economic and political overview

2020

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About CEDA

CEDA – the Committee for Economic Development of Australia – is an independent, membership-based think tank. Working with our members, we identify policy issues that matter for Australia's future and pursue solutions that deliver better economic and social outcomes for the greater good. We seek to impact discussion and outcomes by:

- Undertaking research to understand the most important issues Australia faces.
- Creating platforms to inform, stimulate ideas and promote debate of critical issues.
- Facilitating collaboration to inspire innovative and progressive policy solutions.
- Influencing decision makers by delivering compelling evidence and recommendations and advocating in support of our positions.

CEDA has 770 members. Our cross-sector membership spans every state and territory and includes Australia's leading businesses, community organisations, government departments and academic institutions.

CEDA was founded in 1960 by leading economist Sir Douglas Copland. His legacy of applying economic analysis to practical problems to aid the development of Australia continues to drive our work today.

The content in the 2020 *Economic and Political Overview* was up-to-date at the time of printing. Due to the dynamic current economic and political environment, it may not address the most recent developments. CEDA's Economic and Political Overview event series takes place around Australia to coincide with the publication's release, and provides the latest analysis from report authors as well as business and political leaders

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Foreword

As we looked ahead at the end of 2019, there was a clear sense that 2020 would be a busy and challenging year in Australia and around the world.

There were concerns and questions about the strength of and outlook for our economy, how Australia should respond to challenges in health, aged and disability care; whether Australia would (finally) enjoy a period of relative political stability after years of instability at the federal level and a year of elections around the country including of course the 'miracle' federal election win for Prime Minister Morrison and his government; and questions from around the world including the implications of Brexit, US trade disputes with China, and the US presidential election.

However, these questions have temporarily given way to the immediate tragedy of the bushfire crisis. As the crisis continues to unfold, the nation is asking how we can address the immediate needs of those directly impacted while keeping a longer term eye on the broader impacts of climate change. These issues are deeply important to Australia's economic and social development and to our future prosperity.

As always, CEDA aims to provide insights and analysis to enable our members and audiences to understand and respond to the issues shaping the domestic and international outlook and policy landscape. To this end, CEDA's annual program begins each year with the *Economic and Political Overview* (EPO). This publication focuses on the biggest issues of the day, and not surprisingly EPO 2020 is a bumper edition.

To provide these insights, we have sourced contributions from experts across business, media, research and academia. They each bring considerable expertise in their field and years of experience and we appreciate their contributions.

Our 2020 EPO contributors are:

- Economic overview: Michael Blythe, Chief Economist and Managing Director, Commonwealth Bank of Australia
- Political overview: Professor Peter van Onselen, Political Editor, Network 10 and Professor of Politics, University of Western Australia and Griffith University.
- Aged care: Peter Harris AO, Research Advisor, CEDA
- Fiscal policy: Grant Wardell-Johnson, Lead Tax Partner, KPMG Economics & Tax Centre
- Data ethics: Sarah Kaur, Chief Strategy Officer, Portable
- Europe, the UK and Australia after Brexit: Professor Philomena Murray, Professor and Jean Monnet Chair *ad personam* School of Social and Political Sciences, University of Melbourne
- The US, Australia and the presidential election: Simon Jackman, Chief Executive Officer, United States Studies Centre
- International climate change policy: Martijn Wilder AM, Founding Partner, Pollination

To coincide with the release of EPO 2020, CEDA will be holding events across Australia during February and March with presentations from political and business leaders. These events will provide further analysis on the year ahead and an important opportunity for open and constructive discussion. I look forward to catching up with you at one of these events and hearing your perspectives and insights.

CEDA has a comprehensive program of research and events planned for the year ahead. I hope in this, our 60th year, we continue to reaffirm through research and advocacy, member engagement and events, the important role that CEDA, as an independent, member-based think tank, can play in positively shaping Australia's economic and social development for the greater good.

Melinda Cilento
Chief Executive
CEDA

1 Economic overview

Michael Blythe

Michael Blythe is the Chief Economist and Managing Director at the Commonwealth Bank. His extensive experience as an economist reflects more than thirty years working in economic policy and financial-market-related areas.

Michael's role encompasses monitoring, analysing and forecasting trends in the Australian economy and financial markets. In addition, he prepares a wide range of research material on matters of current interest. In his capacity as the CBA's Chief Economist, he is a regular conference presenter and media commentator on major economic developments and themes. Michael and his team have consistently ranked in the top three for macroeconomic analysis advice in various industry polls.

Rearview

The Australian and global economies wandered down a depressingly familiar path in 2019. Once again, the major forecasting institutions such as the IMF and the OECD revised down their projections for global GDP growth as the year progressed, and once again, Australian forecasters followed suit.

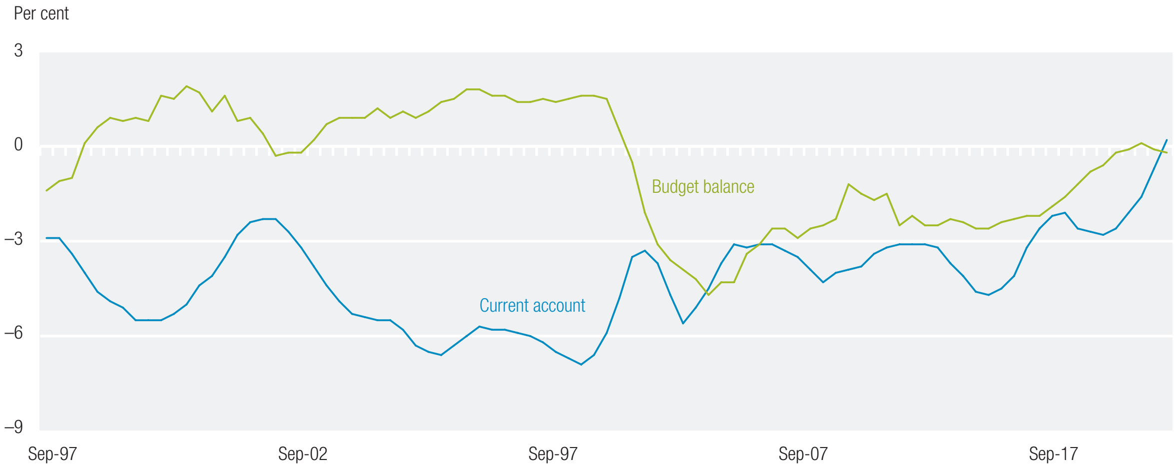
The global economy probably grew by 3.25 per cent in 2019 – 0.5 percentage points lower than expected around the start of the year. Australian GDP growth ran at about 1.75 per cent – a full percentage point lower than initial expectations. Both outcomes matched the weakness evident in 2009.

Accommodative financial conditions and the pursuit of yield provided a supportive backdrop for asset prices. Bond yields fell, share prices rose and credit spreads narrowed.

The common growth theme in 2019 was the uncertainties created by trade and geopolitical tensions. In Australia, a downturn in residential construction activity and ongoing consumer restraint amplified these global uncertainties.

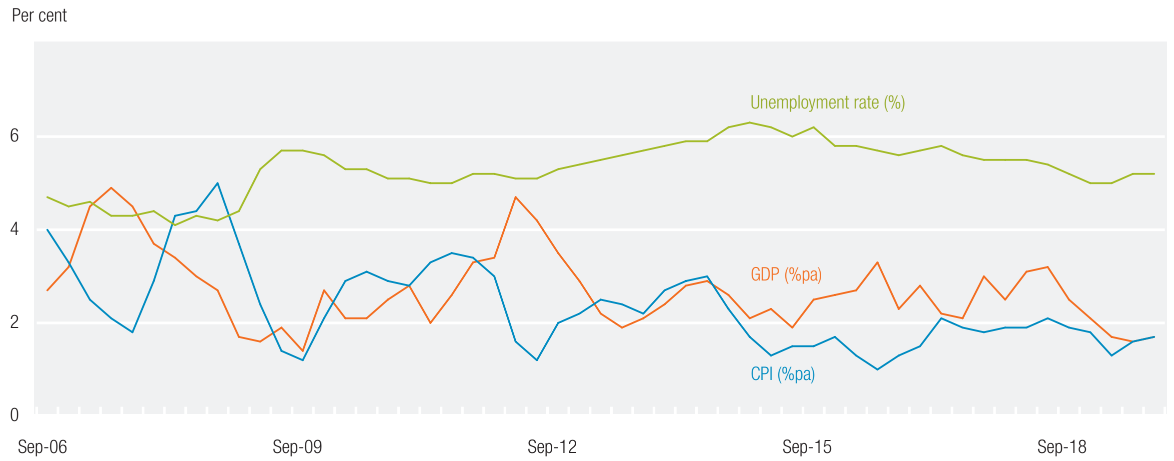
Some perspective is required. In Australia, for example, real GDP growth is running below potential growth of 2.75 per cent. However, growth rates are a long way from recession and Australia has now completed 28 years of continuous economic growth. Progress in reducing unemployment may have stalled, but employment growth is strong and the unemployment rate, at 5.2 per cent, remains well below 2014-15 peaks of close to 6.5 per cent. Wages growth is subdued, but low inflation rates mean small real wage gains are being eked out. The year also saw a balanced budget and a current account surplus – the first since the mid-1970s! (Figure 1, Figure 2)

FIGURE 1
Australia: key balances (rolling annual total, per cent of GDP)



Source: ABS

FIGURE 2
Australia: key indicators



Source: ABS

The starting point for 2020

A degree of pessimism about Australia's economic prospects built up in the second half of 2019.

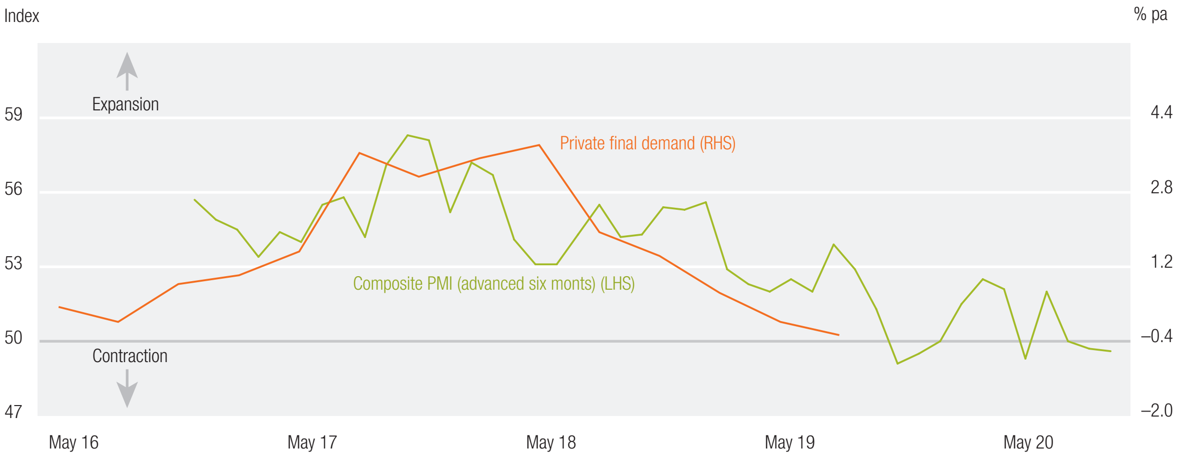
CBA's business surveys make the point. Our Purchasing Manager Indexes (PMIs), covering manufacturing and services, are bouncing around the 50 reading that separates expansion from contraction. The RBA's "gentle turning point" for the economy remains elusive.

Nevertheless, the CBA PMI readings also suggest that some of that pessimism is starting to look a little overcooked (Figure 3). New orders continue to rise, for example, indicating a degree of resilience in the domestic economy. The rise in new export business also indicates a degree of resilience against the uncertain global backdrop.

Certainly the global backdrop looks a little less uncertain at the start of 2020. The risks associated with a US-China trade deal and Brexit have retreated (see pages 11–13).

The RBA is criticised for moving the policy levers too late and the government is criticized for not moving enough, but the reality is that interest rates were adjusted relatively swiftly from mid-2019.

FIGURE 3
CBA composite PMI



Source: IHS Markit/CBA/ABS

Furthermore, in the April 2019 Budget the government topped up the tax rebates that were paid from Q3. Add in a lower AUD, lower corporate bond yields and higher share prices and financial conditions are very accommodative at present.

Our bottom line is that we expect the Australian economy to grow by 2.5 per cent in calendar 2020. The array of forces at work are set to skew in a more positive direction in 2020, but the net balance of these forces still favours another year of sub-trend growth.

A solid contribution from public spending and exports should support this growth. A degree of inventory rebuilding will also help given the size of the rundown in 2019.

Private spending should grow at a faster pace but growth rates are set to remain modest overall. A pick up in business capital expenditure will struggle against lower residential construction and constrained consumer spending.

Sub-trend growth will make it difficult to achieve any inroads into unemployment but we also do not expect unemployment to increase. Following the same reasoning, wages growth will also struggle to gain any real traction, and the RBA looks set to be disappointed again as inflation rates remain stubbornly below target.

A further shift down in key commodity prices towards more sustainable levels points to a declining terms-of-trade, which will in turn slow growth in nominal GDP. Projected budget surpluses may prove difficult to achieve and the current account surplus may be hard to sustain (Table 1).

TABLE 1
Australia: CBA key forecasts (yr av)

	2018 (actual)	2019 (forecast)	2020 (forecast)
Real GDP (%ch)	2.7	1.8	2.5
Real GDI (%ch)	3.1	3.1	1.0
Employment (%ch)	2.7	2.3	1.5
Unemployment rate (%)	5.3	5.2	5.3
Headline CPI (%ch)	1.9	1.6	2.1
Underlying CPI (%ch)	1.8	1.6	1.9
Wage Price Index (%ch)	2.2	2.3	2.4
Terms-of-trade (%ch)	1.8	5.7	–7.1
Nominal GDP (%ch)	5.0	5.2	3.1
Current a/c balance ($bn)	–40.0	+15.9	–5.8

Source: CBA

The global economy from an Australian perspective

The synchronised global upturn in 2016-17 morphed into something more uneven in 2018 and then a synchronised slowdown through 2019.

The main driver was uncertainty. Measures of global uncertainty reached record highs in 2019. The main question for 2020 is whether this uncertainty will continue to drag on global economic activity (Table 2).

Tariffs, uncertainty and the global economy

The most damaging and wide reaching effects of the trade dispute have sprung from the impact on business and consumer confidence. Measures of global uncertainty rose in tandem with US tariff increases. Other factors, like the Brexit debacle, almost certainly contributed as well.

The problem is that in uncertain times, businesses defer their capital spending plans and households put off their big-ticket purchases like motor vehicles and other consumer durables.

Less demand for investment goods and less demand for consumer durables means less industrial production. Because most of these goods are traded, growth in global trade also slowed sharply (Figure 4). Countries exposed to global production chains, particularly in Asia, were hit the hardest.

Australia, outside of mining, has a relatively limited exposure to these production chains, so the direct effects were relatively mild. However, the Australian economy suffered from the falls in confidence that followed the global trend.

Central banks shifted course in 2019 as the global slowdown intensified. The speed of the turnaround was notable; the proportion of central banks cutting interest rates is the highest since the financial crisis in 2008-09.

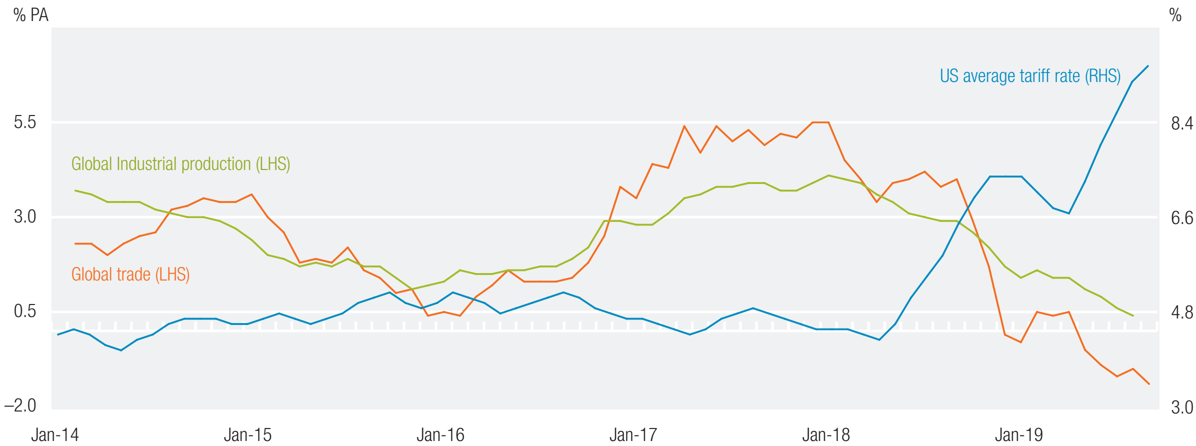
The RBA, concerned about domestic softness and the potential upward pressure on the AUD, had little option but to follow this global trend.

TABLE 2
CBA global growth forecasts (%ch)

	2018 (actual)	2019 (forecast)	2020 (forecast)
World	3.6	3.2	3.2
United States	2.9	2.3	1.7
Japan	0.8	0.7	0.6
Eurozone	1.5	1.1	1.3
United Kingdom	1.4	1.2	1.3
Canada	1.8	1.6	2.1
China	6.6	6.1	5.8
India	7.2	6.6	7.2
New Zealand	2.7	2.2	1.9

Source: CBA

FIGURE 4
Tariffs, trade and production



Source: CBP/ISITC

> "The major forecasting agencies may have revised down economic growth projections for 2020, but the general expectation is that global growth will be faster in 2020 and shouldn't fall far short of trend."

A return to synchronised growth in 2020?

The major forecasting agencies may have revised down economic growth projections for 2020, but the general expectation is that global growth will be faster in 2020 and shouldn't fall far short of trend. A lessening in trade tensions and associated pick up in industrial production and trade should help.

