EMBARGO: 1.30 p.m.

# PRIME MINISTER

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ADDRESS TO THE AUSTRALIAN FINANCIAL REVIEW LUNCHEON, MELBOURNE

I congratulate the Conference on its choice of theme for this address - "The Budget and the Challenge of the Future". This 1978-79 Budget is addressed to overcoming the great challenges facing our nation.

The Commonwealth's annual Budget is the major vehicle whereby Government gives effect to social and economic policy objectives. Budgets tend to be judged from at least two different perspectives: their particular measures, and their economic impact.

As the role of government has increased, scrutiny of a particular Budget from the first point of view has taken on more importance for wider and wider sections of the community. Governments claim and dispense high percentages of our national income through the annual Budget, and many people are thus interested in seeing whether the Budget increases spending on this or that particular objective.

But the Budget is much more than an annual accounting of government expenditures and receipts. To look at it only in those terms risks missing the main point of what any Budget, but particularly this year's Budget, is all about.

Budgets are most importantly the major economic instrument through which governments can shape the course of economic events. This is also where this year's Budget has most relevance to the "Challenge of the Future". To assess the 1978-79 Budget, we need an understanding of the fundamental economic problems which our policies address, an understanding of the "challenge" we have been facing and continue to face.

In 1975 the Australian people gave my government a mandate and overwhelmingly re-affirmed it in 1977, to restore the Australian economy to a prosperous condition, to repair the damage that had been done in the years prior to our taking office, and to restore confidence in our economic system.

This faith had been severely undermined by a number of very severe shocks, shocks that moved us far from the economic stability we enjoyed in the 1950's and 1960's.

Greatly increased uncertainty - as a result perhaps more than anything else of high and accelerating inflation rates - has had very corrosive effects on our economic performance. The challenge has been to restore a climate in which consumers and investors can make their decisions with reasonable faith in the future.

Accordingly, my Government's economic policies have emphasised not the chase after short-term growth rates, but getting the fundamentals of the Australian economy right. The challenge has been to ensure not merely a temporary lift in output, but lasting growth into the 1980's and beyond.

The need to take a medium-term view of the policy formation process was recognised by this government from the outset, as was the need for substantial staying power in applying those policies in a steady, resolute way.

Gradually, the inescapable truth that lasting growth will be achieved only by establishing the essential pre-conditions for growth, is being increasingly accepted. This is true not merely of Australia but abroad. This is most encouraging.

The problems which faced the Australian economy at the end of 1975 can be summarised briefly as follows. Wage rates had outrun prices and productivity, producing excessive wage increases, as a result of which workers were, and still are, being priced out of jobs. As a counterpart, there was a significant decline in corporate profitablity and in the profit share, with disastrous effect on business investment. There had been a huge, and irresponsible expansion of government expenditure, the Budget deficit increased markedly, even though tax rates remained unadjusted for inflation. Monetary expansion had accelerated apace. Inflation was at double digit rates and interest rates had risen sharply. General confidence in the economic system and the Government's ability to manage it were shattered. Consumers and businessmen had gone into their shells, private capital inflow had dropped considerably.

Since taking office we have steadfastly pursued the objectives re-stated in the 1978-79 Budget speech: "First, both for its own sake, and as the only real basis for achieving our other objectives, we are determined that Australia will have still lower inflation. Secondly, and subject to the constraints still upon the economy, we shall pursue higher levels of economic activity and greater job opportunities."

To implement that strategy we first need toredress the key economic imbalances to which I have referred. It was inescapable that until fiscal and monetary stability were restored inflation could not be brought down, inflationary expectations could not be curbed and confidence in our ability to overcome our problems could not be restored at home or abroad.

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Accordingly, we have exercised rigorous control over public expenditure. This has assisted in achieving firm control of the monetary aggregates. And in turn, has contributed much to the wind down in inflation, and increasingly to the reduction in interest rates, from which all Australians are benefitting.

We have consistently argued for moderation in wage demands, not only because this is an integral part of the battle with inflation but because it will allow the imbalance between wages and productivity to be removed more quickly, and business profitability and employment opportunities restored.

