

Gillard rejects American plan to close trade gaps

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against a concerted push by US Treasury Secretary Timothy Geithner.

"We will resist any proposition that is about mathematical and simple rules around current account questions, because we're in a different position," Ms Gillard said.

The comments come as global leaders head to the summit of the G20 nations in South Korea on Thursday and Friday to hammer out an agreement to restore global growth by preventing a currency war and scaling back the huge trade imbalances that contributed to the global financial crisis.

The summit and a subsequent meeting of Asia-Pacific leaders this weekend are shaping as Ms Gillard's most significant tests on foreign policy, with attention likely to focus on her first face-to-face meeting with US President Barack Obama, in Japan on Saturday.

While the Gillard government agreed on a tighter defence alliance with the US at ministerial talks in Melbourne yesterday, the Prime Minister's comments signal her willingness to side with Asian and European nations on economic questions.

Mr Geithner wrote to G20 nations last month seeking their agreement to reduce trade surpluses or deficits "below a specific share of GDP [gross domestic product]" over the next few years. This is seen as a way to encourage China to reduce its mammoth trade surpluses as the Obama administration seeks to cut its trade deficits.

US officials confirmed they wanted to set "indicative guidelines" for the deficits and surpluses but rejected reports that the measure would be set at 4 per cent of GDP, a benchmark that would force a mammoth shift in the Chinese economy to boost domestic demand.

Ms Gillard supported the search for a global agreement on imbalances but pointedly disagreed with the proposal for indicative guidelines, saying the Australian position was different to that of others.

"Our current account circumstances are not because we're poor savers or we're disproportionately consuming, it's because we've got resources and we are seeing major capital inflows to enable the exploitation of those resources," she said.

"So our posture is that it's not as simple as current account deficit equals bad — you've got to unpack, in an economy, why there is that deficit: is it an indicator of an unsustainable imbalance, you pick up your terminology, or is it an indicator of something else?"

"In the Australian economy it's definitely an indicator of something else." Australia's current account deficit averaged 4.5 per cent of GDP over the past two decades, according to Treasury.

China's trade surplus was 5.8 per cent of GDP last year, while the US trade deficit was about 6 per cent of economic output.

Ms Gillard also played down the US idea of creating a "peer review process" to enforce an international benchmark for trade imbalances, given the different factors in each nation.

"I think where we're headed, and where I think we should be headed, is that there should be implementation work and implementation plans that will take into account unusual or exceptional circumstances," she said.

The negotiations over trade imbalances go to the heart of this week's agenda as Mr Obama portrays his visits to the G20 and Asia-Pacific Economic Co-operation (APEC) forum as a push for US exports and job creation, a plan that depends in part on

In her own words

On the US proposal to set "indicative guidelines" on current account deficits and surpluses:

"We will resist any proposition that is about mathematical and simple rules around current account questions, because we're in a different position."

On arguing at the G20 to exempt Australian banks from some Basel III rules:

"There's no cause for our banks to be increasing interest rates out of cycle when, yet again, as a government, we are there pressing the case so that they don't have increased borrowing costs."

On concerns about Chinese government controls of its currency:

"We've seen a small appreciation in China's currency but they are obviously needing to manage that circumstance with considerations about domestic inflation. Consequently, there's some time to get there [to the end goal of a market-based currency]. I certainly accept that reality."



JULIA GILLARD

BANKS WANT BOTH SIDES ON SIDE

The banking industry is pushing both sides of politics to commit unconditionally to phasing down interest withholding tax on foreign borrowings as a way of boosting bank competition.

Both the Johnson report on establishing Australia as a financial hub and the Henry tax review said the tax should be cut.

The government announced in May that it would phase down the tax from 2013-14, a move funded by the proposed new mining tax.

The opposition says it is opposed to the measure — and listed it as a savings measure in the election campaign — because it is funded by the mining tax.

A spokesman for shadow treasurer Joe Hockey confirmed that position yesterday, saying that "as long as it remains linked to the mining tax we'd be opposed to it".

With banking competition now a hot issue, the banking sector is stepping up its lobbying for the tax reduction, arguing it would help foreign banks take on the big four.