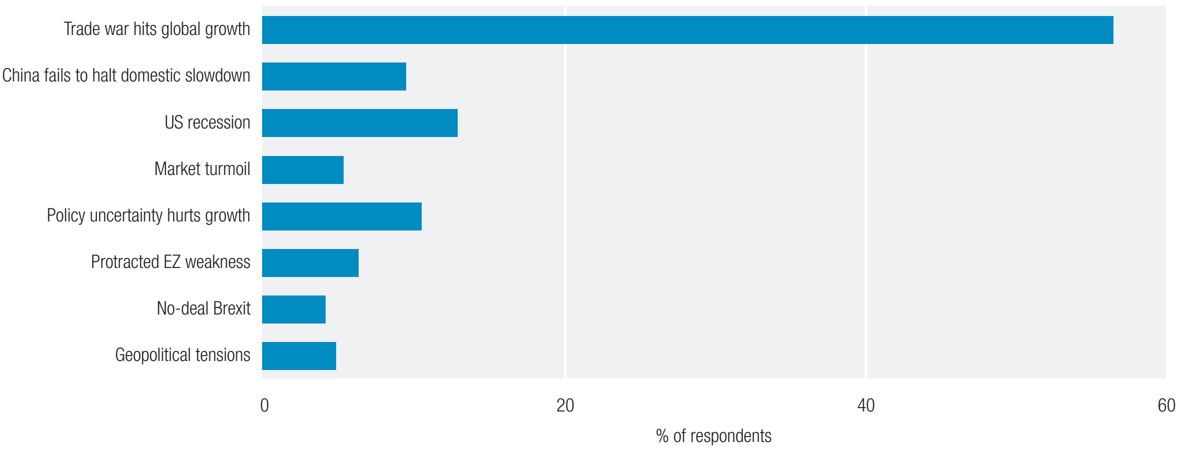
Narrowing the field to Australia's Major Trading Partners (MTPs) points to a reasonably encouraging backdrop. Some 70 per cent of these MTPs are expected to have accelerating growth profiles in 2020. This outcome would be the best result since 2017 and at the high end of the range for the past fifteen years.

Global risks in 2020

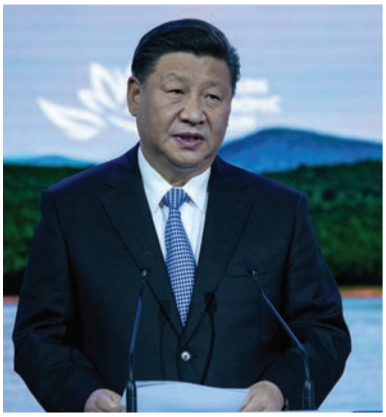
Despite an easing in some of the headwinds, risks to the global economy persist. *The Global Risk Survey* by Oxford Economics provides a sample of these risks. What stands out in the survey is the continued heavy weighting on trade issues despite recent progress (Figure 5).

This continued trade focus is understandable given the on-and-off nature of the trade negotiations in 2019. The shift in the Brexit conversation from an in-or-out decision to a debate about the future trading relationship between the UK and Europe has also kept the emphasis on trade.

FIGURE 5
Top downside risks next two years



Source: Oxford Economics



> "A Phase One trade deal between the US and China was signed off in January. The focus in 2020 will inevitably shift to a Phase Two deal."

1. The trade war?

A Phase One trade deal between the US and China was signed off in January. The focus in 2020 will inevitably shift to a Phase Two deal.

Phase Two will have to focus on the more intractable parts of the US-China trade dispute. These include areas like the role of the state in the economy, state-owned enterprises, subsidies, digital trade and cyber security. Phase Two will almost certainly progress slowly. The risk is that the uncertainty of 2019 re-emerges in 2020.

The Phase One deal involves China buying more from the US – particularly agricultural goods. However, buying more from the US will probably involve a scaling back of Chinese purchases from elsewhere. This means more trade diversion – including from Australia. Australian exports of LNG, beef and wine could be at risk.

2. China slowdown?

The Chinese economy slowed during 2018 and again in 2019. Chinese policy makers have responded with doses of monetary and fiscal policy stimulus, but they have failed to respond to a weaker economy as aggressively as they did in the past.

China has a number of not necessarily consistent goals. Policy makers want to maintain economic growth by implementing a "proactive fiscal policy" and "prudent monetary policy". However, a growth focus conflicts with the "three tough battles" of preventing and defusing financial risks, poverty alleviation and pollution control.

How policy makers resolve this conflict will be crucial for Chinese and global economic outcomes in 2020.

2020 is an important year for Chinese policy makers for other reasons as well. The Communist Party centenary goal of doubling per capita GDP from 2010 levels is due for delivery in 2020. To get there will require GDP growth around the six per cent mark in 2020 – a stretch target given current policy settings.

As a result, we expect an expansionary tilt to Chinese policy settings.

3. A US recession?

A solid labour market, rising real wages and wealth gains are supporting consumer spending, and monetary stimulus is helping the housing market. These factors should keep the US economy comfortably away from recession in 2020, especially given the risks that lie with further fiscal stimulus in an election year. The Fed may also be inclined to take out some more growth "insurance". We expect a further 50 basis points of rate cuts in the second half of 2020.

4. Market turmoil?

The same uncertainty theme has encouraged savings and discouraged investment. The supply of funds exceed the demand for those funds, forcing the price of money – or interest rate – to adjust lower.

Longer-term drivers suggest the savings-investment imbalance can persist, and interest rates are set to remain low for an extended period.

Low interest rates encourage the pursuit of yield and capital gains, with investors taking on more risk in the process. Market volatility is likely to be a persistent risk.

5. Protracted Eurozone weakness?

The Eurozone remains one of the weaker parts of the global economy. Germany and Italy were hit hard by the slowdown in manufacturing and global trade. The impact of new emission standards on car production magnified the impact on Germany. Countries more dependent on domestic demand, such as France and Spain, fared a little better.

The improvement in the backdrop for trade and manufacturing should benefit the Eurozone in particular, as will a turn in the automobile sector. Fiscal stimulus, if delivered, would also help the cause. Business surveys are sending some positive signals.

6. Brexit?

Brexit will occur on 31 January. The potential economic impact remains uncertain but the risks are down. OECD estimates put the potential output loss at more than two per cent of UK GDP.

The uncertainty about Brexit itself will be replaced by the uncertainty generated by the negotiations around the future trading relationship between the UK and EU.

7. Geopolitics?

The main geopolitical event in 2020 will be the US elections in November. Only a brave forecaster would attempt to predict the outcome of those elections, especially given the impeachment process running in tandem. The psephologists suggest sitting Presidents are typically re-elected, particularly if the economy is in respectable shape.

What would help global economic prospects?

Global central banks have already moved in an accommodative direction. However, with interest rates already at very low levels, it is questionable whether further monetary action will do much. The fundamental policy principle remains: monetary policy can help with the cycle but it is not a source of sustainable economic growth.

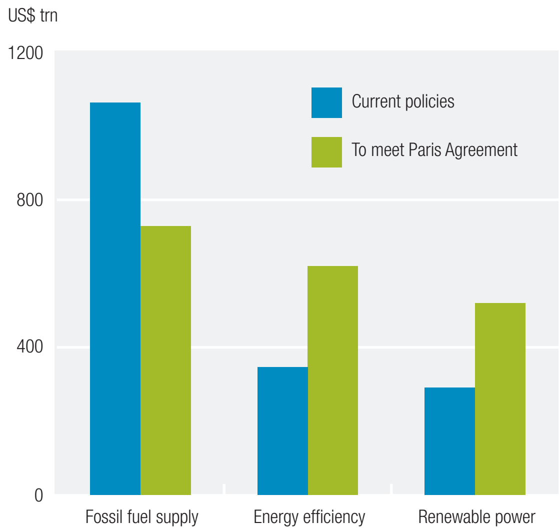
Fiscal policy, however, is different. Some countries, like Australia, do have fiscal space available, but even those with large deficits and/or high public debt have some wiggle room. The OECD notes that the mix of spending and taxing could be shifted in a growth friendly way while leaving the budget bottom line unchanged. More spending on education and infrastructure and less spending on subsidies for example, or shifting the focus from income taxes towards consumption taxes.

McKinsey estimates that some US$47 trillion needs to be spent between now and 2030 on transport & utilities infrastructure. Low borrowing costs means now is a great time to get on with the job.

> "The improvement in the backdrop for trade and manufacturing should benefit the Eurozone in particular, as will a turn in the automobile sector."

FIGURE 6

Global energy capex (per annum, 2019–30)



Source: IEA

The environment also requires substantial new investment. A big lift in capital expenditure is needed between now and 2030 in energy efficiency and renewable power to meet Paris Agreement targets (Figure 6).

The pace of structural reform has slowed post financial crisis. The process could be reinvigorated.

The high hurdle rates used to evaluate investment projects remains a major impediment to business capex. Surveys show that most businesses have hurdle rates of 10 to 13 per cent. Such rates look unrealistically high in a low inflation, low yield, low return environment. Businesses need to adjust their expectations to the new reality.

Commodity prices and uncertainty

The reduction in uncertainty and better tone to global growth prospects means that the fundamental backdrop for commodities is a little brighter. The actions by global central banks are consistent with a recovery in manufacturing activity. The actions by Chinese policy makers, with more to come in 2020, will push in the same direction.

We expect industrial commodity prices to lift during 2020 and the direction of risk to those price forecasts is generally up. However, commodity-specific factors will be important from an Australian perspective. In particular, the remaining supply disruption benefit should come out of the iron ore price (Table 3).

TABLE 3
CBA commodity price forecasts

	End 2019	End 2020	End 2021
Iron ore (USD/t)	91	67	64
Coking coal (USD/t)	140	150	170
Thermal coal (USD/t)	68	70	80
Copper (USc/lb)	283	265	285
Oil (Brent) (USD/bbl)	68	63	63
Gold (USD/oz)	1,510	1,650	1,550
CBA Commodity Price Index (US$, %pa)	–1	–11	0

Source: CBA

"We expect industrial commodity prices to lift during 2020 and the direction of risk to those price forecasts is generally up."

Australia in the global context

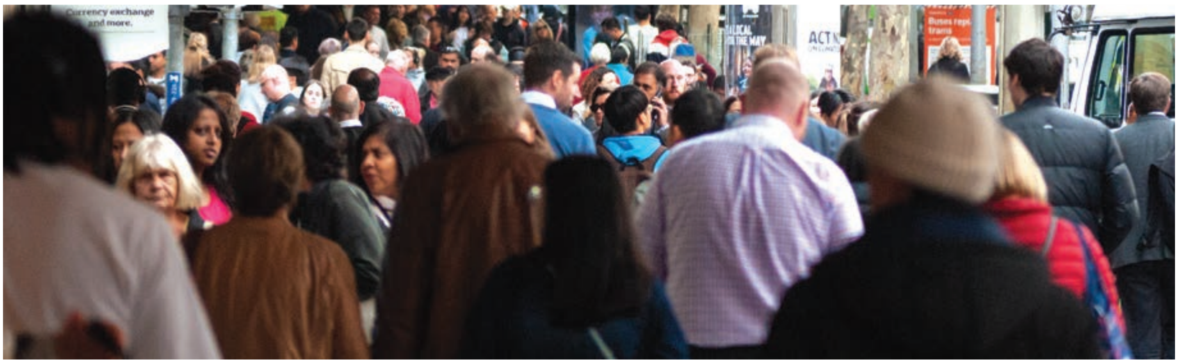
The Australian economy is subject to the same global risks as every other economy, but we are well placed to deal with those risks.

The resilience of the Australia economy to global shocks has been amply demonstrated. The floating AUD has proved to be an effective shock absorber for the Australian economy. Australia's "twin surpluses" – budget and current account – are useful protections in uncertain times.

The nature of Australia's trading relationships also helps. The share of trade exposed to the weaker parts of the global story is quite low.

The one exception is China. China takes more than 30 per cent of all Australia exports (six per cent of GDP). However, 78 per cent of Australian exports to China remain in China. Our exposure is to the Chinese domestic economy and that is where policy stimulus is being applied, with more to come in 2020. This domestic policy focus provides some protection for Australia.

> "The consumer is the biggest part of the Australian economy; consumer spending accounts for 56 per cent of GDP. As such, constrained consumer spending is the biggest domestic risk."



Risk and Australia

The impact of the shocking bushfires on the economy remains to be seen but they seem set to hurt the rural sector and tourism in particular. Beyond the fires, some of the temporary factors that weighed on the economy in 2018-19 have eased, and economic growth rates will lift as a result. However, respectable growth outcomes in 2020 will require more.

In particular, consumer spending constraints need to ease. A bottoming in the residential construction downturn, a lift in business appetite to invest, and continued contributions from LNG, infrastructure and Asian incomes would help – as would the right mix of economic policy settings.

Will consumer constraints ease?

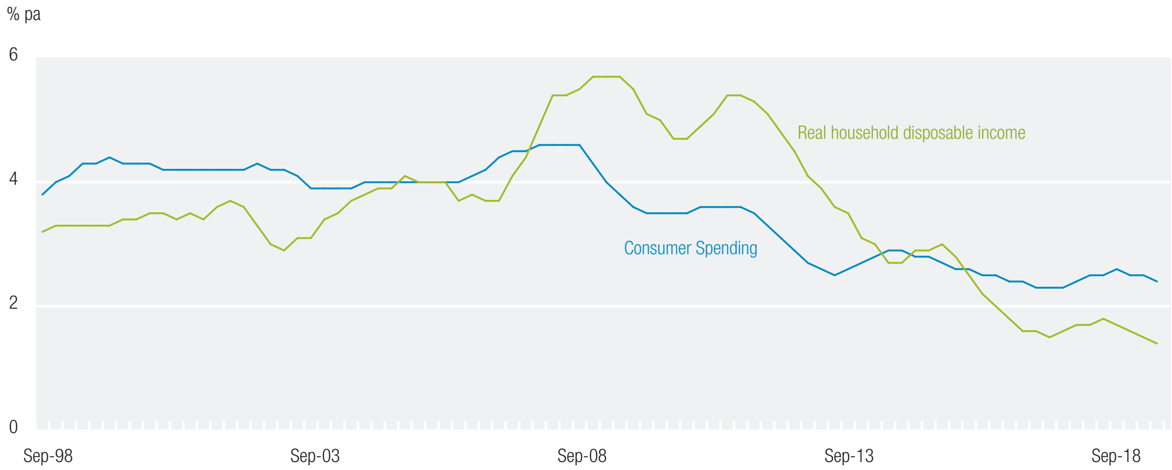
The consumer is the biggest part of the Australian economy; consumer spending accounts for 56 per cent of GDP. As such, constrained consumer spending is the biggest domestic risk.

1. Just the facts

Consumers are constrained by weak income growth, persistent job security fears, perceived household budget pressures and stretched balance sheets (Figure 7).

Subdued wages growth is the main contributor to weak incomes, but non-labour income has also been soft. The drought, softer residential construction and the downturn in housing turnover are all weighing.

FIGURE 7
Spending and income (rolling five-year average)



Source: ABS

Fiscal settings have not helped either. Income taxes have grown more strongly than incomes. Tax as a share of income stood at 15.1 per cent in mid-2019 – the highest share since 2005.

Households have consistently had a negative view of job security over the past couple of decades. The negative impact on consumer spending of these fears is accentuated by the elevated levels of household debt which comprised 186.5 per cent of disposable income towards the end of 2019 (Figure 8).

2. What would help?

The path to better consumer outcomes clearly requires more income, and wages are the primary source of income for most households. The standard forecast for a long time now is that wages growth will lift, but the reality is that wage outcomes have continually disappointed.

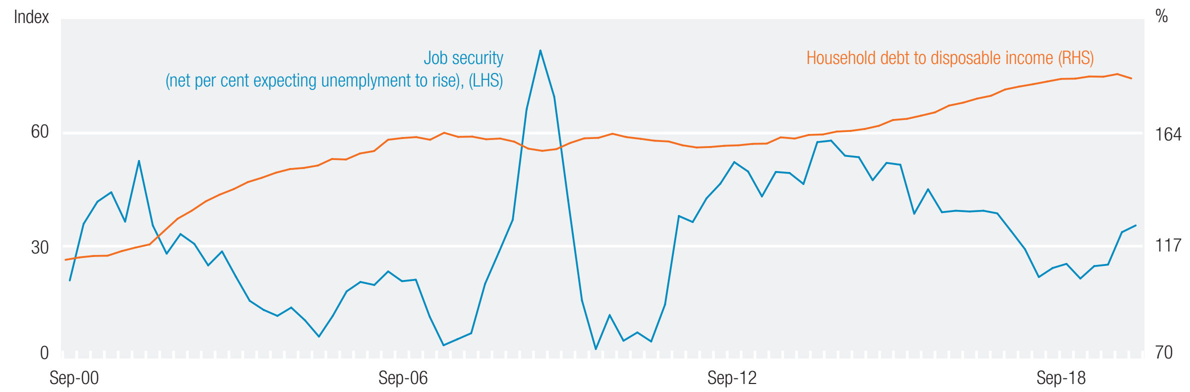
Weak wages growth is a reflection of the slack that persists in the labour market, despite the general decrease in unemployment in recent years. Underemployment, a truer measure of that slack, remains high (Figure 9).

Further inroads into labour market slack would help break this cycle, and this idea lies behind the RBA's refreshed interest in achieving full employment. So ongoing strength in jobs growth is another requirement for better consumer outcomes.

The leading indicators of labour demand, like job vacancies and business surveys, have retreated from recent peaks. However, they remain at levels that suggest jobs growth around the two per cent per annum mark, or about 20,000 per month.

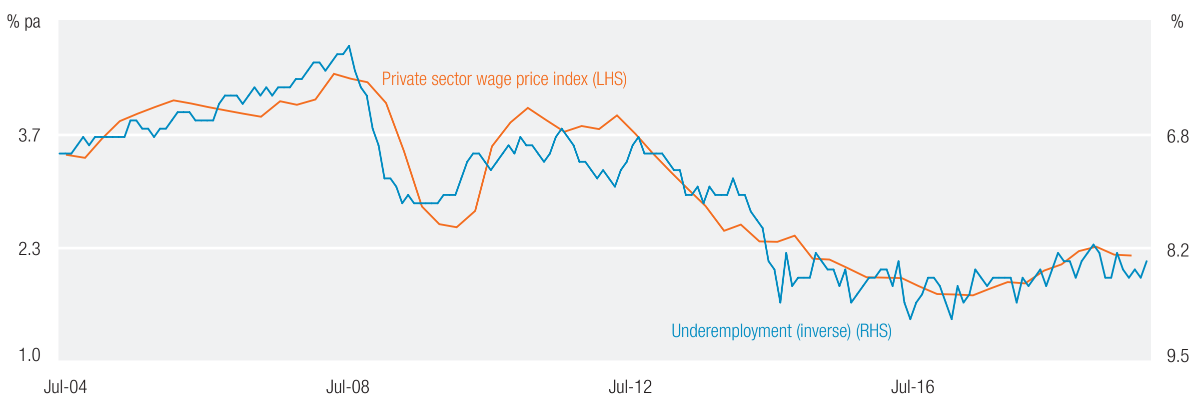
In normal times that sort of growth in labour demand would be sufficient to reduce unemployment and underemployment, but labour supply growth has been unusually robust as well.

FIGURE 8
Household indicators



Sources: RBA

FIGURE 9
Wages and underemployment



Source: ABS

"A turn up in dwelling prices means rising household wealth, more residential sales activity and more residential construction."

Progress in reducing unemployment will be slow, making it harder for the economy to reach full employment and generate stronger wages and inflationary pressures.

Regulatory changes combined with lower mortgage rates and a surprise federal election outcome that removed tax risks drove a strong turnaround in the housing market. Dwelling prices lifted sharply in the second half of 2019 as a result.

