

We have not seen the real crunch that's coming

Myefo
Next year is likely to see an even tighter squeeze on our national income. The wreckers need to get out of the way, or it's deficits far into the future.



Stephen Anthony

The mid-year economic and fiscal outlook 2014-15 should be a stiff warning to decision-makers and opinion-shapers on the fiscal prospects for the nation over the next five to 10 years. It includes a 13.5 per cent terms of trade downgrade for 2014-15 courtesy of the lower iron ore spot price, which looks set to wipe around \$8 billion from the budget bottom line in 2017-18, leaving an underlying cash deficit of around \$12 billion in that year.

Worse, we believe the official 2017-18 deficit includes around \$11 billion in savings announced on budget night which still require Senate approval. So the true 2017-18 deficit right now is likely to be closer to \$23 billion, implying a risk that Commonwealth net debt could move from the current level of \$202 billion, or 13 per cent of GDP in 2013-14, to something closer to \$350 billion or closer to 19 per cent of GDP by 2017-18, with key longer-term spending commitments still to factor on the budget bottom line.

Worse still, the continuing confidence-sapping budget deadlock seems to be feeding back into an economy already suffering from mining boom-induced income slowdown, via falling commodity prices and sub-trend real activity.

We have the start now of a vicious circle of income reduction in the Australian economy in 2015, as subdued profits and wages growth sees business seemingly delaying key spending decisions including new staff or new equipment.

A deal on the budget could have potentially provided a circuit-breaker to instil confidence and support investment.



Joe Hockey has little time to get budget reform through. PHOTO: ALEX ELLINGHAUSEN

Sadly the jolly revellers this Christmas are the budget-wreckers. The opposition and minor parties have had great sport of spoiling the government at every turn. Sadly, too, many of the participants in this soon-to-be tragedy would be better employed as extras at the bar scene from *Star Wars*. When the nation needed prudence, compromise and responsibility, it got an array of colourful characters.

Yes, the first Hockey budget is unfair. So fix it in the Senate. Negotiate, barter, horse-trade, do anything – just repair the structural foundations of the budget. More than anything, we need to stop this stupid fixation on the winners and losers from individual budget measures and start thinking about the budget savings as a “package” where the winners and losers

from each item are cancelled out.

Also, be warned opposition parties: any measure you block now you can't include in your bottom line in the run-up to the 2016 election. On our count, you are up to \$11 billion down in your policy costings, which means finding savings somewhere else. What is our advice to Treasurer Joe Hockey? Keep doing what you are doing. Focus on the medium-term budget balance and just keep offsetting any new spending.

Let the combination of a sub-US\$75¢ exchange rate, a sub-\$US60 per barrel oil price and wage restraint restore trade competitiveness to the domestic economy. Yes Virginia – we are all mercantilists now! Fight tooth and nail for the key structural savings in your budget plan, for instance: (i) reforming age pension indexation; (ii)

tightening family tax benefit B eligibility; (iii) ending of senior health card benefits and (iv) re-introducing fuel indexation.

But jettison the rest, which are like political death by 1000 cuts (such as tighter eligibility for unemployed benefits, uni funding.) Offer to wind back (but not eliminate) key tax expenditures on superannuation and capital gains as the quid pro quo.

This is because the real economic crunch cometh from 2015. A reversal of the investment phase of the mining boom will shave up to one percentage point off real activity, on average, in 2015. At the same time, falling commodity prices are likely to shave more off nominal GDP growth, while the concurrent tightening of Commonwealth and state fiscal policy will act as a brake on expansion.

This could have been even larger but the Treasurer has backdated most of the key budget savings so as not to saddle the economy with a large fiscal contraction while the mining boom is unwinding. Now all other drivers of domestic activity will have to work harder to make up for this.

Regrettably for the Treasurer, the vagaries of the political cycle are such that unless he can implement his major savings round in this budget, or the next, the opportunity for budget reform afforded to a new government may have passed.

If this is true, the Australian government may continue to run budget deficits past the middle of next decade.

Stephen Anthony is director of budget and forecasting at Macroeconomics

Sydney siege raises tough questions for our security

Martin Place attack
The siege in the heart of Sydney is a coming of age for Australia. We need to manage a calm but firm response to it.



Peter Jennings

We don't yet know about the personal motives driving one or possibly more people to take hostages in a café in Sydney's Martin Place, but there's a broader context to the incident which has been unfolding for years. The black flag being held up to the windows of the Lindt Café may be a version of the jihadist “Black Standard”, often used by extremist Muslim organisations.

Flags are inherently political and the use of one in the Sydney siege can hardly be coincidental given ISIS's all-pervasive propaganda use of its own similar black flag. Whether or not the hostage-takers are hardened ISIS-linked jihadist ideologues, or confused loners with a grudge, it seems they want their actions to be associated with radical Islamic terrorism.