The process of reviving the economy has necessarily been a slow one. Though we have a good way to go, there is already abundant evidence of achievement. This is especially true of inflation which has fallen much faster than predicted.

In the year to June 1978, the Consumer Price Index rose 7.9 percent which was a most substantial improvement on the increase of 16.9 percent in the year to June 1975.

Australia lagged well behind the OECD group of countries in recognising the seriousness of inflation, but during the last few years, we have had considerably more success than the OECD group in slowing down the rate of increase in costs and prices.

The most recent OECD report shows that Australia has now brought its inflation into line with that of the OECD average. That of course, is a tremendous improvement.

But it never was good enough for Australia to rank in the average class of the international league table. We used to do very much better than that, which is an important reason why we became a prosperous enterprising society, attractive to international investors and able to sell many products in world markets.

What we must now do - and what above all the government's policies are designed to achieve - is to drive inflation down further. We are determined this financial year to have our inflation well below that of the OECD average.

With respect to the CPI, the Treasury forecast is that by: "mid 1979, or perhaps before that time" we shall have: "an ongoing (inflation) rate approaching 5 percent per annum". (Budget paper no. I, page 49).

That could happen more quickly and the rate could be lower, if only the Arbitration Commission would be more restrained in granting wage increases. The comparable weighted average rate for the OECD countries is presently expected to be about 7 percent.

Because this is a Conference looking ahead to the 1980's, let me also say that I certainly do not regard the achievement of a 5 percent inflation rate as a satisfactory long-term objective.

Our aims go beyond that. I am confident this is what Australians want. We will not slacken our policies in the way some other countries have been tempted to do. It is only too easy to re-ignite inflationary expectations by taking off the pressure too early.

My objective is to see Australia join those few countries in the world - the Japans and Germanies -which having brought their inflation down to 3-4 percent and are reducing it further. In the context of a highly competitive world trading scene,bringing inflation down and killing off damaging expectations of rising inflation is the only realistic option we have.

This is the only way we will keep our products competitive, gain new markets for our exports and attract overseas private capital to Australia.

This is the route we must take if we are to be ready to gain a growing share of world trade and investment. World trade is going to be difficult for a few years yet. Australia does enjoy some special advantages particularly in the natural resources available to us. With inflation down below the world average, and with stability and responsibility in government, we have the capacity to attract more than our normal share of investment.

If we take our opportunities, we can weather the difficult international period ahead rather better than most. While we have been making considerable headway against inflation, and, as I have said, we will do better, we should not overlook the fact that, at the same time, the economy has been recovering.

Let me remind you of some recent indicators. Real private consumption rose at an annual rate of 3½ percent in the first half of 1978. Business investment in plant and equipment rose at an annual rate of 13½ percent in real terms, in the first half of 1978. Surveys indicate continuing very strong performance there in the period ahead. In money terms, total new capital expenditure rose in the year to June by 76 percent in mining, 13 percent in manufacturing, and 23 percent in other industries. Real final domestic demand rose by an annual rate of 4½ percent in the first half of 1978.

I mention these factors to indicate that amid the generally subdued situation, there are strong and increasingly reinforcing signs of progress.

There are still further important areas in which we have made headway. Largely as a consequence of our success in lowering inflation, interest rates have started to come down. The fundamental policy has been to see that reductions in the yields on the government's own securities could be sustained, and in that we have been successful.

Unlike the policies which have been adopted in some countries, we were determined to introduce a Budget that would allow a steady and continuous fall in interest rates. This will further benefit home buyers, builders, manufacturing industry, farmers, consumers and investors.

The burden of taxation has been lightened substantially even allowing for the increases the government has reluctantly had to make in this Budget. To illustrate, the cost to revenue of full personal tax indexation in 1976-77 was $990 million; in 1977-78 the cost of full tax indexation and the rate scale reform in February was an additional $1,370 million. Net savings for taxpayers for this financial year, derived from the rate scale reform and half tax indexation, after allowance for the temporary standard rate increase, will amount to a further $700 million.

As a result of all our measures, taxpayers will pay over $3 billion less in 1978-79 in personal income tax than if the tax rates at the time of the last Hayden Budget still applied.