A turn up in dwelling prices means rising household wealth, more residential sales activity and more residential construction. More housing sales and construction activity would boost non-labour incomes. All of these developments are positive for consumer spending.

The leading indicators suggest further house price gains are likely in 2020. Auction clearance rates are high, new lending has picked up markedly and both house price expectations and home buying intentions have spiked.

Consumer spending should benefit from a positive wealth effect in 2020. However, there are some other risks in this scenario. Our forecasts imply dwelling prices will grow faster than incomes in 2020 so dwelling price to income ratios should rise again.

TABLE 4

CBA dwelling price forecasts (%pa)

	End 2019 (actual)	End 2020 (forecast)
Sydney	5.3	7
Melbourne	5.3	8
Other capitals	–1.1	3
All capitals	3.0	6

Source: CBA

They would remain above the 2014-15 pre-boom average, potentially renewing fears of an overvalued housing stock.

Housing affordability should also decline, renewing the pressures on potential first-home buyers (Table 4).

3. The message from the CBA HSI

Actual spending is typically preceded by an intention to spend. This intention is a useful indicator of shifting spending patterns, and it should shed some light on how the myriad of consumer issues are playing out.

CBA Household Spending Intentions (HSI) indicators attempt to capture how spending intentions are evolving. They combine CBA data on actual consumer spend with relevant Google search activity.

The HSI shows some quite polarised results for household activity at the end of 2019. On the consumer side, spending intentions remain soft but a gentle turn up is evident over the past couple of months (Figure 10). In contrast, home buying intentions have picked up sharply, such that they are now around the record highs seen in the first half of the 2017 fiscal year. Current readings are consistent with an ongoing pick up in dwelling prices (Figure 11).

4. Policy makers and the consumer

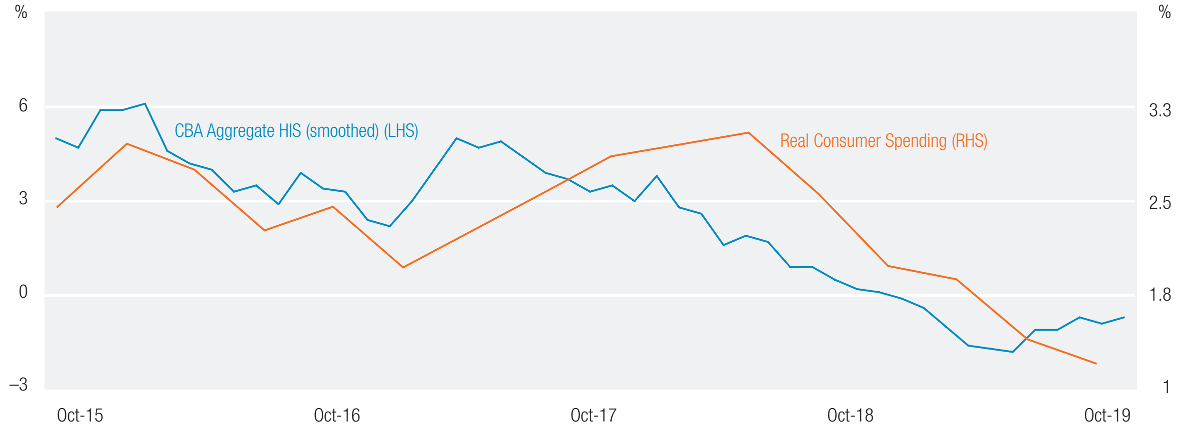
Interest rate cuts are not a very effective tool in boosting disposable income and consumer spending. Most borrowers keep their repayments unchanged when interest rates are cut and take the benefit via a faster reduction in their housing debt. There is no increase in disposable income.

And there are some less favourable outcomes for the asset side of household balance sheets. Households chasing yield and pursuing capital gains have taken on more risk.

The other risk is that rate cuts generate fears the economy is in worse shape than previously thought.

FIGURE 10

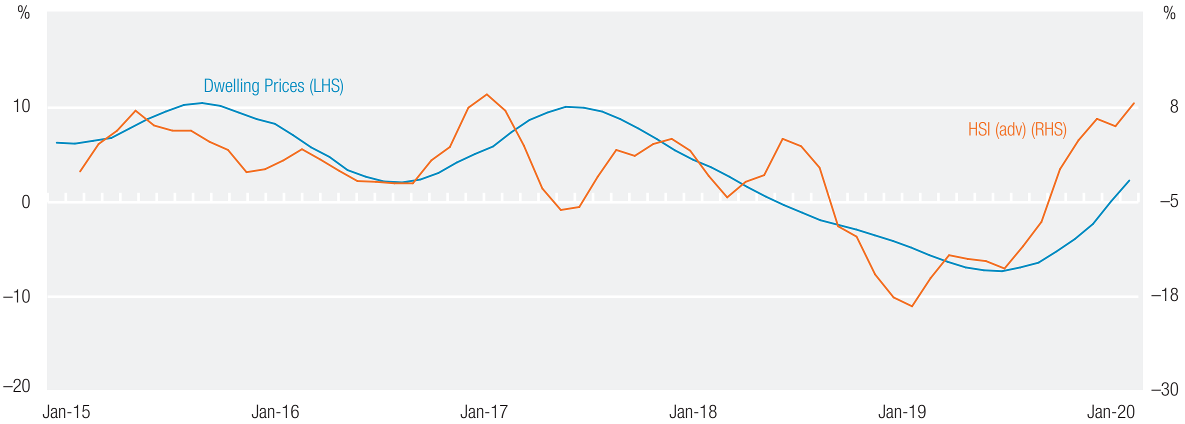
CBA HSI (household spending intentions): selected items (annual percentage change)



Source: CBA/Google Trends

FIGURE 11

CBA HSI (household spending intentions): home buying (annual percentage change)



Source: CBA/Google Trends

Business and consumer confidence has fallen since the RBA began cutting interest rates in mid-2019.

This is not to say that policy makers should refrain from helping households, just that the mix of policies needs to be right.

From that perspective, our clear preference is for more fiscal stimulus via income tax cuts. Tax cuts boost disposable incomes for all households, not just those with a home loan. They can be structured in a way that increases the likelihood that the income boost is spent, and they are affordable in the sense that the budget is in balance and government debt is low. The main options would be to top up the next round of tax rebates (as was done in the April 2019 Budget), or to bring forward Stage 2 of the tax cut schedule from 2022 when tax thresholds are to be increased.

Will the residential construction downturn reach bottom?

Falling residential construction since the Q3 2018 peak has reduced GDP by 0.6 percentage points to date.

Ultimately, we expect the peak-to-trough decline to be equivalent to one per cent of GDP and we expect to get to that trough by mid-2020. That outcome would make the current cycle one of the shallower downturns of the past 35 years.

There are a number of drivers behind this outcome:

- Above-average population growth requires above-normal construction activity;
- Rising dwelling prices are typically associated with lifts in new construction and renovation activity.

"Rising capex is required to help return the capital stock share of GDP back to more normal levels and deal with the demand from strong population growth, and reverse the increasing age of the capital stock."

Will the business appetite to invest return?

After decent outcomes during 2017 and 2018, growth in non-mining capex lost momentum in 2019. Part of this loss reflected industry specific factors. The drought, for example, drove a sharp fall in agricultural investment and the wind down in NBN construction activity drove a fall in information, media and technology capex.

However, business capex and future spending plans were also discouraged by the same uncertainties that weighed on the global capex story. Non-mining capex looks set to fall a little in the year ahead – a disappointing outcome given the needs of the Australian economy.

Rising capex is required to help return the capital stock share of GDP back to more normal levels and deal with the demand from strong population growth, and reverse the increasing age of the capital stock.

A bigger capital stock is also needed to help turn Australia's relatively dismal productivity performance around. Better productivity outcomes are necessary to sustain Australia's potential growth rate over the medium term. It's also important for medium-term income growth and fiscal sustainability in the face of an aging population. Rising productivity is a source of sustainable growth in real wages as well.

One requirement is the right policy settings. It seems clear that some clarity and certainty about energy policy, for example, would help. The pipeline of renewable energy projects has declined.

Press reports suggest that some fiscal incentives such as investment allowances are under consideration, but the company tax debate probably needs to be restarted.

Business also has a role. Uncertainty and caution is understandable, but a recovery in risk appetite is needed and justified by the fundamentals:

- capacity utilisation rates are above average;
- the rate of return on the capital stock is around long-run averages;
- the equity market is valuing additions to the capital stock more highly than the cost of adding to that stock; and
- borrowing costs are low and balance sheets are in good shape.

Part of that risk appetite needs to be a reduction in hurdle rates of return.

Will the growth guarantee deliver again?

The LNG boom, the infrastructure boom and the Asian income boom have proved reliable baseload providers of economic growth over the past few years. The nature of these booms was such that the growth contribution was all but guaranteed. All of these guarantees will remain in 2020, but their contribution to bottom line economic growth is set to wane.

The LNG export ramp up, for example, is getting close to full capacity, and its contribution to GDP growth and the trade surplus will slow. In a similar vein, the infrastructure boom has a long way to run but the capacity to keep lifting work done is limited.

Rising Asian income growth benefits areas like food, tourism and education in particular. This income story has a long way to run, but even here there are some signs of capacity limits. For example, growth in tourist arrivals from China is showing signs of plateauing.

"As in many countries, the pace of structural reform has slowed in recent years; the process needs to be reinvigorated."

What would help Australian economic prospects?

The RBA will probably cut interest rates again in 2020. They may even go down the unconventional monetary policy path. However, as noted earlier, we doubt that there is much more stimulus to be squeezed out of monetary policy. Our preference is for Australia's fiscal space to be deployed to boost household disposable income via the tax system.

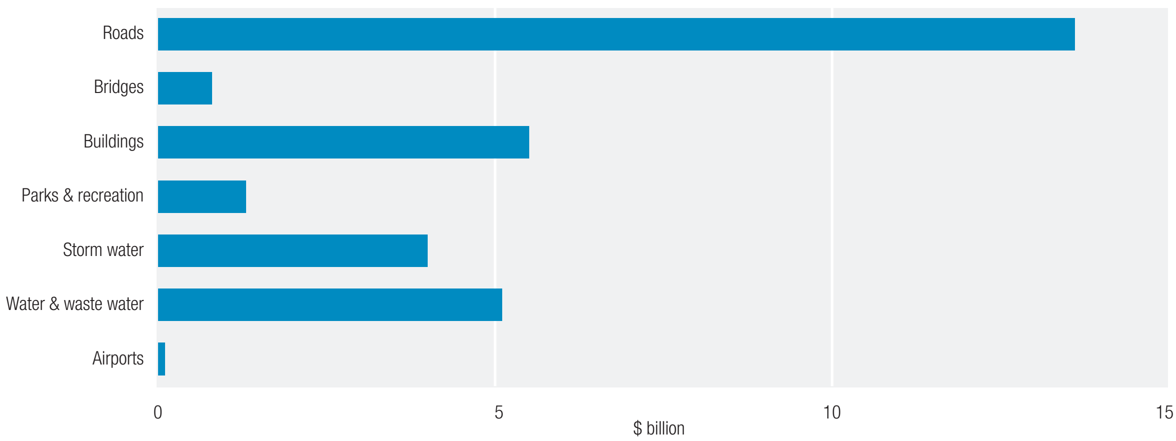
And there are other options as well. Capacity constraints (labour, materials) mean that the ability to ramp up big infrastructure projects is limited, but there is a significant backlog of smaller local government infrastructure assets in need of repair or expansion. Many of these assets are in regional areas that would clearly benefit from some assistance at present (Figure 12).

We have argued for a number of years now that we should be thinking about wages policy as well as the more traditional monetary and fiscal policies.

The Fair Work Commission has taken a step in that direction via above-average increases to the minimum wage over the past few years. Japan's proposal to cut company taxes, but only for those companies lifting wages and capex, is an example of the creative thinking that could be deployed. As in many countries, the pace of structural reform has slowed in recent years; the process needs to be reinvigorated.

The Productivity Commission has suggested that key areas for reform are abolishing stamp duty, replacing fuel excise with congestion charging, axing the "better off overall" test in workplace agreements, overhauling vocational education, energy policy and health service delivery.

FIGURE 12
Local government infrastructure (in poor condition)



Source: Australian Local Government Association

Will inflation matter in 2020?

The inflation story proved to be little more than just background noise in 2019. Inflation rates remained low and underlying inflation has run sub two per cent per annum since 2016.

Potential upside inflation risks come from the turn in the housing market, higher petrol prices and the lower AUD. Nevertheless, it is difficult to imagine a sustained lift in inflation without a preceding lift in labour costs, particularly against a backdrop where some policy makers are actively working to restrain the cost of living. Childcare subsidies, for example, reduce CPI growth, and pressure on power companies to offer discounts has the same effect. The decision to limit the upcoming rise in health insurance premiums to 2.9 per cent (versus 3.3 per cent in 2019 and 4.0 per cent in 2018) will continue the pattern.

Underlying inflation is set to remain sub two per cent in 2020.

The RBA in 2020

There were some major changes to monetary policy in 2019 that set the scene for 2020. These changes were:

- effectively giving up on the idea that wage growth will lift – the RBA now limits itself to saying faster wages growth would be a “welcome development”;
- given the importance that labour costs have in the inflation process, the RBA is now no longer able to project inflation back in the two to three per cent target any time soon;
- the focus has shifted to the other policy objective of full employment, which the RBA now defines as an unemployment rate of 4.5 per cent (well below their earlier long-held view of five per cent).

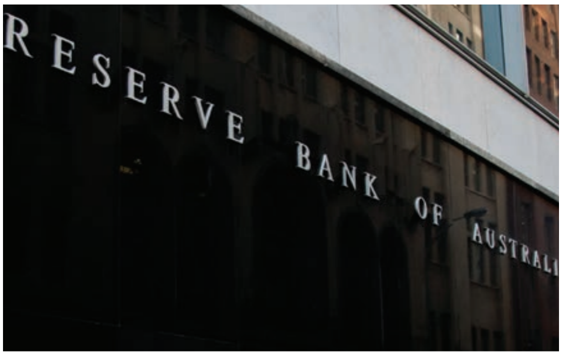
The gap between actual unemployment and the full employment rate demanded action during 2019, and the cash rate was cut to a new record low of 0.75 per cent.

The same thinking means the RBA ended 2019 indicating that they were ready to cut the cash rate again “if needed”. Policy makers have, somewhat grudgingly, acknowledged that interest rate cuts from current lows are less effective than previously. The RBA sees the Effective Lower Bound (ELB) as a cash rate of 0.25 per cent.

We expect the RBA to reach the ELB in 2020 with 25 basis points rate cuts in February and August. At that point unconventional monetary policy (UMP) measures are on the table. The RBA may have its UMP game plan worked out but there is a clear reluctance to put that plan into play.

The RBA views quantitative easing (QE) as a “bigger step” than cutting the cash rate, so the hurdle from rate cuts to QE is high. Part of that hurdle is evidence that the RBA’s baseline forecasts are moving off track.

We see the RBA’s current projections as achievable so UMP is not part of our baseline forecasts (Table 5).



> “Policy makers have, somewhat grudgingly, acknowledged that interest rate cuts from current lows are less effective than previously.”

TABLE 5
Unconventional policy options

UMP Option	RBA View
Negative interest rates	Extraordinarily unlikely
Extended liquidity operations	No need as markets are operating normally
QE: buying private assets	No appetite
QE: buying government bonds (probably also inc Semis)	“If needed”, would not start before cash rate was at 0.25% (the effective lower bound). Would also need evidence that RBA projections were materially off track.
Forward guidance	All ready in use – although the RBA prefers to describe this guidance as “transparency”

Source: RBA

> "The central theme driving our currency expectations for 2020 is ongoing USD strength. The flipside of USD strength is, of course, a soft picture for the other major currencies."

Financial markets in 2020

The central theme driving our currency expectations for 2020 is ongoing USD strength. The flipside of USD strength is, of course, a soft picture for the other major currencies. Most of the adjustment to a strong USD is already in place so the trajectory for most currency pairs is likely to be relatively flat (Table 6).

It is difficult to see interest rates remaining anything other than low in 2020. Inflation rates remain well contained, inflation expectations are subdued and central banks are more likely to be cutting policy rates than raising them.

TABLE 6
Australia: CBA key forecasts

	March 2020	June 2020	Sept 2020	Dec 2020
Cash rate	0.50	0.50	0.25	0.25
3-yr bonds	0.55	0.55	0.30	0.30
10-yr bonds	0.85	0.85	0.85	0.85
Fed funds	1.75	1.50	1.25	1.25
US 10-yr bonds	1.50	1.55	1.55	1.60
vs USD:				
AUD	0.68	0.67	0.68	0.68
EUR	1.10	1.11	1.12	1.13
JPY	103	104	105	105
CNY	7.05	7.08	7.10	7.10

Source: CBA

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Political overview


Peter van Onselen

Peter van Onselen is Network 10's political editor and a contributing editor for The Australian, where he write a weekly column. He is also a professor of political science and Foundation Chair of Journalism at the University of Western Australia, as well as a professor of politics and public policy at Griffith University. Peter has hosted The Drum on ABC and appears regularly as a panellist on The Project and ABC Insiders. He has won Walkley and Logie awards for his broadcast journalism on Sky News where he worked for nearly ten years as a host, and a News Award for his feature and opinion writing in The Australian. He is the author or editor of six books, including an acclaimed biography of former Prime Minister John Howard.

Introduction

For a non-election year, 2020 is set to be a testing time for the Prime Minister and the government. The fallout from the recent bushfires, both in terms of how they were handled and the management of the recovery, alongside the broader economic challenges the year presents, will keep the government on its political toes.

On a personal level, the honeymoon appears to be well and truly over for Scott Morrison after his stunning election victory in 2019. While the first Newspoll of 2020, released on 13 January, didn't show a significant collapse in the Coalition's primary and two-party votes, the personal support for Morrison has fallen off a cliff. His better PM rating dropped nine points, falling behind the Opposition Leader, and dissatisfaction with Morrison's performance went up to 59 per cent - the highest it has been since he took over from Malcolm Turnbull. The first Essential poll mirrored these results.