There is some speculation that bringing forward the phase-down is being considered as part of Treasurer Wayne Swan's bank competition package.

Australian Bankers Association

chief executive Steven Munchenberg said yesterday the banking industry would prefer it if both sides of politics were committed to the measure on its own merits — as something that boosted competition — rather than making it contingent on the mining tax.

Assistant Treasurer Bill Shorten said yesterday interest withholding tax was an impediment to overseas funding by international banks competing in Australia (such as ING or HSBC) and placed an additional cost on finance to Australian business and consumers.

The announced tax phase-down was a substantial decision already taken by the government to increase choice in banking, he said.

By contrast, the Coalition's decision not to support the move was "another pretty bizarre policy inconsistency from the opposition".

"They are too much bluster and no bang when it comes to banking reform," he said.

"If [Opposition Leader] Tony Abbott and Joe Hockey are seriously committed to banking competition and a better deal for mortgage holders, why do they oppose phasing down interest withholding tax and increasing choice in banking?"

Laura Tingle

China agreeing to boost domestic demand rather than relying for growth on mammoth trade surpluses.

Australian officials regard an agreement on trade imbalances as the preferred long-term solution to global growth because it would ease the tensions over currency exchange rates, given US concerns that China sets its exchange rate to spur export growth.

While Mr Geithner has backed away from putting numerical "targets" on trade balances, he confirmed on Saturday that his proposal for "indicative guidelines" remained on the table.

But China's Deputy Foreign Minister, Cui Tiankai, has dismissed the idea as a return to "planned econo-

mies" and warned that the Obama administration's move to inject \$US600 billion into the economy, known as quantitative easing, was a greater challenge in global affairs.

While the US is advocating stronger action by China to remove government controls on its currency, Ms Gillard acknowledged that this would take time because of China's domestic economic priorities.

"We see the merit of having a system of balanced and sustained growth, but it is going to take some time to get there," she said. "We've seen a small appreciation in China's currency, but they are obviously needing to manage that circumstance with considerations about domestic inflation."

Swan needs to

Michael Dwyer

The federal government has plenty of scope to use the Mid-Year Economic and Fiscal Outlook today to make significant spending cuts and easily exceed its goal of returning the budget to surplus by 2012-2013, according to analysts.

What may be missing is the political will.

"Recent experience tells us that it is easy for governments to spend and indeed sometimes it is necessary," said Stephen Anthony, a former official in the federal Treasury and Department of Finance who now runs the Canberra-based consultancy Macroeconomics.

"Right now, with the economy strengthening, governments have a better than average reason to undertake a savings round."

Prime Minister Julia Gillard and Treasurer Wayne Swan have both said they will stick to the government's pledge to bring the budget back into surplus three years early, even as a the stronger dollar trims tax revenues by damping the profits of exporting companies.

Officials have indicated today's statement will therefore need to include some new savings measures to compensate for that slide in revenue collections.

Economists say there are plenty of areas the government could look at to save money, especially in terms of industry and middle-class welfare and the hefty concessions and exemptions delivered to taxpayers through the tax system.

"There is a bunch of spending that Australia does that is not achieving national gains in the national interest," said Chris Richardson, another former Treasury official who now works as a director at Access Economics.

"There are some macro reasons to cut back on spending to take pressure off interest rates, but that's not enormously pressing.

"More important are the micro reasons to make sure we are doing the right spending, which is becoming increasingly urgent over time."

Mr Richardson points out that the last time Australian policymakers looked seriously at the quality of government spending was more than a decade ago with the National Audit of Inquiry in 1996.

While the government may be facing weaker corporate tax receipts because of the strength of the dollar, Australia's robust employment growth may result in stronger personal tax collection.

The government is now forecasting the budget to shift from a deficit of

PM backs big four on Basel III

David Crowe

Chief political correspondent

Prime Minister Julia Gillard is to push this week for changes to global banking rules that threaten to increase costs for Australian banks, raising the problem at the Group of 20 summit as she calls on the banks to curb their interest rate increases.

She will propose that Australian banks be exempted from some of the capital limits that are expected to be agreed at the G20 summit in Seoul.