I have gone to some lengths to stress the medium-term perspective in which the 1978-79 Budget must be viewed,because to view it in isolation from what the government has been trying to do for the last two and a half years would be, again, to miss the point.

There are those who have described the 1978-79 budget as the toughest budget in well over twenty years. Those are the sorts of catchphrases that sell newspapers, but to see the Budget in those terms is to miss the point. This Budget takes its place in the Government's ongoing strategy to remove the fundamental constraints on our economy. It rejects the illusion that there is a quick and easy way to economic prosperity.

By firmly controlling government spending and the deficit, this budget paves the way for continued firm control over the monetary aggregates, further sustainable reductions in interest rates, and most importantly, further reductions in inflation.

The Budget has involved difficult and unpopular decisions, but to have backed away from those decisions would have meant squandering our hard-won gains in reducing inflation and interest rates and progressing towards economic recovery.

Let me turn now to some of the main features of the Budget measures, and the way in which they will contribute to achievement of our basic objectives. Measures in the Budget constitute an important step towards winding down the share of our national product that is pre-empted by the public sector.

The projected increase in Commonwealth outlays - 7.7 percent - is the lowest in a decade. All government programmes have been scrutinised rigidly. Expenditures on social security, for instance, have shown the lowest rate of increase for about a decade. Nevertheless, the aged, the handicapped and the poor will not find this a harsh Budget. Economies have been made by directing resources in areas of greatest need. And despite the impression that one might get from press reports, expenditure on key programmes for the aged, handicapped, and children have recorded significant increases.

Restraint in payments to the States is encouraging them to review their own programmes critically, in order to ensure that, like Commonwealth programmes, they represent good value for the taxpayer's dollar.

A major feature of the Budget is the change in the health financing arrangements. We were not satisfied by the health care arrangements inherited from the Labor government. They provided no effective constraints either on cost escalation or usage.

The changes we have made in this area over the past 2½ years have produced significant economies and improvement, but we reached the view that those arrangements were capable of further simplification. The Budget changes provide basic, universal health cover for all Australians, particularly directed to the coverage of major or "catastrophic" disability.
The Government pays 40 percent of scheduled medical fees, and 100 percent after the patient has paid $20 of the bill.
All Australians remain eligible for standard ward accommodation and treatment in public hospitals, without charge. Pensioners and socially disadvantaged people are fully protected by bulk billing arrangements.

Under this approach, the individual decides whether to take out further insurance on top of the basic cover the government provides to cover the gap in medical costs, intermediate and private ward hospitalisation.

Even after reducing the prospective growth in outlays to less than one-half that implied by the forward estimates, it was not possible to produce what we regarded as a responsible budget deficit for 1978-79 without taxation increases. A significant factor in this was that the government faced, for the first time in twenty years, a reduction in revenue in real terms.
Previous governments have avoided this problem by leaving taxation scales unchanged in times of inflation. They were thus able to increase the real burden of taxation covertly, and without the need for openness with the Australian people.

As part of its programme of taxation reform, my government put an end to this easy option. There can now be no increase in the taxation burden without a deliberate and public decision.

Under our system of personal tax indexation - the merits of which have been widely recognised both within Australia and abroad - the yield from taxation is no longer boosted by the hidden toll of inflation. However, developments since the last budget have meant that we began this financial year with a revenue base which was lower than we thought it was going to be.
These developments adversely affected taxation receipts in 1977-78, and resulted in a shortfall compared with Budget estimates of $977 million. Two factors in particular accounted for $700 million of this: the higher individual tax refunds and the lower non-PAYE tax receipts.

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In 1977-78 there was also a decline in the profit share, whereas a recovery had been expected a year ago. This is affecting revenue in 1978-79. Had taxation revenue not been affected in these ways, we would not have needed the temporary tax surcharge - a surcharge which by legislation expires in June 1979.

But the Government was not prepared to mortgage Australia's future with the "soft option" of an excessively high borrowing requirement. It believed that adherence to our basic economic strategy called for a substantial reduction in the budget deficit from last year's outcome. The measures chosen are more equitable and responsible than the other alternatives we were faced with. The temporary increase of 1½ cents in the dollar in the standard rate of income tax is an important element in that reduced deficit. Against what I have said, you will appreciate that this decision was not arrived at lightly, and the alternatives would have been far more inequitable, and would have been detrimental to economic activity and inflation.