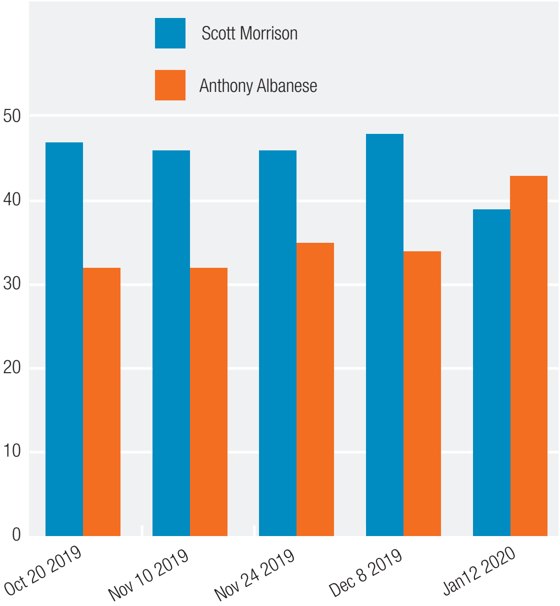
Voters reacted angrily to the timing of Morrison's overseas holiday in Hawaii and the lack of empathy he showed on his return. The obfuscation when it came to answering questions about what he could or should have done differently appears to have weakened the PM as a political force. While it's unlikely the shift will permanently damage Morrison, the possibility cannot be dismissed as this year begins. At the very least, it is likely to remove the previous benefit of the doubt he had when confronting challenges. How the PM and his team respond to future challenges will be more closely scrutinised because of their mismanagement in the early days of the bushfire disasters.

This year will also be interesting for how the climate change debate develops more generally. Partisan divisions on this important policy front have ebbed and flowed ever since both Kevin Rudd and John Howard took an emissions trading scheme policy framework to the 2007 election. The momentum seems to have once again shifted towards greater action on climate change, but what that might look like remains an open question. It remains to be seen if the Coalition plans to change its current policies, although Morrison alluded to possible adjustments to emissions targets in a 12 January interview with David Speers on the ABC. In subsequent media appearances, the PM and senior ministers discussed "climate change adaptation" as the focus going forward. Despite this, reactionary conservatives within the Coalition's ranks are unlikely to tolerate any shift, just as they opposed former PM Malcolm Turnbull's attempts to introduce the National Energy Guarantee in 2019, which Morrison and now Liberal Party Deputy Leader Josh Frydenberg supported at the time.

Prior to the bushfire tragedies, 2020 appeared set to be the year of the surplus, with the Treasurer and the PM adamant that this would be achieved no matter what. The final budget numbers for the previous financial year came in agonisingly close to a surplus. Equally, the likelihood of tensions in the Labor Party because of its unexpected defeat at the May poll last year appeared odds-on to be a major issue in 2020. But that was all before Morrison's horror start to the new year. If Morrison's recovery in the polls is swift, the pressure will quickly shift back onto Labor and Anthony Albanese.

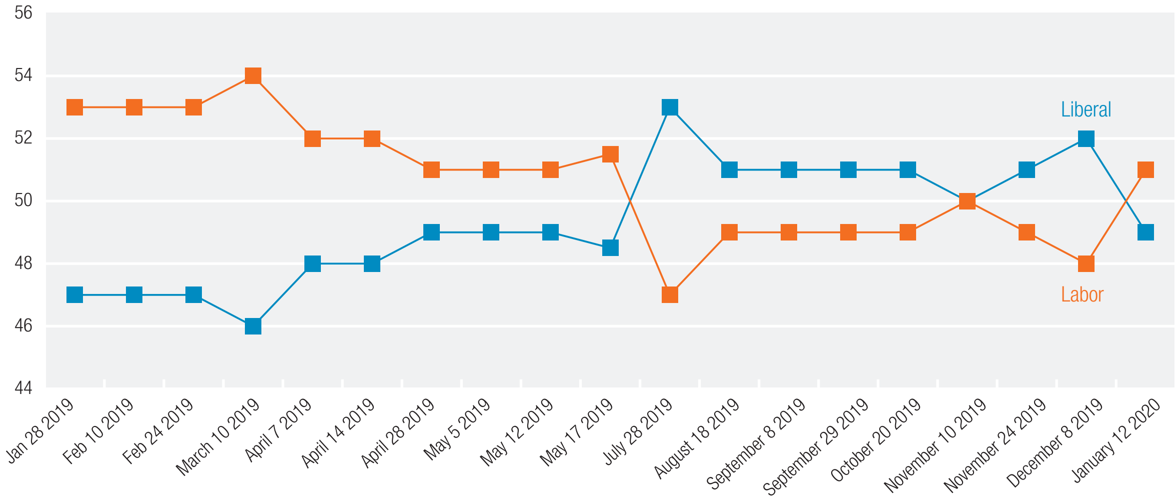
Of course, achieving a surplus is more symbolic than anything else, especially in the context of growing debt levels courtesy of off-budget infrastructure investments. The political goal of a surplus also runs counter to the Reserve Bank's monetary policy of lowering interest rates to stimulate economic growth. But will the politically desired surplus still be achieved now that the federal government has committed to significant bushfire recovery investments? This is alongside revenue lost because of the

FIGURE 1
Newspoll: better PM



Source: Newspoll/The Australian

FIGURE 2
Newspoll: federal two-party preferred



Source: Newspoll/The Australian

> "Morrison's victory was built on a scare campaign targeting Labor's big target agenda. In another parallel with the 1993 election, Shorten took the biggest selection of policies for an opposition into a campaign since Hewson's Fightback! package."

economic impact on communities, which will lower taxes being paid and business being generated.

Another area to watch politically in 2020 is what happens with the US-China trade war, as well as how the United Kingdom copes with a Brexit go-ahead, following Boris Johnson's thumping election win late last year. And of course, 2020 is a Presidential election year in the United States. These issues will be important external factors when assessing how the Australian economy is travelling this year, and how our trade and security relationships develop.

Finally, how both major party leaders handle internal party pressures will be important come the end of this year – a question examined in greater detail towards the end of this chapter. While a federal election isn't due until 2022, the most likely date for the next poll is the second half of next year. That means by this year's end both major party leaders will want to be moving onto a campaign footing. Morrison will therefore hope to have his conservative right flank under control, while Albanese won't want tensions between Labor and the Greens, for example, to erode his capacity to challenge for the centre ground. The state election later this year in Queensland may have a telling impact on federal seats in the Sunshine State, whether Labor is removed from power at the state level or finds a way to hold on for another term.

A look back: 2019 in review

Last year will go down as the year the opinion polls lost the trust of voters and commentators. Even though the Coalition lost every single two-party poll since shortly after the 2016 election, right up until Election Day on 18 May last year, Morrison still won the federal election, increasing the Coalition's number of seats and the Coalition's two-party vote. His victory means that Bill Shorten has replicated the dubious feat of John Hewson in 1993: losing the unloseable election.

Morrison's victory was built on a scare campaign targeting Labor's big target agenda. In another parallel with the 1993 election, Shorten took the biggest selection of policies for an opposition into a campaign since Hewson's Fightback! package. The failure all but guarantees that a generation of oppositions going forward will shy away from large scale policy agendas, returning to the mantra of only presenting limited ideas ahead of elections, which in turn makes it difficult for new governments to manoeuvre in other policy directions if the times demand it. This shift will play out in 2020 as Albanese tries to avoid getting bogged down in policy defences, trying instead to point the public towards unpopular government policies without explaining exactly what Labor would do differently.

We have already seen Labor start crab walking away from the agenda Shorten took to the 2019 election. The Coalition in the second half of last year looked a little like the dog that caught the car - returning to government, but with only limited ideas for the years ahead. It did manage to quickly implement the income tax changes it took to the election, eventually with Labor's support. And before parliament rose for 2019, the Medevac laws introduced in the last term without the Coalition's consent were successfully repealed. Labor ended the year still stunned by how the election played out, and the Coalition remained buoyed by the victory it didn't see coming. So much so that the confidence it instilled may have contributed to the PM's misguided decision to holiday with his family in Hawaii before Christmas just as the intensity and tragedy of the bushfires was beginning to take hold.

The fallout from the bushfires and climate change debate

While the critical reaction to the PM's decision to initially take a back seat during the bushfires took Morrison by surprise, the intensity of the fires shouldn't have been a surprise to anyone. The tin-ear of the PM was startling. Ex-emergency chiefs had written to Morrison mid-way through last year warning of what was to come in the upcoming bushfires season. Morrison refused to meet with them, dismissing them as has-beens. In a 2007 report for government at the time, economist Ross Garnaut spelt out that by 2020 bushfires would significantly grow in their intensity because of the changing climate. Even though the response to bushfires has long been a state not a federal issue, there have been growing calls for a coordinated national response for years now. The Royal Commission into the Black Saturday fires in Victoria included findings on this front and Shorten included a policy of introducing a national water bombing fleet at the last election, announced in March 2019.

This year will start with a very strong focus on the fires as they continue to burn during the summer months and possibly beyond. The Prime Minister intimated at a Royal Commission into the fires at the beginning of 2020, and will no doubt put more meat on the bones of what that might look like before

"In a 2007 report for government at the time, Ross Garnaut spelt out that by 2020 bushfires would significantly grow in their intensity because of the changing climate. Even though the response to bushfire has long been a state not a federal issue, there have been growing calls for a coordinated national response…"

"Make no mistake, the impact of these ongoing natural disasters is profound, not just on the communities affected but on the national economy as well as the political standing of the government."

formal terms of reference are announced later this year. It will be interesting to see if Morrison seeks to limit the scope of the inquiry to prevent embarrassing findings around climate change action from pointing the political spotlight on to the government. The PM will want any inquiry to target the performances of state governments, but he won't want any Royal Commission to be easily dismissed as a political exercise, which would mean framing the terms of reference such that federal Labor and the states support them.

Once the fires are eventually brought under control, the focus will shift to the recovery efforts. Recriminations into what went wrong and the significance of the ongoing drought will return to centre stage. By year's end, including through the budget process before then, the cost of the bushfires' recovery will become more and more apparent. What the potential fire season at the end of 2020 looks like will frame how the political year closes out. Make no mistake, the impact of these ongoing natural disasters is profound, not just on the communities affected but on the national economy as well as the political standing of the government.

Politically, Morrison will hope that his virtual takeover of the handling of the fires – bringing in the army and moving to more regular public briefs on the crisis – will help patch up sentiment that he was slow to respond in the first place. He will also hope the recovery is smooth and without too many controversies, such that voters begin to appreciate the Commonwealth's handling of events. The states will use 2020 to take full advantage of Morrison's weakened political state on this issue, using his fiscal generosity – designed to quash anger at his failures early on – to help rebuild damaged state infrastructure. It is unlikely the Federal Government will push back on the states in this respect, but tensions may emerge as the recovery process moves into full swing.

One notable aspect to the bushfires was the amount of media coverage overseas they received and the ensuing criticism Australia faced for its lack of climate change policies. What impact this has had on our standing internationally, indeed on our tourism industry and the desires of foreign students to come here to study, and how that might impact the political year in 2020, will become more apparent by year's end.

To be or not to be: the budget surplus

Ever since the Rudd government blew the budget and started racking up national debt following on from the Global Financial Crisis, the Coalition has sought to use its status as the preferred economic managers (according to the polls) as a political weapon against Labor. It was a crucial ingredient in Morrison's take down of Shorten on 18 May last year. The promised return to surplus has been a central part of this narrative and 2020 was supposed to be the year it came to fruition.

Even though national debt has doubled since the Coalition came to power over six years ago, a strong budget focus over that time has been to keep a lid on recurrent spending in a bid to balance the books. Much fanfare has been made of this objective and as the certainty of achieving it grew, so has the certainty of the promise to do so. The question now is, will the government still get there this year? Or will the impact of the bushfires alongside already weakening economic growth turn the promise into a mirage? Indeed, even if the surplus is achieved in 2020, does it become "five minutes of economic sunshine," as John Howard referred to a brief uplift in the Australian economy under Paul Keating in 1995? If the surplus does fall by the wayside, will the public be more forgiving of the Coalition for the reasons behind that broken promise than the Coalition was of Labor post the GFC? The comparison may not be precisely analogous, but that doesn't mean events won't be compared that way.

All of these questions will be increasingly answered as this year unfolds. However, they will only be truly answered in a political sense once the results of the next election are known. It remains more likely than not that Josh Frydenberg does still hand down a budget surplus come May, albeit smaller than what was forecast in the mid-financial year economic update released in December. Much of the spending on the recovery won't hit this year's budget bottom line. And even though taxation collections over the summer months within the tourism industry will be hit hard, the surplus goal is still achievable. Ultimately though, discussion over narrowly achieving a surplus versus narrowly missing out is a vacuous debate.

Irrespective of the impact of the bushfires, 2020 was already set to be a difficult year economically. Wages growth is sluggish, as is economic growth. Unemployment started the year higher than initially predicted, and the problem of under-employment in the gig economy is only likely to grow.

"In 2020 the budget will continue to be propped up by higher than forecast commodity prices, stimulated by ongoing demand from China."

While the Coalition has had a strong focus on achieving a surplus for political reasons, the central bank has been acting in a rather contradictory way - dropping interest rates in 2019 to new record lows, with economists predicting more falls again this year. If the bushfire recovery further hampers economic growth, such outcomes might see even greater reductions in the cash rate this year. Not that there is much room to move with a rate of just 0.75 per cent to start the year. If the monetary and fiscal policies of the nation continue to run counter to one another in 2020, that might eventually force a debate about why that is the case and what needs to change.

That said, strong property prices growth in some parts of the country at the end of 2019 and the start of this year may force the Reserve Bank to re-think any plans to further cut the cash rate in 2020.

In 2020 the budget will continue to be propped up by higher than forecast commodity prices, stimulated by ongoing demand from China. If that doesn't happen then the surplus target really will fade from view. The Coalition has been deliberately bearish with its commodity price forecasts, so that if economic growth doesn't live up to expectations, which it likely won't, the actual numbers don't punch a hole in the forecasts. It is a political strategy which has seen the politicians overrule the Treasury when it comes to forecasts; yet more evidence that the days of a powerful independent Department of Treasury are behind us. But it has also ensured that forecasts of a better budget bottom line don't result in spending for political reasons which turns out to be with borrowed money.

Trade talk

No political forecast for a new year is complete without considering the impact that the continuing emergence of China will have on the domestic economy. In 2020 that forecast includes what, if any, risks are attached to a looming trade war between China and the United States, remembering that 2020 is also a Presidential election year in the US. While Donald Trump may need to dial down the rhetoric of a trade war with China in an election year, risks remain in 2020. Australia's closest ally is the United States, and Trump's America expects this to count for something. Yet China is Australia's largest export market, and its significance to our economic success continues to grow. A trade war between these two super powers really would see Australia caught in the middle, with profound risks. Politically, the Coalition will be inclined to back the US, albeit mindful that if China retaliated for such positioning a recession becomes a real possibility. The chances of this happening remain remote, but real.

"Queenslanders go to the polls towards the end of this year, and a change of government is in the offing."

Britain's looming departure from the European Union will see it clamouring for new trade deals, and Australia will be one middle power which could benefit from that. The Coalition government has signed a series of trade deals since coming to power in 2013. Negotiations with the UK for new arrangements will feature in 2020, as will the ongoing discussions with India for a free trade deal.

What's happening in state politics and overseas in 2020?

Queenslanders go to the polls towards the end of this year, and a change of government is in the offing. Morrison and Albanese will be watching closely, because what happens in Queensland state politics could have a profound impact on the next federal election. Labor only won six seats across all of Queensland at last year's federal election. The Coalition picked up seats in Queensland as well as New South Wales and Tasmania, but the biggest surge in support for the government came across regional parts of Queensland. Unlike other states, Queensland's population is heavily dispersed outside of the capital city of Brisbane. A change of government in Queensland might not be in the best interests of the Coalition federally, however. Yes, it would deprive Labor of the resources of incumbency at the state level in Queensland, but it would also rule a line under anger currently directed at state Labor. The risk therefore might become the Coalition's to bear, as a new Liberal National Party government does what new governments always do: break election promises and upset various constituencies with political decisions early in a first term. We have seen Queenslanders transfer anger between tiers of government before with their voting patterns.

The result of the race to the White House is even more difficult to predict than what will happen at the next Australian federal election, partly because the electoral system carries with it so many uncertainties, and partly because the Democrats haven't yet chosen their candidate. The choice will be important to how Trump is framed and whether or not he can mount a similar campaign to the one he used to defeat Clinton last time. While Morrison's official state visit to the US last year saw him and Trump cosy up to one another, don't expect the PM to weigh into the US contest – unless a Trump victory becomes an obvious outcome closer to November perhaps.

Party internals

Expect 2020 to be another year where the reactionary right within the Liberal Party stirs up problems for a Prime Minister, especially in policy areas such as climate change and religious freedoms. However, unlike past years when such rabble-rousing risked leadership tensions, Morrison will face no such problems, notwithstanding the collapse in his personal support in the first Newspoll of this year. This is because there is no obvious alternative leader and the credibility of last year's election win alongside rule changes for challenges, renders a leadership challenge almost impossible. Even if Morrison's popularity fades in 2020, he will likely benefit inside his own party from the same capable-of-winning-elections glow that insulated Howard from internal adversaries.

That protection, however, doesn't guarantee internal stability. The nature of the modern media landscape is such that recalcitrant Coalition backbenchers will continue to contradict government policy on everything from climate change to nuclear power. Furthermore, divisions within the Nationals are almost certain to re-emerge in 2020, despite the authority of the Liberal PM. Deputy PM and Nationals leader, Michael McCormack, doesn't enjoy the same authority at the top within his party that Morrison does within the Liberals and will therefore continue to be undermined from within this year.

Internal instability is most significant for Team Morrison if it puts its wafer-thin majority at risk. It is possible reactionary conservatives defeated at pre-selection could move to the crossbench, but they would likely continue to support someone like Morrison as PM over any shift to Labor. However, most pre-selections for the next election won't start until next year. Moderate MPs, unhappy with inadequate action in areas such as climate change, could in theory desert the party. However, in practice looking at the names of supposed moderates in the Liberal ranks, it is highly unlikely any would be so bold. More likely, they will increasingly speak out from the safety of the Liberal party room, which would still cause instability for the PM without putting his majority at risk.

While it is unlikely Albanese will face a challenge to his leadership in 2020, if he isn't competitive in the polls by year's end it is possible that the traditional killing season comes into play for the Labor leader. Labor's rules on electing its leader should in theory protect Albanese through until the next election, but as the man himself used to tell people when Shorten was leader, those rules can be easily changed by the same simple majority of caucus it previously took to oust a leader.

"Internal instability is most significant for Team Morrison if it puts its wafer-thin majority at risk."

More likely, Albanese will get a clear shot at an election campaign next year (or the year after), with ambitious leaders of the future knowing that if he fails that's when the Melbourne Cup list of contenders can start jostling for position more openly. The first among equals in that respect is Shadow Treasurer Jim Chalmers, whose 2020 performance will be important to his ambitions as well as the fortunes of the opposition this year.

The internal challenge for Labor in 2020 will be balancing the more left-wing forces within its ranks, who are determined to ensure the party doesn't lurch to its right in response to the 2019 election defeat. In their view, pandering to coal mining communities is a misreading of what needs to happen to recapture centrist voters for the party. Albanese has already indicated a penchant for wanting to find ways to re-engage with traditional working-class communities. He has affirmed Labor's support for coal exports, which suggests if the Coalition does dominate Labor in the polls in 2020, these divisions will become a problem for the Labor leader on his left flank.