Ms Gillard told *The Australian Financial Review* she expected the banks to keep their mortgage rates low given that she was taking action at the global summit to shield them from changes that would increase their borrowing costs.

The government action comes as the banking industry raises concerns over the impact of the Basel III regime, which will impose new liquidity rules to require banks to hold enough cash and government bonds to trade for 30 days in a crisis.

Australian banks have expressed concern about the proposal because the domestic market for government bonds is not large enough to accommodate the bond purchases they would need to make to meet the benchmark.

The Basel Committee on Banking Supervision agreed in September to introduce new global standards that will require banks to increase their capital, but the proposals need to be formally agreed by national leaders at the G20 on Thursday and Friday.

Once defined this week, the rules

would be worked on by the Basel committee at a meeting to be held on November 30, after which national regulators including the Australian Prudential Regulation Authority are to consult and implement the regime.

Ms Gillard said she would push for changes to address the concerns among local banks.

"As these rules are developed for the world, we need some special consideration for Australia because we are in a special and stronger position than other countries," she said.

"So I'll be particularly making the case, as we deal with the Basel III rules, for which we've been a strong advocate, that we do need special consideration of Australia's position because the rules deal with liquidity questions and the percentage of government debt that should be taken up by way of bonds for stability."

She said the banks should take her actions into account in the debate over rate increases.

"There's no cause for our banks to be increasing interest rates out of cycle when, yet again, as a government, we are there pressing the case so that they don't have increased borrowing costs," Ms Gillard said.

"Yet again we're taking a step that makes a difference to their functioning, in a positive way."

Her argument is not expected to lower the liquidity rules for Australian banks but seek a different formula to meet a similar benchmark.

Rather than holding cash and government bonds, the Australian banks could be allowed to hold another class of liquid assets.

ECONOMIC UPDATE 2010


Prime Minister Julia Gillard and Treasurer Wayne Swan will release the government's mid-year economic update today.

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take tough decisions on spending

Trimming the fat

Where the government can cut spending



Program	2010-11 (\$bn)	Reform	Saving (\$bn)	Cumulative (\$bn)
Age pension	32.0	Tightening eligibility	6.0	6.0
Superannuation tax concessions	22.3	Tax all payouts before and after 65 at normal MTRs*	5.4	11.4
Family tax benefit	17.8	Tightening eligibility	3.8	15.2
Defence capital	7.7	Incentive contracting	1.0	16.2
Pharmaceutical benefits scheme	10.2	Restoring original eligibility criteria for seniors health card	2.4	18.6
Road transport	5.0	Incentive contracting	0.6	19.7
Private health insurance rebate	4.1	Abolish and pay directly to hospitals	4.1	23.8
Carer allowance	1.3	Means testing eligibility	0.4	24.2
First home-owners grant	1.5	Introduce means test and apply only to new homes	0.3	24.5
Child-care tax rebate	1.0	Means testing eligibility	0.4	24.9
GFS payments & concessions	102.9			24.9

*Marginal tax rates

SOURCE: MACROECONOMICS

\$10.4 billion in 2011-2012 to a surplus of \$3.5 billion in 2012-2013, with the estimates based on the technical assumption of a currency worth about US90¢. Those forecasts will be updated in today's MYEFO.

Since then, the dollar has soared above parity against its US counterpart and in late trading yesterday was quoted at \$US1.014.

"In terms of revenue flows, whatever revenue flows they get over and above should go straight to the bottom line," said Colonial First State's head of investment market research Stephen Halmarick.

The government should also scrap any new programs aimed at providing further fiscal stimulus to an economy already operating at close to full

capacity, he said. That would include the \$400 million so-called "cash for clunkers" car scheme, the introduction of which has already been postponed from January 1 to July 1.

"In terms of outlays, any policy that is designed to add any extra stimulus into the economy is no longer necessary," he said.

Mr Richardson said the govern-

ment's tax expenditures, which are provisions of the tax law that provide a benefit to a specified activity or class of taxpayer that is concessional when compared to the "normal" tax, are also a "target-rich environment for savings".

Tax expenditures are expected to climb to \$116 billion in 2012-13 from \$104 billion this year, according to

Treasury projections, with superannuation concessions alone worth \$32 billion and housing benefits amounting to \$30 billion.