Martin Place is, moreover, an iconic Sydney address known to millions of people around the world. That may be another coincidence, but more likely it shows the hostage-takers have an eye to media coverage.

The war against ISIS in Iraq and Syria is the immediate backdrop for the Sydney siege. ISIS was born in the aftermath of the 2003 invasion of Iraq. ISIS's precursor, known as al-Qaeda in Iraq, led the bloody fight against the US occupation until the “Anbar Awakening” in 2008 saw Iraqi Sunnis turn against the group.

ISIS grew in strength and competence in the vacuum of the Syrian civil war. Until its forays into northern Iraq in June, it was said to have about 6000 fighters, many of whom were from outside the Middle East. Mow much larger after its recent victories in Iraq, ISIS's success has been driven by its capacity to recruit thousands of jihadist fighters internationally by adroitly using social media.

ISIS issued a fatwa in September calling on their supporters to “kill the disbeliever whether he is civilian or military” of any country that joined the Coalition mounting air-strikes in ISIS.

International jihadist violence has seen attacks on police in Melbourne and New York, and an attack on Ottawa's war memorial and parliament in November.

In each of these cases the perpetrators



Siege a 'coming of age'. PHOTO: DANIEL MUNOZ

Lone wolves are useful cannon fodder for ISIS, and ultimately cost the group nothing even if their attacks fail.

had “self-radicalised” by moving down an individual path of increasing support for Islamist violence. It's possible that ISIS's call to use indiscriminate violence against innocent civilians was part of the radicalisation path followed by the Sydney hostage-takers – it would certainly fit into the pattern.

The term “lone wolf” is an overly romanticised way of describing people who are typically marginalised, at the edges of their communities and in some cases suffering from a mental disturbance. Such people present a difficult challenge

for police and intelligence agencies because they are not necessarily part of a traceable network of like-minded jihadists.

For ISIS, lone wolves are useful cannon fodder, able to inflict damage in the homelands of their enemies, to gather further publicity and to inspire yet more recruits to the cause, yet ultimately cost the group nothing, even if their attacks fail.

What lessons emerge from the Sydney siege for Australian policymakers? Thus far, the NSW Police response has been impressive. The siege area was cordoned off quickly; a large-scale evacuation of the central business district was calmly handled and public communication has been handled well.

Federally, the National Security Committee of Cabinet has swung into crisis management mode and the government's response had been calm and proportionate. The judgment call made in September to lift the terrorism threat level to “high”, was clearly necessary and had the benefit of making police and other agencies review their planning. Serious consideration will now be given to lifting the threat level to “extreme”.

Beyond the immediate response to the siege, though, difficult questions have to be asked about what further steps, if any, should be taken to reduce the possibility of further such crises.

More work needs to be done to make sure schools, mental health institutions, police and intelligence agencies are geared to respond early to signs of the lone-wolf pathology emerging in the behaviour of individuals. Communities must be involved and the overall approach should not over-react to what is the marginal behaviour of a troubled few.

Sadly though, we know that incidents of this nature inspire people with grievances to mount similar attacks.

The Sydney siege is a coming of age for Australia.

Now we need the maturity to manage a calm but firm response.

Peter Jennings is executive director of the Australian Strategic Policy Institute at www.aspistrategist.com.au.

Italy starts out on hard reform

Roger Cohen

Italy has long suffered from inertia, its individual vitality smothered by the bureaucracy and opacity of the state. Italians are rich, prudent savers. Their state is poor, profligate and inefficient. For 30 years now, since I was a correspondent in Italy, I have watched the country deploy its ingenuity to evade modernisation, culminating in the orgy of baroque escapism known as the Berlusconi years.

So it was with some astonishment that I found Prime Minister Matteo Renzi sweeping in to meet me the other day in jeans and a white open-neck shirt (“I hope you don't mind, it's casual Friday!”), without the obsequious retinue of past Italian leaders, bearing a message of change. His aim: the creation of “*un paese smart*” — a smart country — that has “stopped crying over itself”.

Renzi, in office less than 10 months, is 39 – unthinkable for the gerontocracy that was Italy, the lugubrious state epitomised by the late Giulio Andreotti, who was prime minister five times.

Renzi is a man in a hurry: constitutional reform, electoral reform, sales on eBay of a fleet of official luxury cars, women thrust into top jobs (half the cabinet is female), plans to slash the number of members of Parliament (almost 1000 of them).

The Jobs Act, Renzi's pivotal economic reform, was approved by Parliament this month. It simplifies the labour code, makes it easier for companies with more than 15 employees to fire workers, and links workers' protection to their length of service. By Italian job-for-life standards, it is a revolutionary step.

A spell has been broken in Italy. Politics have shifted. Renzi compared the country to “a Sleeping Beauty in the enchanted wood that can be woken up”.

The Beauty is certainly stirring.

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