"…set-backs in the Senate, as well as surprise defeats, will likely still be a part of 2020 negotiations for the government."

What about the Senate?

The complexion of the Senate, at least on paper, improved for the Coalition at last year's election, with fewer crossbenchers to contend with, along with more Coalition personnel. And the negotiations in the aftermath of the new Senators taking up their seats suggested that if the government can settle on an agenda of significance for its third term in office, passing that agenda through the Senate may be easier than in the recent past. Mathias Cormann, as government leader in the Senate, continues to be an important point of contact for Senate negotiations. He is credited with doing the heavy lifting when it comes to negotiations and remains well respected on both sides of the chamber.

However, set-backs in the Senate, as well as surprise defeats, will likely still be a part of 2020 negotiations for the government. Pauline Hanson blindsided the industrial relations minister Christian Porter in late 2019, when she voted against laws the government believed had been sufficiently amended to pass. Such uncertainty is a feature of dealing with the minor parties on the crossbench, but their small collective now compared to the previous parliament is a lesser of evils to deal with as far as the government is concerned.

The populist bent of the Senate is a concern for business. The crossbench is a mix of left of centre parties (the Greens) and populist personalities (Jackie Lambie and Hanson for example). This will likely make it harder for the government to pursue what might be termed a "pro business" agenda, unless the Labor Party decides to support the legislation. That is an open question. Will Albanese choose to take a non-obstructionist path in 2020, or emulate Bill Shorten's tactic of constraining the government at every opportunity to create the appearance of dysfunction?

While not legislatively important, how Senate committees spend their time in 2020 could play a role in the extent to which issues the government would rather not focus on emerge. From the climate change debate to civil liberties in the age of cyber security to the ongoing issues around offshore processing of asylum seekers, the power and independence of the Senate committee system will likely generate unwanted headlines in 2020 for the government, even if it can't have a legislative impact.

Conclusion

If 2019 was Scott Morrison's year politically – which it surely was – that became the case because of his campaigning skills. For the PM to make 2020 a winning political year also, he needs to use it to prove he can govern as effectively as he can campaign. In other words, policy, not marketing, must become the focus of the former marketing man; substance not spin must become the focus of the former party official. The year has started with significant deficiencies in his office and the unravelling of his media persona. So far there has been little evidence of change on either front. The reaction privately within Team Morrison to these deficiencies being exposed so publicly has been one of annoyance and frustration, rather than reflection on what needs to change. That said, there is no guarantee voters will turn on their PM, having just recently endorsed him for three more years in office.

The policy agenda for the year ahead, beyond pet projects like a religious discrimination act, appears rather bare. One of the most interesting things to watch in 2020 will be if the Morrison Government is treated like a new government, or one now into its third term. If the former is the case, life may be hard for Labor this year; no first term government has lost an election in this country since 1931. If, however, the Coalition is treated like the third term government that it actually is – albeit one onto its third Prime Minister – public expectations will rise. Only three governments have managed to win a fourth term since Federation.

The smart money has to be on the Prime Minister and Coalition surviving right throughout this new year and the next. But whether or not the government thrives in office remains an entirely open question.

3 Domestic policy overview

3.1 Fiscal policy

3.2 Aged care

3.3 Data ethics

3.1 Fiscal policy

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Introduction

There is an old Soviet joke: a train is crossing the steppes and is approaching a hill. It is slowing down and the train driver bursts out of the cabin and yells, "Comrade Lenin, I don't think we can make it over the hill". Lenin makes a great speech and the passengers push the train over the hill. Later the train is slowing down as it approaches another hill and the driver yells, "Comrade Stalin, I don't think we will make it over the hill". Stalin shoots a few people and throws them off the train which makes it lighter, so it goes over the hill. Later the train is approaching another hill and slowing down and the driver yells, "Comrade Khrushchev, I don't think we will make it over the hill". Khrushchev realigns the passengers and, better balanced, the train makes it over the hill. Later the train is approaching another hill and slowing down and the driver yells, "Comrade Brezhnev the train is slowing down and I don't think we will make it over the hill". Brezhnev says, "close the blinds, shake the seats and imagine we are moving".

My thesis is that Australia's current fortune is substantial: we have had nearly three decades of uninterrupted economic growth and our major cities are some of the most liveable in the world, with Melbourne, Sydney and Adelaide ranking in the top 10. On productivity, we have benefited from the economic reforms of the 1980s and 1990s, demand for our raw materials remains strong, we have high quality public services, a strong liberal democratic tradition, high standards of education and we are one of the most biodiverse countries, with a strong Indigenous heritage linked to the land that we value.

However, this fortune masks some very complex challenges. While the Australian train clearly won't stop, there is a significant danger that over the longer term it will slow down and that we will face a period of relative decline by global standards. There is a Brezhnevian risk that we will "close the blinds, shake the seats and imagine we are moving" over the next decade or so. Alternatively, if we can take Kent's advice and "see better, Lear", our future will be formidable and involve lifting the quality of life for all.

Each Federal Budget contains a narrative. Sometimes the narrative matches what is perceived to be happening, such as in the Costello "Future Fund" budget of 2005 or the Dawkins "One Nation" budget of 1992, and sometimes it does not, as in the case of the Hockey "Fair contribution from all" budget of 2014. A Federal Budget is also a cross-road, albeit in a specific contextual setting. Turning points form into wider paths taken or paths not taken – challenges addressed or opportunities lost. I will deal with the contextual setting first and then turn to our longer term challenges.

> "On the domestic front, the major concern is weak consumption growth. Consumer spending is almost 60 per cent of GDP."

Contextual setting

The Mid-year Economic and Fiscal Outlook for 2019-20 (MYEFO) estimates or projects a surplus for the underlying cash balance of $5.0 billion, $6.1 billion, $8.4 billion and $4.0 billion for the four years ending 2022-23. This is thin, at least at the time it looked realistic. The government's stated objectives, albeit before the bushfire crisis, were to boost productivity and workforce participation, cap the tax-to-GDP ratio at 23.9 per cent, maintain a budget surplus of one per cent of GDP and eliminate net debt over the long term.

There are several negative factors impacting the current budgetary state of affairs as expressed in MYEFO. A significant one is declining global growth, which is expected to fall to three per cent for this coming year as a result of uncertainty in relation to trade and technology tensions, Brexit, and financial instability in Italy, Turkey, Argentina and Brazil. However, growth is expected to pick-up to 3.5 per cent in 2021, in part supported by monetary policy easing in some large economies.

MYEFO says our terms of trade are expected to decline by four per cent in 2019-20 and nearly nine per cent in 2020-21. This is largely based on an anticipated fall in iron ore prices, substantially as a result of greater Brazilian production, which declined dramatically in 2019 following a dam collapse at Brumadinho in January, and the decommissioning of 10 similar dams by Vale. Lower growth in Chinese steel production has also contributed to the decline in iron ore prices. At the beginning of 2020, the iron ore price was around $US94 per tonne. It is expected to fall to $US55 per tonne by mid-2020 in the government's projections, which is nearly a $US40 decline. This is a very conservative position and is likely to act as a buffer for protection of the surplus over the next four years. By 2020-21, for every $US10 decline that does not occur, the budget is improved by $5b in revenue per annum. As hollow logs go, that is more than a possum box.

On the domestic front, the major concern is weak consumption growth. Consumer spending is almost 60 per cent of GDP. The rate of growth in consumer spending has been just over one per cent for 2018-19 – the lowest since 2009 – due to falling house prices and soft wages growth. MYEFO predicts that this will improve, with household consumption growth rising to 1.75 per cent in 2019-20 and 2.5 per cent in 2020-21. This is predicated on rising house prices, which generally increase household consumption through the "wealth effect", and spending of income tax cuts, which to date has not been as great as anticipated. This is an area to watch. It is possible that the household savings ratio will remain high due to low wages growth, higher household debt – currently about 190 per cent of income which is up from 170 per cent four years ago – and poor consumer sentiment.

In addition, while MYEFO took into account the impact of the drought towards the end of 2019, the timing was such that it did not take into account the impact of the bushfires, which will be substantial. The government has indicated that bushfire relief will take precedence over maintaining a surplus.

Three points should be made here. The first is that MYEFO is predicated on a return to "average seasonal conditions" in 2020-21. There is a question, of what those average seasonal conditions are and whether they need to be modified in the future. The second is that there will be direct costs as a result of the bushfires in terms of infrastructure and potentially generous compensation schemes. Thirdly, there is a question of whether the bushfires have provided a trigger point for the government to modify its position on carbon emissions. This may give rise to the government either putting in place a concrete plan for its own target of 26-28 per cent reduction of emissions based on a 2005 baseline by 2030, or resetting the targets. It seems that a political tipping point has been reached, and it is likely that 2019-20 will see heightened discourse on climate change as one of the major complex challenges we face.

There are some positives in the incremental framework. We appear to be nearing the end of the mining investment drag that arose as a result of high mining investment a number of years ago; investment in dwellings, while currently negative, should increase over the longer term, even in the absence of a government stimulus to public housing. Government expenditure on the NDIS and infrastructure will also have a positive impact on GDP.

Thus in the short term we will see headwinds on global growth; declining terms of trade which have been accounted for; some consumption growth (weak but possibly improving); low to moderate wages and employment growth and relatively stable unemployment. Leaving aside the political discourse on the causes of the bushfires, the danger is that this state of budgetary comfort masks the need to confront the complex challenges we face.

Beyond the Budget in May, the Intergenerational Report is due to be released in July with the report on Retirement Incomes to be released in June between the two. The Intergenerational Report provides a major opportunity to discuss some of the challenges that are outlined below. We are ageing, with the proportion of working-age people projected to fall from 66 per cent now to 60 per cent in 40 years' time, when our population will likely be more than 40 million. This will impact economic output, the demand for health services, and infrastructure requirements, putting a significant burden on government budgets. The Royal Commission on Aged Care is due to present its findings in November. This sequencing will set a focus for 2020 on ageing.

The six big challenges to confront in 2020

Before we address the challenges facing us in 2020, a few points need to be considered. The first, made above, is that our current fortune can mask the importance, complexity and urgency of these challenges. The second is that for the most part, these challenges don't conflict – a positive in one domain is likely to be beneficial in other domains. For instance, dealing with the education challenge clearly flows through to productivity and social cohesion. The third is that this is not all about "throwing money at the problem" – it is about understanding issues and options deeply, setting good policy frameworks, which are empirically rather than ideologically based, leveraging past experience, seeking innovative ideas and embracing community dialogue, all with political savviness and economic discipline.

1. Productivity

New technologies, which will be the main source of future productivity lifts, will substantially alter traditional industries. We should be mindful that the rate of destruction might exceed the rate of creation of new jobs, at least for a time. That rightly scares us, but three things are important here. First, we need to ensure that all will share in the benefits of change. Second, slowing down change is not an option. Third, being ahead of the game is an advantage. For example, we should have large pilot programs of new technologies, such as autonomous vehicles, notwithstanding the short-term job losses they may bring about. This requires long-term planning.

Australia specifically has a clear innovation challenge based on size, business regulation and culture. We ranked 69 out of 104 countries on the 2018 Global Innovation Index. We need to be internationally competitive on company taxation, and reducing the company tax rate is the best way of achieving this, but there are many other potential reforms on taxation. At the individual level, the interaction of our childcare subsidy system and the tax system gives rise to high work disincentive rates for those who expand their hours of work. This creates significant long-term economic detriments that particularly impact women.

Our Federation produces many regulatory inefficiencies for business and funding inefficiencies for governments. We need harmonisation and a recognition that the best solutions will usually require co-operation from all levels of government. This impacts all sectors, although our biggest productivity gains will be on human services as the Productivity Commissioner has indicated.

Ultimately, lower productivity gives rise to lower real wages growth. Thus, we need a New Technology and Innovation Plan and a Human Services Productivity Plan both involving all levels of government, and we need reforms to taxation and our transfer system specifically focused on capital deepening, productivity and participation.

2. Rise of Asia

In only 10 years' time, the Asia-Pacific is expected to have 65 per cent of the world's middle class. That is an enormous opportunity in virtually every domain of our economy including tourism, health, education, finance and professional services. This will involve negotiating our major geopolitical relationships in a sensible and nuanced manner.

We need a new multi-faceted program that will set us in the best position to embrace these opportunities in our region. This could be a recalibrated version of the 2012 white paper on Australia in the Asian Century.

3. Environment

We need a clear plan for achieving the government's targets on carbon. Obviously the global response is critical, but our position feeds into that response and has reputational implications. A stable framework will lead to lower energy costs.

There are many other aspects of the environment and land use that require deep consideration – our use of water being chief among them. Here we can learn from Israel, where, for instance, they make greater use of pipes, rather than open canals, to reduce evaporation. Furthermore, it is sad that while we treasure our biodiversity, Australia has the highest rate of decline in species of all OECD countries.

4. Cities and infrastructure

Our major cities need to be denser with multiple hubs and varied housing types that are closer to jobs. We should rely more on mass and active transport to move our workforce, but also ensure our key freight supply chains and logistics networks enable the efficient movement of goods and services. We should seek to develop satellite cities with their own diversified economic base as well as providing rapid transport to major cities. Once again this requires co-operation from all levels of government, which moves beyond the traditional allocation of federal and state responsibilities.

"Ultimately, lower productivity gives rise to lower real wages growth. Thus, we need a New Technology and Innovation Plan and a Human Services Productivity Plan both involving all levels of government…"

5. Education

Our PISA scores are declining, particularly in maths and science, but also in our bottom 15 per cent of students. This does not stand us in good stead. Given evolving technologies, we need to refocus our education system on agility to give us the adaptive skills and creativity for a rapidly changing world. This refocus should extend beyond the traditional education system and become a feature of business culture for those in employment. We need to focus on creating skilling pathways to ensure our labour force meets the needs of our economy.

6.Social cohesion and inclusion

We need the community at large to be onside as we embrace change. This will not occur if a significant group is left behind. We need a stronger safety net – a social insurance policy. This involves thinking through the adequacy of Newstart for instance, and finding innovative ways of dealing with housing affordability and other areas of disadvantage such as education.

Conclusion

All of these challenges are hard, complex and require substantial political, business and community leadership, but they are also exciting. In the new decade, we need to overcome our fear and positively deal with the challenges we face. If we do not, we are at risk of closing the blinds, shaking the seats and imagining that we are moving.

3.2 Aged care

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Prior to appointment to the Productivity Commission, Mr Harris served as Secretary of the Commonwealth Department of Communications; and for Victorian Government agencies responsible for the environment, primary industries, and public transport. Peter was made an Officer of the Order of Australia in 2013 for distinguished service to public administration.

Introduction

Following the interim report of the Royal Commission into Aged Care Quality and Safety at the end of October, public comment instantly crystallised in support of the Commission's initial judgement: in Australia today we have a sad and shocking aged care system that diminishes us as a nation.

It could hardly have been otherwise, given the evidence the Commission received.

The evidence of course emphasised the failures; Royal Commissions are not instigated to find success. Poor care quality; bad food; delays in assessment; residents not placed in the right facility; excessive use of pharmaceuticals; poor training; declining use of highly qualified staff – the list of failures is long.

Accompanying this is the expectations of family members. The potential outcomes of placing a relative in a facility include disappointment, resentment and guilt for the family member and new resident alike. For staff working in this environment, a great deal is often expected for a quite low level of financial and emotional reward.

The report also acknowledges that aged care services are experiencing a range of issues including:

- difficulty in attracting and retaining staff, who have to undertake many difficult tasks;
- difficulty in obtaining funding and targeting it to meet the rising incidence of conditions like dementia.

The report also notes that aged care services are difficult to regulate, as the financial pressure that most facilities are under make it hard to apply penalties and incentives.

A fundamental overhaul

The Royal Commission has now explicitly set itself the task of redesigning the system:

> "It is clear that a fundamental overhaul of the design, objectives, regulation and funding of aged care in Australia is required. This will be the central purpose of our Final Report."[1]

So when the Commission says the state of the present system diminishes all of us, it should also be very clear: *all of us* will have to work harder to make our parents and grandparents better off in their later years, in residential care or with in-home care.

Much early attention has been applied to the use of *home-based* services in aged care and the chronically long waiting lists. But the more intractable public policy problem is the changing nature of *residential* aged care.

The data is complex, but at its most basic it shows that while the percentage of Australia's older population using residential aged care has fallen in the past two decades, absolute numbers continue to rise and will not peak for a decade or more.[2]

Moreover, because people are increasingly committed to ageing at home (with the support of home based care), clients in the future are more likely to arrive in an aged-care facility nearer to the end of their lives when home care is no longer viable. As a result, the clients for aged-care facilities in the future are more likely to be well into their 80s and have higher levels of assessed frailty and incidence of dementia.[3]

The government's recent response to the Interim Royal Commission suggests they are committed to supporting home care, which is unsurprising given that home care costs about one third of residential care. Given that, the Royal Commission should design its new residential system around those characteristics.

The economics of aged care

To do this effectively, much more recognition will need to be applied to the economics of running aged care facilities.

Media reports calling aged care licences 'lucrative' are in fact far from the truth for the average facility. Some high-end commercial facilities may be sustainable, but even for them, return on capital invested is poor. Worse, around 40 per cent of operators made a loss last year.[4]

Data collected annually by the Aged Care Financing Authority clearly shows just how challenging it is to be in this business (see Figure 1).

The financial characteristics of the average resident compounds this. Fully 80 per cent of residents receive the aged pension, and most will have already cashed in their home to access aged care or did not have one in the first place.[5] While superannuation balances will be higher in future, the new 2020 design will nevertheless need to recognise that, due to the nature of the client base, taxpayers will be the primary funders of change in aged care.

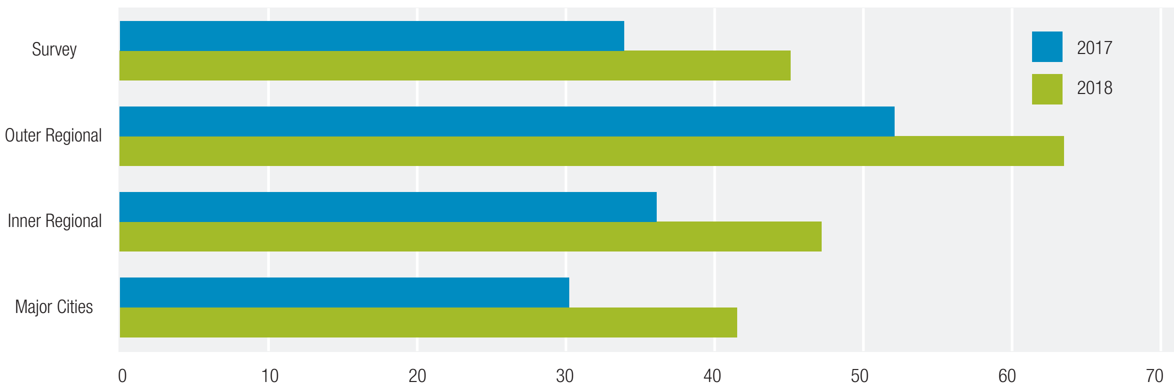
Costs will certainly rise for all operators. The question for the many small and struggling operators (plus some larger non-compliant ones) is whether subsidies, or perhaps charges on residents, can rise to offset this cost increase. If stability for all is to be assured, subsidies or fees would have to rise disproportionately in some cases to prevent these struggling operators from closing.

