets have become less transparent. No one knows who is holding what, which saps confidence. When the repricing of risk finally occurred in September, investors panicked, causing a liquidity run and a credit strike.

So what is to be done? It will be hard to reverse financial liberalisation, but its negative side effects – including greater systemic risk – require reforms.

First, more information and transparency about complex assets and who is holding them are needed.

Second, complex instruments should be traded on exchanges rather than on over the counter markets, and they should be standardised so liquid secondary markets for them can arise.

Third, we need better supervision and regulation, including regulation of opaque or highly leveraged financial institutions such as hedge funds and even sovereign wealth funds. Fourth, the role of rating agencies needs to be rethought.

Finally, liquidity risk should be properly assessed in risk management models, and banks and other financial institutions should better price and manage such risk.

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