"Treasury has been sending up black smoke signals for some time about tax expenditures," Mr Richardson said.

Middle-class welfare is also a potential source of savings for the government, although policymakers have frequently shied away from making difficult decisions in this politically sensitive area.

Mr Anthony noted that the Henry review of the taxation system contained many recommendations with regard to applying consistent and more stringent means testing to some welfare benefits, which often equally benefit both low income and high income families.

While the government may unveil only limited savings measures in today's MYEFO, the statement is expected to update Treasury's economic forecasts.

Treasury now expects economic growth to accelerate from 3 per cent in 2010-2011 to 3.75 per cent in the following 12-month period, while inflation of 2.75 per cent is forecast for this year and next.

The unemployment rate is tipped to drop from 5 per cent this fiscal year to 4.75 per cent in 2011-2012.

Revenue slump puts election promises at risk

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account for all other measures involving spending this year in the review.

But the review is also likely to open a question mark over a range of election commitments to take effect in future years, which the government has foreshadowed will not be brought to book today and whose future will have to be decided before the May budget. The 2012-013 surplus will be higher than the budget forecast of \$1 billion, but slightly less than the \$3.5 billion forecast in the pre-election fiscal outlook.

A spokesman for Mr Swan said last night the review "will confirm that despite the big hit to revenue caused by the higher Aussie dollar, our budget will still be back in the black in 2012-13".

"MYEFO will begin the process of delivering on the government's election promises, with savings put in place to offset the cost of new commitments," the spokesman said.

"The MYEFO will adhere to the

Gillard government's strict fiscal rules and demonstrate again the fruits of our responsible economic management."

The release of the MYEFO comes as Labor is under pressure to confirm its claims to fiscal prudence, with the opposition arguing that government spending is fuelling higher interest rates.

Continuing questions over the budget position are likely to dampen the good economic news in the mid-year review, with better forecasts for growth and unemployment expected.

The government is under particular pressure to find savings between now and the May budget.

In addition to funding election commitments, money needs to be found for annual spending decisions not included in the budget forecasts, such as \$1.7 billion for overseas defence operations.

There are also various savings measures now blocked in the Senate, potential spending on the Murray-

Darling basin plan and uncertainty over the revenue gains from the sale of spectrum licences

Both sides of politics have relied more and more on making spending promises for the medium term – beyond the so-called "out" years of the budget – to minimise their apparent budget impact.

The Department of Finance warned in its brief to the incoming government (the so-called *Red Book*) last month that considerable new spending commitments would be contained in the budget for the first time next May, when spending in the 2014-15 year is included in the forward estimates

Finance Minister Penny Wong said yesterday MYEFO would "reflect the strong economy, the strong state of the budget".

"The government's finances are in good shape. The economy is strong. The budget is in good shape. But the soaring Aussie dollar is going to deliver a hit to government revenue."

However, opposition finance spokesman Andrew Robb has continued his calls for the review to take the form of a mini-budget and says the government "must have the courage and discipline to cut spending, reduce borrowing and to repay debt".

The announcement at the weekend that the government would delay the

The government must have the courage and discipline to cut spending.

Opposition finance spokesman Andrew Robb

cash for clunkers rebate until next financial year has not satisfied the car industry, which is calling on the government to scrap the \$400 million rebate altogether.

The Australian Automotive Aftermarket Association argued yesterday that the scheme was "ill-conceived, open to rorting and abuse and would

cost jobs while delivering no tangible benefit to the environment. This is another pink-batts debacle waiting to happen, but this one is on wheels," said AAAA executive director Stuart Charity.

The association argued that up to 20 per cent of a car's life cycle emissions were produced during its manufacture and that the optimal vehicle life was 19 years. It maintains that the claimed environmental benefit of paying \$2000 to scrap up to 200,000 pre-1995 cars took no account of the emissions resulting from the production of the new vehicles.

"The fundamental flaw in vehicle scrappage schemes is that they focus on vehicle age rather than actual emissions produced," Mr Charity said. "This approach is based on the erroneous assumption that old cars are dirty cars. However, the true culprits are gross polluters – vehicles of any model year that are poorly maintained."

with Mark Skulley

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