Staffing costs are a clear candidate for significant change. Research for the Royal Commission has cited both a potential shift in staffing ratios (in favour of registered nurses) and in absolute care hours (20 per cent in national aggregate but much higher for poor performers), drawing from standards in the US.[6]

Wage rises to attract staff are also inevitable in the face of competing pressures from the NDIS, which is expected to absorb 20 per cent of the growth in

FIGURE 1

Percentage of facilities with negative EBT by location



Source: Aged Care Financing Authority/StewartBrown

"In Australia, to our credit, when faced with big structural reforms in the past we have had car plans, GFC response plans and more recently, energy plans. This industry and its customers need a care plan that anticipates big structural change."

the Australian workforce over five years,[7] and from the ever-expanding health system. The scope for immigration to contribute will have to be seriously re-examined by the Royal Commission, or in the Commonwealth Government's subsequent policy assessment.

For the small stand-alone operations that comprise a majority of aged care facilities (63 per cent), every year in which the returns from the service do not cover recurrent costs brings closer the decision not to remain in the sector.

Managing change

From this, it seems obvious that managed structural change is going to be essential *before* imposing new standards. Encouraging businesses to merge to create scale and scope economies could increase efficiency and partly offset rising costs. We can leave this to happen by itself, at some risk to affected residents, or we can ensure it happens in a planned fashion. The latter is clearly preferable.

Boards (or their equivalent) should be asked to formally commit to meeting new standards before they are imposed, and governments must ensure operator decisions are made in full consciousness of new expectations and standards. In Australia, to our credit, when faced with big structural reforms in the past we have had car plans, GFC response plans and more recently, energy plans. This industry and its customers need a care plan that anticipates big structural change.

Something like a five-year plan is advisable. During this period, governments must co-ordinate a structured transition.

Moving forward

As a consequence of the rising average age of entry into aged care facilities – now well above 80 – residents' care needs are rising too. Until the government called a halt to expansion in 2017, care packages experienced a massive rise in the proportion of residents receiving the highest level of care support, from 13 per cent in 2009 to 61 per cent in 2016.[8] In part, this shift might reflect the absence of formal case-mix assessments in setting care packages. We can expect that to change.

Regulation to deal with exploitation of the current system, whether financial in nature or a breach of care standards, has proven almost impossible to apply without such blunt measures. The ultimate sanction of closure is very challenging – alternative facilities are usually few and in locations or at costs unattractive to families with settled arrangements.

As part of a structural change plan, insurance bonds from operators that can be forfeit in the event of material breaches should be considered.

Finally, there is the question of essential investment in new facilities.

Capital funding to develop new facilities to accommodate growth in the oldest cohort of the Australian population will be required, even if we continue to see a slightly smaller percentage of this cohort accessing formal care facilities.

The scale of the population most heavily driving demand for residential care is growing significantly. In 2018, there were 510,000 Australians aged 85 or over, with about 240,000 Australians in permanent residential aged care. In another 10 years' time, the aggregate number of over 85s will be about 670,000.[9] Based on lifetime risk of using such facilities, at least half of this growth is likely to need to be accommodated.[10]

Thus, even with the increasing use of home care packages, a crude estimate of the unavoidable minimum need is 60,000 to 80,000 residential beds in the next decade.

The current dire economics of the industry make this a hard ask. The most recent industry data suggests a halving of plans for new capital investment.[11]

The residential aged care sector has long relied on residents paying large up-front bonds, known as Residential Accommodation Deposits (RADs), as a means of providing part of its capital needs. RADs are, in a unique Australian policy twist, heavily promoted by reference to real estate prices in the local area, rather than the actual recovery of the build cost of accommodation. An alternative to RADs is the Daily Accommodation Payment (DAP), but this too is calculated by reference to the RAD for that facility.

The implied judgment is that moving in to residential care is akin to a real estate purchase, but nothing about this decision is similar to buying a home, which is a long term and usually highly tradeable investment with very transparent pricing.

Entering residential care is far more akin to renting a serviced apartment. In truth, the term of occupation for the average resident is around 30 months. A quarter of residents depart inside one year, and half inside 19 months.[12] All trend evidence suggests this will not improve, and the exit arrangements are unusually complicated.

In recent years, RADs have achieved a certain notoriety, as conditions associated with them have at times proved to be opaque and a source of shock when residents leave. The use in metro areas of an index of serviced apartments as a benchmark check on RADs would be a useful regulatory tool.

"The RAD model looks increasingly anachronistic, but its replacement must still recognise the need for new capital, or new units will simply not be built to the extent required."

The RAD model looks increasingly anachronistic, but its replacement must still recognise the need for new capital, or new units will simply not be built to the extent required.

The Royal Commission has taken on a serious structural reform covering not just an entire industry but a major social contract between generations. Its efforts are to be applauded, particularly if it can develop policy substance to match the expectations now raised across the board.

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3.3
Data ethics

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Introduction

Emerging technologies present considerable opportunities to boost innovation and consumer convenience in the Australian economy, but they depend on having the right data and the trust of the community. With several landmark proposals put forward by the government in 2019 and the Consumer Data Right and other legislative frameworks coming into place, 2020 could be an integral year in Australia's data journey. It is vital that this journey continues to be informed by data ethics.

The Australian government wants to implement a data regime that enables us to use data assets effectively while enhancing their protection and status. To balance these goals, we need to think critically about how we apply ethics to data.

Data ethics is at the intersection of many cultural forces: the demand for increased productivity and innovation, the desire for deeply-held privacy concerns to be respected, and the swift ascent of artificial intelligence (AI), which makes it possible to analyse more data than ever. The ethics of data in 2020 will be shaped by government policies, private interests, and fundamentally, the trust of the citizens and consumers who contribute their personal data to the aggregated datasets held by public and private organisations. The public needs to trust not only that data will be held securely, but that it will be used for purposes acceptable to them. Transparency about the use and collection of data is a major part of this trust, but we cannot conflate transparency with fully informing consumers on how data is being used in a way that they understand.

An ethical data framework that aligns with social values can proactively and holistically inform Australia's data policies, or it can be developed and improved in response to perceived threats, such as cowboy innovation or actualised harm in the form of critical data breaches. Data ethics and its application is an emerging field so both approaches have their place. As Australia's approach to data policies evolves, our understanding of the issues will deepen, and the public, as key stakeholders of these policies, will be able to better inform their development.

"From 2020, we will be able to see the Consumer Data Right's effect on banking, as banks around Australia start to make customers' loans and accounts data accessible to them and safe to transfer to trusted parties – a process known as Open Banking."

Four pillars of data ethics

The Turing Institute defines data ethics as "the branch of ethics that studies and evaluates moral problems related to data, including generation, recording, curation, processing, dissemination, sharing and use; algorithms, including artificial intelligence, artificial agents, machine learning and robots, and corresponding practices, including responsible innovation, programming, hacking and professional codes, in order to formulate and support morally good solutions (for example, right conducts or right values)."[1] Data ethics is the difference between using data for a "good" purpose, like sharing medical records for research to cure diseases, or for "bad or morally ambiguous" purposes like sharing medical records with insurance agencies in order to penalise individuals with potential disease profiles.

Although this definition specifically applies to ethical frameworks for data rather than information, or computational technology, it is still very broad and complex, which presents a barrier to participation and understanding. For discussion, we can break "data ethics" into four pillars:

1. the ethics of the *dataset itself*, which includes how it was collected, curated, whether it contains biases, whether it is large enough, and who and what it truly is able to represent
2. the ethics of *how data is used with AI*, which includes the rules, processes, algorithms, machine and deep learning models applied to data for analysis and problem-solving
3. the ethics of *data governance*, which includes consent, privacy, ownership, custody, administration, valuation and responsibility for setting global standards
4. The ethics of *implementation*, which includes the design of the interaction between humans and the systems, services and products collecting and using data and its outputs, and how they are tested, distributed, manually reviewed, evaluated and disputed.

Four landmark proposals for the future of data ethics in Australia

The Consumer Data Right

The Consumer Data Right (CDR) gives consumers greater access and control over their data. The CDR was passed into Australian law in August 2019. From 2020, we will be able to see its effect on banking, as banks around Australia start to make customers' loans and accounts data accessible to them and safe to transfer to trusted parties – a process known as Open Banking.

Energy and telecommunications sectors are to follow, improving consumers' ability to compare and switch providers and increasing innovation and competition. Increased responsibility and accountability for data protection and network security will be placed on organisations who are part of the CDR rollout, with the ACCC responsible for accreditation.

These companies will be expected to comply with the 13 Australian Privacy Principles and will be regularly audited on that basis. Entities found in breach of the privacy principles will face potentially significant fines of up to 10 per cent of annual turnover.

Traditional insurance products are carving out cyber coverage, and the insured are turning to new cyber insurance products to maintain adequate protection. To be accredited by the ACCC under the CDR, people or entities are required to be adequately insured, and cyber insurance is one potential type of insurance recommended. Cyber insurance can cover third party liability arising from privacy breaches and cyber incidents, liability arising from unauthorised access or damage to the insured's data or computer systems, or for acts or omissions of the insured in connection with data.[2]

The CDR interacts with the ethics of data governance by recognising individual consumers as having a specific and a priori claim to data relating to them, as well as a fair expectation that organisations holding this data will guard its private and personal status. A key ethical issue that may play out in its implementation is the friction between intellectual property generated from derived data, and the right not to expose that asset to competitors in the market. It is not clear at present how an organisation that invests resources into generating intellectual property in the form of derived data by adding value to initial consumer data (for example by matching and analysing and interpreting and predicting consumers' future needs) may be compensated for creating, holding, sharing and storing the additional data related to a consumer in the case that this data is released to a direct competitor.

Data availability and transparency legislation

To maximise the value of public sector data for all Australians, the Office of the National Data Commissioner plans to introduce a Data Sharing and Release bill to parliament in mid-2020. The government has shown their commitment to promoting an open-data sharing framework for all departments and agencies underpinned by a "privacy by design" approach to data sharing and release.

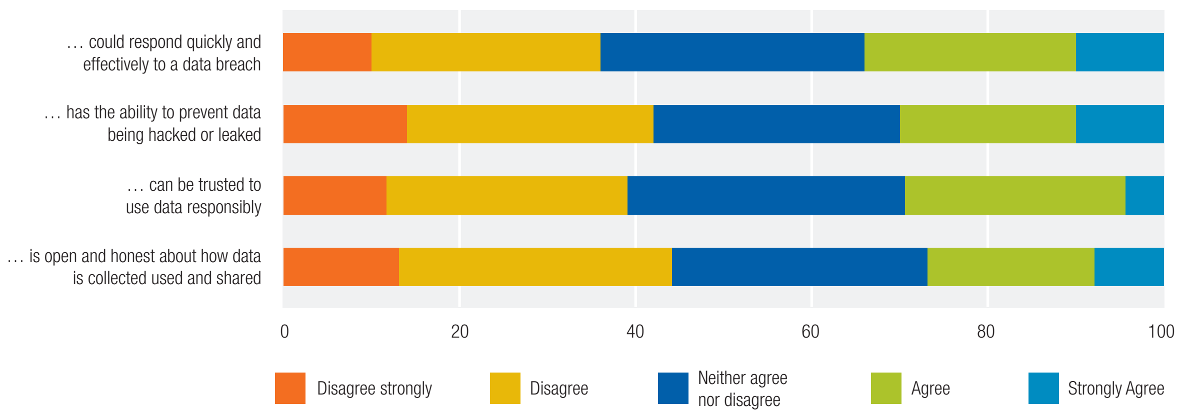
Rather than explicitly requiring consent from citizens for government-held data to be shared, this proposed reform shifts the responsibility to accredited government data custodians to "safely and respectfully share personal information where reasonably required for a legitimate objective."[3]

In practice, this means the government does not need the consent of individuals to share and release their data, including personal information, if sharing it passes a "purpose" test. The purpose test sets out that this public sector data sharing is for public benefit, and is necessary to inform service delivery, program and policy planning, or support research and development. The ONDC has not yet developed a purpose test specifically for the sharing of public sector data for commercial use by the private sector. This remains an uncomfortable topic for Australians who expressed concern during the consultation period about public sector data being shared for commercial uses that didn't meet community expectations.

The government's approach to data sharing is quite nuanced. It addresses a common concern among data advocates that if you require consent to collect and share data, the data collected may

FIGURE 1

To what extent do you agree that the Australian Government…?



Source: Biddle, N, Edwards, B, Gray, M, McEachern, S 2018 *Public attitudes towards data governance in Australia*, Australian National University Centre for Social Research and Methods, vol. 12, no. 12, p. 8

not represent the diversity of Australia's citizens, but rather only those who "consent" to be shareable. This skews the data and makes it less useful, or unsound to use for research, policy and program design. The reform includes strict privacy and security safeguards to support the shift from "need to know" to "responsibility to share" in public sector data.

This proposed legislation also has implications for data ethics. The emphasis on privacy and security of personal data in this bill is crucial, because public trust in how data is being collected, stored, used, and shared by government is low. According to a 2018 Australian National University study on Public Attitudes Towards Data Governance, "only 34 per cent of people think that the Australian Government could respond effectively to a data breach (Figure 1). Even fewer people think that the Australian Government has the ability to prevent data being hacked or leaked (29.7 per cent); can be trusted to use data responsibly (29.3 per cent); or is open and honest about how data is collected, used and shared (26.8 per cent).

However, the legislation does not touch on what exactly will be done with the data once it can be shared and how it will be shared with the private sector in particular. Public trust depends on the government declaring its specific intentions (or "legitimate objectives"), and proving their competence, consistency and reliability to use data well. The public will also need to see how the Government learns from and resolves poorly designed or executed data-driven projects, such as Centrelink's Robodebt debt recovery program.

ACCC Digital Platforms Inquiry

In July 2019, the ACCC released the final report in its Digital Platforms Inquiry, stating concerns that Facebook and Google had an asymmetric relationship with consumers. The report argued that consumers did not understand what data Facebook and Google collected or how, and did not feel able to exercise meaningful control over how their data was being used or shared with third parties. More broadly, the report cautioned policymakers to "consider the extent to which important decisions about the dissemination of information, the collection of

"The emphasis on privacy and security of personal data in this bill is crucial, because public trust in how data is being collected, stored, used, and shared by government is low."

personal data and business's interaction with consumers online should be left to the discretion of certain large digital platforms, given their substantial market power, pervasiveness and inherent profit motive, including their need for very strong profit growth."[4]

The ACCC said that broader reform of Australia's privacy laws is required to maintain effective protection of consumers' personal data. It proposes that the definition of personal information grow to include new types of data including IP addresses, location data, device identifiers and any other online identifiers. In December, the Government responded and committed to several of the ACCC's recommendations, including a review of the Privacy Act and the introduction of a binding online platforms privacy code as part of the 2019-20 budget. No specific proposals were mentioned about the immediate interaction between the CDR and digital platforms. However, if the CDR is applied to social media in the future it would give consumers the ability to access, transfer or delete the data they create while interacting with online services. This would create a more ethically rigorous operating environment for Google and Facebook in which consumers are better informed.

This report touches on the ethics of data governance, the ethics of the datasets itself, and the ethics of using AI. It questions the ethics of using data to better target advertising, the role of data in market power, and the monetisation of data in general. Millions of Australians enjoy and rely on Google and Facebook's products and services, and the ACCC will have to respect consumer choices and preferences if or when they choose to pursue allegations of misconduct further.

With the global precedents of the EU GDPR being implemented in 2018 and California Privacy Protection Act taking effect from January 2020, Australia looks now poised to join a global set of players enshrining individual rights to privacy and standards regarding the ethical use of data.

Data61's AI Ethics Framework

The Government has made progress on establishing principles by which data may be collected, stored and shared, but it has reflected much less on how data should be used. CSIRO's Data61, in collaboration with the Department of Industry, Innovation and Science (DIIS), have worked on addressing this gap with their eight principles of AI Ethics, released after public consultation in late 2019. While the principles received positive feedback from stakeholders and the community, the 130 submissions received by DIIS during the consultation suggested the principles were too broad, too vague and in some places, inconsistent. Some also felt that the principles did not offer enough practical guidance to AI practitioners on how they might be applied in different contexts.[5]

Unlike most areas where new products or services are heavily scrutinised and regulated before they are released, services and products based on data AI and machine learning are not being systematically evaluated. The DIIS has been cautious on this point, emphasising that the AI Ethics framework is "aspirational" rather than a set of binding principles or regulations that practitioners should be held accountable to.[6]

This means that individuals, companies, boards and other parties who contribute to the creation of AI-powered applications of data can embrace or ignore the obligation to act in an "ethical" way. Without a clear and binding set of operating principles, AI systems could in practice unintentionally deviate from ethical frameworks and values Australians hold.

For example, the concept of "fairness" is widely held as a moral imperative, however the concept of fairness, or being free of bias in AI is problematic. Algorithms used in AI require strict and precise instructions on how to define fairness and bias, and what outcomes people find acceptable and fair.[7] Having AI systems developed and released without a rigorous and speculative evaluation of their potential to produce negative or unintended outcomes would significantly erode public trust in data, curtailing efforts to expand the data economy.

Trust in collectively held datasets and their potential benefits for training AI will fall if this subject is not addressed openly and pragmatically. The design and evaluation of datasets and algorithms should be central to the rollout of these systems, but it should also consider the way that people will interact with these systems, and the how their design makes clear to users what outcomes their interactions with the system might have.

Ethical considerations here include providing transparency to consumers and citizens when AI is being used, explaining how and why it's being used, seeking feedback from affected parties where experiences are not as expected, and manual human review of decisions or outcomes. Data61's work into the ethics of AI is the government proposal that comes closest to addressing all four pillars of data ethics in a comprehensive way. Working through the details in collaboration with all stakeholders to turn the guidelines into policy will be complex and take time. Currently, there are no milestones in place to progress this work.

"The value of the data economy is underpinned by public trust, understanding, and engagement, so it is imperative that we equip every Australian to participate in it."

Conclusion

Governments and consumers have finally caught up with the private sector in appreciating the value of data. The Consumer Data Right and the proposed data availability and transparency legislation are priming and optimising our digital systems for data liquidity and portability. This means that as much as possible, Australia wants its data to be at its most valuable state – pre-processed, transformed, matched, distributed – so it can be used for multiple purposes by a range of stakeholders. If data is to continue to be valuable, we need to maintain public trust in how it is being collected and used.