The temporary increase should also be seen in perspective. Even with that temporary increase, the growth in personal income tax collections in 1978-79 will be significantly less (6.7 percent) than in 1977-78 (9.7 percent). In both years, tax collections will have risen more slowly than personal incomes, reversing the trend towards a rising tax burden which has persisted so long. It should also be remembered that this year $3 billion less is being collected in personal income tax than if the Labor Government's tax scales still applied, and that the temporary increase is being imposed under legislation which specifically provides for its termination on 1 July 1979.

The immediate move to import parity for crude oil is an important revenue decision. But it is much more than that, it is a move that will have benefits for energy conservation and the adoption of more energy-efficient processes and technologies.

This measure has brought forward, so far as consumers are concerned the effects of increases in crude oil prices that would have been inevitable over the next few years. The price to producers will continue to reflect the arrangements announced last year.

The motorist will face a rise in petrol prices, but he will also see a large fall in car prices, resulting from the reduction in the rate of sales tax on passenger motor vehicles - over $500 for a car with a retail price of $7000.

This reduction from 27½ percent to 15 percent will also remove the sales tax advantage enjoyed by commercial motor vehicles, some of which are directly competitive with passenger motor vehicles. The Government expects this measure to be of benefit to the automotive industry - a major employer - and to the many other industries which supply it with materials and components. It should facilitate the adjustment to smaller, more efficient cars as the price of petrol rises.

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The revenue increases have enabled the Government to achieve a smaller deficit which will - as markets are already showing - provide essential confidence for private investment, and which will contribute to monetary growth in the range of 6 to 8 percent during 1978-79, while interest rates keep coming down. At the same time, our economic policy is that adequate funds will be available for sustainable recovery in private sector activity and employment, while continuing to bear down steadily on inflation and inflationary expectations.

We have taken special steps to make sure that our policy of monetary restraint does not unduly restrict the supply of finance to certain key sectors such as housing. The Budget represents a continuation of our economic policy strategy, in which fiscal and monetary restraint is the cornerstone of the battle against inflation and the other major distortions in our economy presently inhibiting a return to full prosperity.

The speed with which our strategy yields its rewards also depends on the decisions made by the Arbitration Commission. Preliminary figures for average weekly earnings for the June quarter 1978 show an increase of 8.4 percent over the figure for the June quarter of the previous year. This increase exceeded the CPI increase of 7.9 percent.

Wage restraint is vital in the struggle to defeat inflation. We regret that the Commisison has not paid the heed it might have to the views which the Government has put to it. We shall continue to press our views.

We shall not accommodate wage increases by a passive monetary policy. It should not be assumed that there will always be finance available to accommodate excessive wage increases. The community must appreciate that the sharp increases in labour costs since 1973-74, relative to productivity have put many Australians out of work.

A start has been made to reverse this trend. This progress must continue if the economy is to recover , if we are to be a leading trading nation, and if employment is to grow.

The overall short run challenge we face is to keep that strategy in place, so that in time sustained recovery can speed up, generating expansion of production, incomes and employment.

The 1978-79 Budget meets that challenge. As 1978-79 unfolds we will, I believe, see the continued benefits of that strategy and the increasing community confidence in it.

I want to conclude by commenting briefly on the call for stimulus raised by some commentators. When people talk of stimulus they usually have in mind increased government spending on government services, transfer payments and other programmes. We have firmly rejected that course - for a stimulus of this kind would be false and short-lived.

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Our view is that the only way in which the community as a whole can be given a lasting stimulus is through lower inflation and lower interest rates, for it is in this way that we can encourage more home purchases, more business development and investment, which in turn will lead to strong and sustained growth.

It is when a government adopts policies which bring about lower inflation and lower interest rates that domestic and overseas investors are encouraged. These investors know that Australia is one of those countries which is moving forward from its own inner strength, and not from the kind of stimulus attempted by a government which could not stand the pace.