As legislation and regulation continues to be implemented, it is vital that Australian social values are embedded in an effective framework for data ethics, with clear roles and responsibilities for organisations.

For people to trust how data is being collected and used, they need to understand what data is being collected and how it is used to drive decisions, and the impact these decisions could have on their lives. Promoting this understanding should be a foundation of data ethics in Australia. To do this, we need to establish clear and practical standards and practices, including working definitions of "informed consent" in the context of data. Understanding requires a meaningful transparency, which may call for public and private organisations to make their intentions for data use clear and contextually relevant. For example, beyond stating that the purpose of collecting and storing data is to provide personalisation for improved user experiences, organisations may also need to declare how people's data could be used to turn a profit or inform research for new policy.

Transparency about how data is being used means next to nothing if we do not offer people choices that respect their autonomy. Transparency requires that people engage with the information that is available to them. Once a person understands the way their data is being used, they need to be able to put that understanding into practice. Rather than being presented with binary agreements that require a person to release all of their data to provide any service at all, people should be able to tailor the data they choose to release based on the services they want to use.

At minimum, organisations should be looking to audit and understand the data they hold, and how they are required to store and share it. Organisations should also be seeking to understand why they need the data they hold and what the reasonable uses of this data might be and destroying data that they don't need. They should also be carefully curating their datasets, so that the contents, context, accuracy and limitations of the data is available for future reference.

Crucially, organisations need to clearly explain to users and consumers how they collect and use data, and the value and benefits of this to the user, or wider community. Organisations should also offer choices to people about how they might access and manage their data while maintaining ability to access service offerings.

The value of the data economy is underpinned by public trust, understanding, and engagement, so it is imperative that we equip every Australian to participate in it. By doing so, we can ensure that the growth of the data economy is informed by our ethical expectations. In 2020, I'd like to invite all Australians to put their hands up, ask questions, deepen their understanding, and share their perspectives to influence the evolution of a national data regime.

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4

International policy overview

4.1 Europe, the UK and Australia after Brexit

4.2 The US, Australia and the presidential election

4.3 International climate change policy

4.1 Europe, the UK and Australia after Brexit

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Introduction

The December 2019 election in the UK delivered a clear result: the Conservative party had a decisive victory. The post-referendum period of three and a half years of uncertainty is coming to an end; the UK is leaving the European Union (EU) in 2020. Now, as the Johnson government commences this trajectory and the drama of election night recedes, it is timely to evaluate the long-term implications of Brexit, particularly for Australia's relationships with the UK and the EU.

Australia will now seek to recalibrate its relationship with the UK, a state that will now no longer be an EU member state. The UK is stepping out of the EU but not yet stepping into a clear new form of international and regional engagement.[1] The work takes place in earnest throughout 2020, as the UK commences negotiations with the EU's institutions and its 27 national governments, once the Withdrawal Agreement is ratified by the UK Parliament and the European Parliament.[2]

The UK government will then be presented with the considerable task of negotiating the future relationship with the EU during the transition period from 1 February 2020 to 31 December 2020 – a time period that Prime Minister Johnson does not wish to extend. The dialogues will focus on trade, alongside a vast array of policies such as security, foreign policy, nuclear materials, services, health and immigration.

Negotiating the transition

This transition period throughout 2020 will be intense. In addition to determining the degree of alignment between UK and EU trade and customs, there will be services to deal with. Businesses in the UK have expressed concern about the need for financial passporting, the possibility of elimination of tariffs and quotas, alignment of rules of origin criteria, and local-content requirements.[3] And alignment is not simply about trade or services technicalities, which are already significant. It may encompass the stringent sanitary and phytosanitary (SPS) legislation and veterinary inspections that the EU has in place, and which the UK may wish to retain – or reject it so that it can possibly embrace a trade agreement with the US, which does not adhere to some of these standards.

Notwithstanding any future trade deal with the US, and Mr Johnson has indicated a clear priority will be accorded to the US, the UK will be engaged in daily discussions with the EU's Commission, which is an experienced trade negotiator. By contrast, the UK has not been a trade negotiator since it joined the EU's predecessor in 1973.

There will be a significant asymmetry between the UK and the EU, a market of over 450 million consumers, once the UK departs the EU. The EU will not wish to make difficulties, but neither will it countenance providing a template of a transition agreement that renders it attractive for other EU states to also contemplate an exit. Although other national exits are not looking likely at present – support for EU membership across the remaining EU states is currently as high as it has been for some two decades[4] – there remains a populist challenge to the EU in many parties and some governments across the continent.

As the UK withdraws, it will no longer contribute, nor have access to, the EU budget of €148 billion.[5] It will no longer have access to cohesion funds for parts of Wales; Scotland; Northern Ireland and the north of England. UK universities will no longer compete for European research funding and access to the right to study for UK citizens in European universities will come to an end.

> "…the impact of Global Britain will be determined by the way that it forges its newly independent trade negotiations."

On leaving the EU, the UK relinquishes its current privileged access to global markets that is mediated through the EU's agreements. It is exiting significant trade agreements, such as the EU-Japan Economic Partnership Agreement that was signed in 2019 and the substantial trade access to the Japanese market it allowed. It will now be obliged to commence separate trade talks with Japan – and with dozens of other countries, including Australia. When it comes to regional bodies, the EU reached an agreement with Mercosur, the common market of South America, in June 2019, after decades of deliberations, and this will exclude the UK.[6]

Trading places

Trade talks take time and effort, diplomacy and patience, as well as alignment of actor preferences. Even when dealing with similar trade regimes and political systems, there can be hurdles and domestic pressures. When it comes to the UK's preparedness for doing deals with the rest of the world, the fact that the British government has not negotiated any such deals since it joined the EU's forerunner, the European Economic Community, in 1973, will need to be addressed. Although the UK civil service has been preparing for this, it will be a steep learning curve for even seasoned officials, who will face the prospect of either re-negotiation or adoption of the substance of trade agreements with some 168 countries. This significant challenge cannot be taken lightly, and now, post-election, it is the highest priority as the UK looks set to leave the EU on 31 January 2020.

Leaving on 31 January will have medium and long-term implications well beyond trade. The UK will be obliged to reject, adopt or adapt agreements on policing, defence, customs, transport, air traffic control, fisheries, social policy, environmental policy, nuclear energy, agriculture and food, health and safety, workplace safety, and consumer protection.

Thus, the impact of Global Britain will be determined by the way that it forges its newly independent trade negotiations. Although this may focus on the US and possible renewal of ties with the Commonwealth, especially Australia, it is to be expected that the UK's main trading partners will remain their close neighbours in the EU. Its current commitment to trade multilateralism will also be closely observed for any deviation from that stance.

"Australia featured as a priority for the UK, especially in Commonwealth narratives, for a trade deal. Australia may well constitute a test case for the UK as it commences its FTA negotiations."

At the same time, the UK will be forging an independent foreign policy. Not all will be completely new, of course, as security relations within NATO and the Five Eyes Agreement look to remain unchanged for the moment. However, the UK will need to determine whether it will continue agreements that it helped to shape as an EU member state, such as the European Arrest Warrant, including on extradition, which is a core concern in counter-terrorism. It will also need to engender trust with its neighbours in Europe and in international forums.

What does this mean for Australia?

At the same time that the Australian policy community is devising a new engagement with the UK, Australia is negotiating a deep free trade agreement (FTA) with the EU. This agreement, coming on the heels of the Framework Agreement between Australia and the EU,[7] places that relationship on a firm footing and provide considerable benefits to Australia. The era of acrimony regarding agricultural market access is now apparently at an end.[8] One of Australia's largest agricultural lobby groups, Meat and Livestock Australia, has noted that "[as] developed economies with a shared belief in a free, open market, Australia and the EU are natural partners".[9]

The FTA negotiations draw upon a broader commitment to "the rule of law, global norms and free and open markets".[10] Both parties recognise advantages in strengthening their current trade relationship. For the past two years, then, while awaiting some certainty regarding Brexit, the Australian government has accorded priority to the EU-Australia FTA talks,[11] with market access; sustainable development; public procurement; SPS (sanitary and phytosanitary) measures; geographical indications; sheep meat, beef and goat-meat quotas; GIs (geographical indications); and public procurement all featuring.

Yet Australia has not ignored recent developments in the UK. Shortly after the referendum result, in September 2016, the Australia-UK Trade Working Group was established. As Australia is recalibrating its relations with an EU of 27 member states, it is also adapting to dealing with the UK alone, with new bilateral relations, joint agreements and dialogues.

Australia will seek to finalise and sign post-Brexit deals with the UK, while concurrently EU-Australia trade relations are gaining strong momentum.[12] All of this will be subject to public, parliamentary and media scrutiny in both states.[13] The UK-Australia relationship already encompasses the Five Eyes Intelligence Alliance, the Five Powers Defence Arrangements and the Australia-UK Ministerial Dialogue (AUKMIN). The AUKMIN agenda for closer cooperation in its Action Plan of 20 July 2018, entitled *The UK and Australia: A Dynamic Partnership for the 21st Century*, aims to enhance their strategic defense partnership; strengthen collaboration on global issues, including the international order; counter global threats; strengthen their partnership in the Pacific; enhance their strategic economic partnership and develop closer ties between their diplomatic services.[14] It could well expand to encompass an agreement along the lines of the EU's Europol agreement with the Australian Federal Police.

Australia featured as a priority for the UK, especially in Commonwealth narratives, for a trade deal. Australia may well constitute a test case for the UK as it commences its FTA negotiations. This will no doubt complement the accords already in place,

TABLE 1
Major UK-Australia agreements and dialogues[15]

Year	Name of major agreement and dialogues
1956	Australia joins Five Eyes Treaty
1971	Five Powers Defence Arrangement
2008	Australia-United Kingdom Ministerial Dialogues (AUKMIN)
2013	Defence and Security Cooperation Treaty
2014	UK Department for International Development-Australia DFAT Partnership Arrangement
2018	Australia–UK Leadership Forum
2018	Australia-UK Nuclear Cooperation Agreement
2019	UK-Australia Space Agreement
2019	Australia-UK Wine Agreement
2019	Australia-UK Mutual Recognition Agreement

TABLE 2
Key Australia-EU agreements

Year	Name of major agreement and dialogues
1982	Euratom-Australia agreement on transfers of nuclear materials
1997	Joint Declaration signed
1998	Euratom/Australia Cooperation Agreement
1998	Mutual Recognition Agreement: Conformity Assessment, Certification and Markings
2008	EU-Australia Partnership Framework
2008	Revised Agreement on Trade in Wine
2009	Revised EU-Australia Partnership Framework
2010	Agreement on the security of classified information
2010	New wine agreement between Australia and the EU entered into force.
2011	Launch of negotiations on a Framework Agreement and crisis management agreement
2015	Framework Partnership Agreement on crisis management signed
2017	Framework Agreement signed
2018	Framework Agreement provisionally applied since 4 October

as seen in Table 1. Australia and the UK have been drafting agreements that are similar to those that Australia already has with the EU. The Australia-UK Leadership Forum (AUKLF) was established to strengthen dialogue and cooperation. In 2018 and 2019, the UK and Australia negotiated bilateral agreements including a Wine Agreement and a Mutual Agreement to guarantee a continued trade flow post-Brexit and to ensure that measures already in place between Australia and the EU continue to apply to the UK after Brexit.

Table 2 illustrates that Australia already has a constructive engagement with the EU, and this will be enhanced by a free trade agreement. This will provide significant opportunities to Australia, and closer trading alignment with the EU's other 27 countries. Some of these states may well replace the UK as a possible gateway to the EU for Australia and other states. Ireland was discussed as a likely candidate in an Australian Parliament report on the implications of Brexit[16] and the Netherlands has also been regarded as a substitute by that government and by an observer of Brexit.[17]

The Australian government's approach to post-Brexit UK can be characterised as pragmatic realism, as it pursues a deal with the UK that will be robust, with cost-benefit calculations, and shows little nostalgia for the two centuries of close relations and affinity of traditions the two countries have shared.[18] A shared common heritage, cultural affinities, parliamentary traditions and the Commonwealth represent important historical links but they cannot override the political and trade realities.

Commonwealth ties may help recalibrate Australia-UK relations, yet it is increasingly evident that Australia's trade is diversified with the EU, the Asia Pacific region and the US.[19] Although the UK is the largest European export market in goods and Australia's fifth largest two-way trade partner in goods and services, its overall share of Australia's two-way trade only accounts for 3.5 per cent and thus only represents a small overall percentage of Australia's trade.[20]

As the year 2020 sees Brexit and the transition period taking effect, the UK will seek to strengthen links with old friends and establish new allies. The long, rich history between Australia and the UK could well ease engagement. In fact, Brexit presents an opportunity for Australia and the UK to potentially forge stronger bonds. Although historic ties and Commonwealth relations feature, Australia, as a seasoned trade negotiator, can be expected to adopt a pragmatic approach with the UK at the same time that both the UK and Australia are making new deals with the EU.[21]

Finally, these relationships do not exist in a vacuum – they influence each other and are influenced by geostrategic and geopolitical trends relating to Great Power Rivalry; regional belonging and the current undermining of multilateralism by the US President.[22] Australia, the EU and the UK have much in common, as they seek to manage rivalries; hegemonic behaviour and challenges to global governance. Seeking allies will not doubt remain a priority for all three.

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4.2 The US, Australia and the presidential election

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Jackman's research has appeared in the leading journals of political science, in a publishing career spanning 30 years. Between 1996 and 2016, he was a Professor of Political Science and Statistics at Stanford University. Jackman served as one of the Principal Investigators of the American National Election Studies, the world's longest running and most authoritative survey of political behaviour and attitudes, directing this project over both the 2012 and 2016 presidential election cycles.

As CEO, Jackman oversees the policy-focused research of the US Studies Centre, with a special interest in measuring and analysing American and Australian public opinion, studies of investment flows between Australia and the US and comparisons of energy policies in the two countries.

Introduction

Like the rest of the world, Australia will not be a disinterested spectator of the United States in 2020. The United States is the single largest investor in Australia and the single largest destination for Australian investment abroad. Australia is a voracious consumer of American R&D, technology and culture. The United States is far and away Australia's most important ally, with both countries keenly focused on the Indo-Pacific in their respective foreign policy and national security strategies.

2020 is, of course, a presidential election year in the United States. Given the deep and long-standing ties between Australia and the United States, much is at stake for Australia in the outcome to any US presidential election. But the stakes seem particularly high in 2020.

American politics touches Australia through the vectors of US foreign policy, defence policy, and the state of the US economy. Will we see four more years of the Trump administration's "America First" approach to national security and trade? Or will a Democratic president take a more conventional, internationalist approach to American foreign policy? Even if a Democrat were to defeat Trump in November 2020, what elements of the Trump administration's approach to foreign policy might remain?

To answer these questions, I will review elements of American foreign policy that impact Australia, look ahead to the US 2020 presidential election and identify likely points of continuity and change for Australia arising from the outcomes of the election.

"...Australia's relationship with the United States is as close as it has been in living memory."

Australia and the US in the age of Trump

With all things to do with Trump, it is important to distinguish style from substance. This is especially true in the realm of foreign policy, where rhetoric and tweets designed for media impact may well differ from "facts on the ground" or the actual conduct of policy far away from Washington.

For all Trump's talk about allies being freeloaders, and the rocky Trump-Turnbull phone conversation of early 2017, Australia's relationship with the United States is as close as it has been in living memory. The relationship between the Howard government and the George W. Bush administration, which saw the adoption of the Australia-US Free Trade Agreement and joint military action in the Middle East following the 9/11 attacks, is probably the closest historical parallel.

Across multiple policy domains, spanning defence, intelligence, law enforcement, trade and financial services, links between Canberra and Washington are deep and robust, supported by a long history of goodwill and mutual respect trumpeted by political leaders on both sides. 2018 marked a centenary of US-Australian military co-operation. In 2019, Trump hosted Morrison for a state visit and Australia hosted three US cabinet secretaries and over a hundred members of Congress and staffers. 2020 marks the 15th anniversary of the Australia-US Free Trade Agreement and 2021 will be the 70th anniversary of ANZUS.

There is also a less visible but equally important driver of the relationship between the two countries. At the risk of invoking the spectre of the "deep state", it is clear that government officials and defence and law enforcement personnel transacting relations between the two nations buffer the US-Australia relationship from political vagaries, a feature that has been especially valuable in the era of Trump.

In no small measure, the strength and depth of the US-Australia relationship is due to the two countries settling on a new, shared mission of sorts: addressing the rise of an increasingly assertive and unabashedly authoritarian China. This has required policy coordination both across and between the two respective governments. The Trump administration's *National Defense Strategy* suggests a return to great power rivalry as the shaping force behind US policy for the foreseeable future. This assessment is widely shared in Canberra – albeit with more circumspection and less public fanfare – but with policy consequences for Australia that are perhaps more immediate and more profound than the American assessment has had for US policy thus far.

This is not to say that Canberra and Washington always agree. There are several distinct policy disagreements between the two governments that are likely to continue and perhaps intensify should Trump be re-elected.

"America First" foreign policy is premised on the idea that America must act in its own national interests before it acts in the interests of others and that America is powerful enough to transact its relations with others bilaterally. Canberra disagrees profoundly, much preferring a world in which the behemoths of the global economy voluntarily bind themselves to the "rules-based international order" and its multi-lateral institutions.

Accordingly, Australia was disappointed when the Trump administration pulled out of the Trans-Pacific Partnership; Australia and Japan responded by accelerating progress on the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The US-China trade dispute, which is being transacted outside WTO channels, stems from a deep-seated frustration among Trump and his advisers towards multi-lateral institutions that has become a hallmark of Trump foreign policy. Australia continues to advocate for the effectiveness of the WTO, while the Trump administration has let the WTO's appellate body become inquorate and hence non-functioning.

On Indo-Pacific strategy and balancing China's rise, the United States welcomes Australian decisions such as the ban on Huawei participating in the 5G and the NBN, a prohibition on foreign political donations and the establishment of the Foreign Influence Transparency Scheme. Australia and the United States are partners in a variety of initiatives in South East Asia and the Pacific on infrastructure provision, energy security and public health – part of the Australian government's "Pacific Step Up". The United States would welcome Australia participating in freedom of navigation operations in the South China Sea, but having not engaged in that area thus far Australian governments are reluctant to now cross that line. Australia's decisions on Huawei notwithstanding, a commonly heard American concern is that Australia is too beholden on trade with China and is strategically hobbled, if not compromised, in standing up to China and contributing to the shared aspiration for a "free and open Indo-Pacific".

A widely shared concern in the Australian strategic affairs community is that America's strategic aims in the Indo-Pacific are underdeveloped – more a set of diagnoses and aspirations than a strategy – lacking both operational specificity and breadth and unlikely ever to be sufficiently resourced in dollars and materiel, nor able to displace the Middle East in the competition for Washington's attention. Australia, like other US allies, finds itself responding to a longer-term, secular decline in relative American power and presence in the region and a nearer-term uncertainty in American resolve and commitment to the Indo-Pacific, the latter accelerating the former. The "America First" ethos informing Trump administration decision-making – if not policy-making – has accelerated Canberra's acceptance that Australia shoulder more responsibility for its own security and regional stability, while highlighting the value of working with like-minded partners.

The 2020 US election

How likely is it that Trump is re-elected in 2020? Any reasonable forecast must be tempered with modesty and uncertainty at this stage, with the identity of the Democratic nominee still unknown. But with that caveat, here is the case for Trump's re-election.

First, most presidents seeking re-election win a second term. Recent exceptions are rare: George H.W. Bush in 1992 (seeking a 4th consecutive Republican presidential term), Gerald Ford in 1976 (the first election after Nixon's resignation and pardon), Jimmy Carter in 1980 (hamstrung by a lacklustre economy and the Iran hostage crisis) and before that, Herbert Hoover in 1932 (seeking re-election in the Great Depression). This tends to be a self-fulfilling prophecy, in that presidential aspirants choose not to run against incumbents, leaving weaker candidates to win the out-party nomination.

That said, an unpopular president will attract quality challengers. For example, Jimmy Carter's approval rating was in the high 30s in the summer and fall of 1980, as was George H.W. Bush's rating in the same period of 1992. In early 2020, Trump has an approval rating of 45 per cent – towards the higher end of a narrow band of approval ratings that Trump has recorded over his presidency. These ratings are historically low for a president seeking re-election, although Barack Obama had a similar approval rating at the same stage of his presidency. The sheer size of the Democratic field in 2020 suggests that many ambitious politicians consider Trump beatable.

Second, at least in the aggregate, the US economy is in relatively good shape, long considered an important indicator of a president's

"If the Democrats nominate Sanders or Warren, from the left of the Democratic pack, Trump will almost surely carry these battlegound states, and almost surely be re-elected…"

re-election chances. Unemployment has been falling for a decade since the post-GFC high, although wages growth is soft. GDP growth was above an annual rate of two per cent for all of 2019, but many forecasts see lower growth in 2020. The US-China trade war has been a drag on business investment; the steps towards resolving this conflict announced in early 2020 might help GDP growth stay in more friendly territory for Trump's re-election chances.

Third – and perhaps most critically – if Trump is re-elected, it will almost certainly be a re-run of the 2016 election, where Trump lost the national or "popular" vote to Hillary Clinton by almost three million votes (2.1 percentage points), but won the Electoral College. Recall that the Electoral College determines who wins the presidency, with each state's "Electors" allocated under a "winner-take-all" system,[1] creating the possibility of a mismatch between votes won and the election outcome. In effect, just a handful of states decided the 2016 election, in particular, Pennsylvania, Wisconsin and Michigan, with 77,000 votes (or 0.08 per cent of the national electorate) the difference between Trump or Clinton becoming president.

Trump's path to re-election in 2020 runs through these same states, plus another four or five battlegrounds like for example Minnesota, which Trump almost won in 2016, or New Hampshire, Iowa, Ohio, North Carolina and Florida. National polls, rules of thumb or statistical analysis of the predictors of national vote shares matter less than what happens in these battleground states. At this stage, despite suffering with what is typically considered an election-losing approval rating, Trump remains relatively popular in these states. It is difficult to imagine Ohio voting for any of the potential Democratic nominees over Trump and no one has been elected president without carrying Ohio since John F. Kennedy in 1960. Perhaps the biggest factor suggesting that Trump can and will win re-election is his standing in these hinterland, battleground states that he narrowly won in 2016. If the Democrats nominate Sanders or Warren, from the left of the Democratic pack, Trump will almost surely carry these states, and almost surely be re-elected, repeating the 2016 mismatch between the popular vote and the Electoral College.

Pointing in the opposite direction is the fact that Trump won these states very narrowly in 2016. Democrats are powerfully motivated to defeat Trump and many who sat out the 2016 election may not sit out in 2020. Polls suggesting Hillary Clinton would comfortably win some of these battleground states may have lulled some Democrats into complacency in 2016, particular those on the left of the party who would have much preferred to see Bernie Sanders as their party's nominee. These Democrats won't make the same mistake again, should, say, a centrist like Biden be the party's nominee. Turnout in the 2018 midterm elections was at a century-high level, with Democrats out-mobilising Republicans and white, college-educated suburban voters leading the charge.

In short, much turns on who the Democratic nominee turns out to be. Battleground state polling shows Biden to be the only front-running Democratic candidate reliably beating Trump in hypothetical head-to-head match ups in key battleground states. If Biden is the nominee, we will have a real contest. Otherwise, Trump's reelection chances increase markedly.

What will change?

America is at a crossroads in 2020. Re-electing Trump to a second term will mean a doubling down on "America First" and its policy ramifications. Indeed, a safe bet is that a 2nd term of Trump will see an emboldened version of "America First". Over Trump's first term, many experienced foreign policy and defence experts have come and gone. The buffering of alliance relationships that experienced public servants can provide – interposing themselves between the Oval Office and allies – will happen less often. The unilateralist impulse of "America First" foreign policy will be more evident.

It is difficult to predict what a 2nd Trump term might mean for Indo-Pacific strategy and America's stance towards China. Trump seems keen to progress trade negotiations, but this is in no small measure with an eye towards re-election. With that out of the way, what might 2021-24 bring in US-China relations and their implications for Australia? A resumption of trade hostilities could well be on the cards.

Whether Trump is re-elected or not, the mindset in Washington towards China is not changing. Australians ought to understand that while many in Washington and elsewhere disagree with Trump's methods (e.g. unilateral tariffs), there is a strikingly widespread and bi-partisan acceptance that (a) the United States ought to confront China; (b) that Trump is doing so; (c) that any future US administration ought to as well. Reasonable people disagree on the methods involved, but it is close to impossible to see any future US administration reverting to a circa 2000-2010 mindset on China. The only uncertainty concerns whether US thinking about China evolves into a coherent strategy and the implications of that strategy for Australia.

Thus, under almost any scenario, Australia will be in the same delicate position it finds itself now, but almost surely taking more responsibility – and spending more – for ensuring our security and safeguarding our sovereignty.

"Reasonable people disagree on the methods involved, but it is close to impossible to see any future US administration reverting to a circa 2000–2010 mindset on China."

Endnotes

1 The exceptions are Maine and Nebraska, which allocate electors by the winner of the presidential election in each Congressional district. Each state is entitled to as many electors as they have Congressional districts (minimum of one per state) plus each state's two senators. Thus, Wyoming has three Electoral College seats, while California has 55.

4.3 International climate change policy

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The development of international climate policy

Over the past 30 years, the international community has built an international climate change law and policy framework, commencing with the 1992 United Nations Framework Convention on Climate Change (UNFCCC). This framework has been critical for bringing together and driving the international effort to address climate change and to set the ambitions to lower both annual carbon emissions and, consequently, total atmospheric concentrations of greenhouse gases.

The 1992 UNFCCC Agreement was ambitious, in that its goal was to stabilise atmospheric greenhouse gas concentrations at a level that would "prevent dangerous anthropogenic interference" with the climate system. However, it did not quantify allowable atmospheric concentrations, global emissions, or global temperature increase and it gave parties flexibility in the terms of their implementation and approach to this objective.

Noting the inadequacy of the UNFCCC agreement in terms of reducing real emissions, including the fact that UNFCCC did not address the period after 2000 and that the emissions aim was not legally binding, a new agreement was reached, the Kyoto Protocol. This imposed specific emissions targets, but only on parties that were identified as developed countries. The targets, which applied to the 2008–2012 period, were legally binding, and required parties to reduce developed country emissions by at least five per cent below 1990 levels during the 2008–2012 period. In this regard, while Kyoto was an important agreement, it completely excluded developing countries, even those with rising emissions. The United States did not join Kyoto, and China joined but had no new commitments; ultimately, the world needed to come up with an instrument that would cover the two largest emitters.

In 2009, countries agreed the Copenhagen Accord, under which for the first time, the world set the goal of limiting the global temperature increase to below two degrees Celsius and to consider attempting to limit it to 1.5 degrees. The Accord provided maximum national flexibility – each party could design its own mitigation commitment (in schedules proposal, derived from the World Trade Organization). Such bottom up flexibility was necessary to promote wide participation, including in particular by the United States and China. At the same time, many commitments ended up lacking clarity and the Accord did not provide for commitments beyond 2020. The Accord also did not otherwise seek to put parties on a path to achieving its temperature goal.

Finally in 2015, countries agreed to the Paris Agreement, which sets out a long-term framework to mitigate climate change and adapt to climate impacts. It aims to "strengthen the global response to the threat of climate change", including, among other things, by holding the increase in global average temperature to "well below 2 degrees Celsius", as well as by "pursuing efforts to limit the increase to 1.5 degrees Celsius". It sees every country commit to domestic targets and actions in the form of a Nationally Determined Contribution (NDC) to help achieve the temperature goal. However, the NDCs that form the foundation of the Paris Agreement cover only approximately one third of the emissions reductions needed to be on a least-cost pathway for the goal of staying well below two degrees Celsius. The gap between the reductions needed and the national pledges made in Paris is alarmingly high.

The outlook

The international climate regime under the 1992 UNFCCC, the Kyoto Protocol of 1997 and now the Paris Agreement of 2015 have established a global regime of commitments to address climate change. However, they have not created the conditions for success on reducing carbon emissions on a magnitude and timescale relevant to avoiding "dangerous (human) interference with the climate system".[1]

"…in 2015, countries agreed to the Paris Agreement, which sets out a long-term framework to mitigate climate change and adapt to climate impacts."

Annual emissions of greenhouse gases from all activities into the atmosphere is now approximately 40 billion mtCO2e (metric tonnes of carbon dioxide equivalent) and rising. Since the start of the UN climate change negotiations under the UNFCCC began in 1990, annual carbon emissions have continued to grow unabated. While these frameworks have driven a suite of domestic policy initiatives, collectively these climate policy responses have not created the market conditions necessary to mobilise enough capital and technology to reduce annual emissions on a scale meaningful enough to lower the risks associated with climate change.

As we begin 2020, it is clear that the international climate policy process must make real progress on the two key climate response objectives: reducing annual global carbon emissions and, more importantly, reducing the total amount of greenhouse gases in the atmosphere produced through human activities. To avoid the worst effects of a global climate system significantly modified by human

"The gap between the reductions needed and the national pledges made in Paris is alarmingly high."

activity, we will need to lower global annual emissions from 40 billion mtCO2e today to eight billion mtCO2e by 2030 (an 80 per cent reduction in 10 years) and to achieve zero net emissions by 2050. Estimates suggest this will require additional funding of between US$1-2 trillion per year for the next two decades. Both the levels of atmospheric concentrations and the rate of change are unprecedented over the last 50 million years.

Adding up the total voluntary NDC emissions reductions, the Paris Agreement currently does not reduce emissions either on a magnitude or timescale significant enough to avoid the enormous and growing climate risks we face. Countries were expected to announce more stringent NDC targets for 2030 and 2050 at the UN climate policy negotiations (COP25) in Madrid last year, but obstructions created by some countries have pushed this out to COP26 to be held in Glasgow, Scotland in November of this year. As such, expectations are high for a successful COP26 and a collective improvement in the NDC targets and the measures to implement and finance them.

Barriers to progress

Achieving progress on the UNFCCC/Paris process on a scale meaningful to the global climate challenge will require overcoming four obstacles. First is the prevailing view by most countries that reducing their emissions on this scale will be expensive and will limit economic growth. This incorrect belief leads to the second obstacle: the fear countries have that lowering their emissions will reduce their competitiveness against countries that do not lower their emissions. This has led some countries, including very recently France, to announce they will tax the carbon content of imports to avoid the loss of trade competitiveness.

The notion that reducing carbon emissions is expensive and will lower economic growth is now completely invalidated by the actual costs. In more than 67 major countries, including most of Europe, the US and Australia, solar power is now the cheapest form of electricity. This means electrifying transport and replacing ageing coal-fired powered plants is economically viable today and the costs of doing these things are falling faster than anyone predicted. Two of the largest sources of carbon emissions, stationary power and transport, could be largely decarbonised immediately and generate higher levels of economic output than the fossil fuel-based activities they are rapidly replacing.

Now that the falling cost of energy storage enables us to manage the intermittency of solar and wind power, the transition from centralised fossil fuels to distributed renewable energy with storage will only accelerate. The question is not if this transformation will occur, but whether it will happen fast enough to address the climate challenge at scale. A more appropriate focus for the UNFCCC/Paris process may to be focus on eliminating the policy and market barriers to an accelerated energy transition.

The third barrier is financing emissions reductions and adaptation activities in developing countries, as this is where the bulk of emissions now occur and where all the expected increases in emissions will happen. The UNFCCC process enshrined the idea of "common but differentiated obligations" between developed and developing countries, recognising that most of the historical emissions were created by developed countries. This led to the idea that developed countries had an obligation to take the lead in reducing their emissions first and to provide new levels of financing to developing countries. Many nations have pledged under the UNFCCC and G20/G7 processes to provide substantial amounts of capital to developing countries both to reduce their emissions and fund adaptation to the changes in the climate regime which are now inevitable. However none of these financial pledges have been met and this represents a major sticking point for many developing countries under the UNFCCC/Paris process.

The final barrier is the failure to value and make significant public and private financial investments in adaptation measures and resilience, which may well have no traditional financial return, as well as the failure to finance the preservation of critically important global natural capital assets, such as forests, watercourses, and reef systems. Continued failure in this area will only increase the impacts, risks and costs of climate change.

Climate change and the global economy

To overcome these barriers, the international climate policy regime must engage with and incorporate into the UNFCCC/Paris process the critical developments in the financial sector that are being led by central banks and financial regulators.

The Financial Stability Board (FSB) created by the G20 in 2009 in response to the global financial crisis of 2008-2009 quickly discovered there was a bigger looming source of systemic risk to global capital markets than the subprime market. In 2015, Mark Carney, the Governor of the Bank of England and the FSB Chairman, declared climate change was now the biggest risk to the global finance sector. This led the FSB to launch the Task Force on Climate-related Financial Disclosures (TCFD), which, in 2017, released a set of climate risk disclosure guidelines for the financial sector and for all companies accessing capital markets.

The TCFD process has led to the recognition of two categories of climate risks that threaten the proper functioning of global capital markets. First are the physical climate risks where, for example, changes in the frequency and intensity of extreme weather events lead to major damage and devaluation of assets. Disasters such as hurricanes, tornados, and large fires destroy assets, lower economic growth and can lead to entire classes of assets becoming uninsurable.

“A growing list of companies operating in the energy coal value chain are filing for bankruptcy as a result of lowering demand for coal to produce electricity.”

The recent bushfires in Australia and California are robust evidence of how increasing physical climate risks can quickly destroy billions of dollars in assets and economic output. Pacific Gas and Electric, a major energy provider, recently filed for bankruptcy as a result of their role in starting a major fire in California, which climate change made bigger and significantly more destructive.

The other category of climate risks currently not identified or priced by capital markets are transition risks. These are substantially larger than physical risks and, as a result, impact a much broader and more valuable set of companies and assets. Transition risks flow from changes in regulations and the market that can lead to substantial devaluations of carbon-intensive assets and even stranded assets. A growing list of companies operating in the energy coal value chain are filing for bankruptcy as a result of lowering demand for coal to produce electricity. The energy and transport sectors are rapidly decarbonising due to the lower costs of lower carbon-intensive options and this is leading to substantial reductions in the asset values of carbon-intensive companies.

The potential impact of physical and transition climate risks on companies operating across the financial value chain including, for example, commercial banks, fund managers, insurance companies and pension funds, is both material and existential. Commercial banks hold debt in the order of trillions of dollars by companies which were not evaluated for these risks when the loans were approved. As a result, the Bank of England just announced it will begin to stress test banks and insurance companies against their exposure to physical and transition climate risks. Other central banks, including the Reserve Bank of Australia, are expected to conduct similar tests soon. The move by central banks to

> "However, (the UNFCCC/Paris process) can only be successful if countries convert their targets into higher levels of decarbonised economic growth."

begin identifying, quantifying and pricing physical and transition climate risks has led to similar efforts by their financial regulator colleagues. In Australia, both the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have made statements about the material levels of climate risks facing companies listed on the ASX.[2]

In mid-January, the Bank for International Settlements, the organisation that coordinates and oversees central banks, released a landmark report on the enormous climate-related risks now facing capital markets. With the provocative title, *The green swan*, the report highlights the challenges now facing central banks as they attempt to lower climate risks without triggering a rapid collapse in the value of high-carbon fossil fuel assets. The report suggests that central banks may need to intervene in the worst case and acquire distressed and stranded high carbon assets, such as coal mines and coal-fired power plants.[3]

Moving forward

Responding to the global climate crisis and substantially reducing carbon emissions by 2030 and 2050 are now largely a capital markets activation challenge. In 2018, total global investments into decarbonising assets and activities was approximately US$400 billion and in that same year, investment into high carbon emitting assets and activities was US$1.6 trillion. When we combine the declining costs of lower carbon stationary energy and transport options with the need to stimulate higher levels of economic growth not tied to asset bubbles driven by artificially low global interest rates it becomes clear: the only pathway to higher levels of sustainable prosperity for the entire international community is the complete decarbonisation of the global economy – along with prioritising the financing of natural capital asset protection. The investment into decarbonisation is substantial by all historical benchmarks yet the potential returns are also unprecedented.

In conclusion, the UNFCCC/Paris process, with its focus on voluntary NDCs has been critical in driving the global response to climate change. However, it can only be successful if countries convert their targets into higher levels of decarbonised economic growth. The COP26 in Glasgow later this year represents a substantial opportunity to leverage the market reforms being led by central banks and financial regulators to both meaningfully reduce annual carbon emissions and sustain levels of economic growth commensurate with the aspirations of the world's growing population. As Professor Ross Garnaut highlights in his 2019 book, *Superpower: Australia's low carbon opportunity*, no other country is in a better position to leverage the advances in low carbon energy to create greater economic growth than Australia.[4] We can only hope the UNFCCC/Paris process quickly recognises that decarbonisation is not a cost burden but the only growth engine large enough to deliver a sustainable future and greater prosperity for all countries.

Endnotes

1 This language, with the original text including the word "anthropogenic", comes directly from Article 2 of the 1992 UNFCCC entitled "Objective".

2 Australian Prudential Regulation Authority 2019, *Information paper – climate change: awareness to action* and Australian Securities & Investments Commission 2018, *Climate risk disclosure by Australia's listed companies.*

3 Bolton, P, Despres, M, Awazu Pereira da Silva, L, Samam, F, and Svartzman, R 2020, *The green swan: central banking and financial stability in the age of climate change*, Bank for International Settlements

4 Garnaut, R 2019, *Superpower: Australia's low carbon opportunity*, La Trobe University Press, Melbourne.

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