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AUSTRALIA

PRIME MINISTER

EMBARGOED UNTIL DELIVERY CHECK AGAINST DELIVERY

PRIME MINISTER'S SPEECH
COMBINED MEETING OF ECONOMICS SOCIETY AND INDUSTRIAL RELATIONS SOCIETY - CANBERRA - 14 MARCH 1985

Since the Labor Government came to office two years ago committed to relieving this country of deep and worsening recession, there has been a recognition, both within Australia and internationally, of the very significant success which has attended its management of the economy. This recognition has been positive and widespread. It has been reflected in the almost deafening silence in the last Parliament of our political opponents in the area of economic debate.

In these past two years we have steadily been implementing policies directed at restoring economic growth and moderating inflation, which we have describedas fighting unemployment and inflation at the same time.

And from the beginning we have given equal priority to the development of policies directed at removing structural impediments to improving Australia's long-term growth performance.

The main elements both of our short-term macro-economic policies and of our long-term growth policies are well known to a group like this, and it is not necessary to traverse in any depth that old territory.

But it is necessary to say this by way of preface. Our policies have been successful for two basic reasons. One, they have been intrinsically correct, and relevant, in economic terms. Two, they have been well founded in a clear understanding of, and a preparedness to work within, the realities of our economic and industrial system.

Problems will arise because we live and operate in the complex real world, a world of prejudice, of passion, of preconceptions and of power - power which will not always be exercised by individuals and groups within the economic system according to what may be adjudged impartially to be in the national interest.

That leads me to make this point which I believe is compellingly true : while a Government is entitled to be questioned, criticised, about the implication of its policy decisions there is a corresponding obligation to test alternative policy prescriptions with similar rigour. To give a specific example, I find it only slightly less than ludicrous to hear it suggested that the Government's wage policies are inappropriate because they will lead to undesirable wage increases. It may be true that the policies may lead to some wage increases which from some perspectives are undesirable. What is absolutely certain is that the muddle-headed prescriptions of our opponents for the abandonment of the regulated centralised system in favour of decentralised bargaining would be a recipe for a devastating wages explosion. The critics ignore history, they ignore reality.

That said, I want in this real context, to use our time tonight to discuss some of the major challenges that we face this year in maintaining the economic recovery without a resurgence of inflation, and to improving Australia's long-term growth performance.

Our policies for fighting unemployment and inflation at the same time have embodied mutually supportive approaches to fiscal, monetary and wages policy.

Our fiscal policies were initially highly expansionary, making substantial changes to the direction but only slightly reducing the magnitude of the fiscal stimulus implicit in our conservative predecessors' economic policy U-turn in the nine months before they lost office. We made it clear in those early days that we would reduce the budget deficit as private investment expanded in the course of economic recovery.

The fiscal expansion of 1983-84 contributed to the strong recovery that commenced in the September quarter of that year. In our second budget, 1984-85, we provided for a reduced rate of growth in Government outlays and a lower budget deficit in money terms, which reduced the Commonwealth deficit as a proportion of GDP from 4.3 per cent to 3.3 per cent. In the confident expectation of continued economic recovery, and therefore of continued increases in private investment demands on financial markets, prior to last year's election I pledged my Government to :

- Further reductions in the deficit in money terms in 1985-86 and as a proportion of GDP over the life of the current Parliament;

- No increase in Commonwealth tax revenue as a proportion of GDP in 1985-86 and over the life of the Parliament; and

- A reduction in Government expenditure as a proportion of GDP in 1985-86 and over the life of the Parliament.

Since the election we have moved quickly to give effect to these undertakings. The whole process of budget preparation has been accelerated and the Government is currently well advanced in designing a budget with a deficit significantly below the current year in money terms. This further substantial reduction in the Commonwealth deficit, from 3.3 per cent to approaching two and a half per cent of GDP, will have been achieved entirely through the combination of expenditure restraint and economic growth, without any increase in the overall tax burden.

We have consistently applied monetary policy designed to support strong growth but not any resurgence of inflation. There has been no change in our application of firm monetary policy within this approach since we suspended the monetary projections in January, when it became clear that deregulation was seriously distorting monetary measurement.

And underpinning all of our policies for economic recovery, and making it possible to implement fiscal and monetary policies for growth, is the Prices and Incomes Accord.

The Accord has always had its detractors. There were, of course, those who said it could not work because the ACTU could not deliver. Others argued on doctrinal grounds that incomes and prices policies cannot succeed. Even in the face of its obvious success there are those who contend that a slower rate of wage increase, purportedly more appropriate to current economic circumstances, would have been generated within a decentralised system without the Accord.

The evidence is against the detractors. The decline in real unit labour costs to the levels of the late 1960s and early 1970s and the halving of the rate of inflation over the past two years, through a period of strong economic growth, are against them. The continued commitment of the overwhelming majority of the trade union movement to wage moderation within the Accord is against them. And the Australian historical experience, when time after time incipient economic recovery has been dissipated in unrealistic income claims and a resurgence of inflation, is against them.

With two years of reduced inflation and moderated wage demands behind us, there is no doubt at all that the Accord, combined with the Labor Government's other policies, has produced a marked break in inflationary expectations.

The wages policy dimensions of the Accord do not exist in a vacuum. Crucially, they are supported by the Government's commitments to consultation and consensus, to the equitable distribution of the benefits of economic growth, and to the achievement of sustained, strong non-inflationary growth. I have always seen these three commitments as inter-related parts of the one great program.

No progress can be made on any one of the three without support from the others.

Without sustained non-inflationary growth, there can be no progress towards any other objective.

Without sustained growth, high and rising unemployment will increase the number of Australians living in poverty. Without sustained growth there will be insufficient resources to provide adequately for Australians in need.

But equally, only an Australian society that is broadly united on the great national goals, and which is seen by most of its citizens as a fair society, will embrace the changes which are necessary for sustained growth.

This is the essential context of the Accord - and the fundamental reason why the Accord is equal to the challenges that inevitably lie along the path to establishing sustained non-inflationary growth in Australia.

The immediate challenge is the re-establishment of stable conditions, favourable to non-inflationary economic growth, in financial markets, and to ensure that the recent fall in the international value of the Australian dollar does not give rise to a resurgence of inflation. And the greatest challenge to our long-term aims of establishing Australia as a fairer, growth-oriented society is the implementation of a progressive reform of the Australian taxation system; reform within the constraints of the trilogy and the Nine Principles that I announced during the election campaign, and which does not threaten the gains we have made in reducing inflation. Later, I will deal with each of these in some detail.

There were good grounds for expecting a third year of strong growth in 1985-86, even before the recent depreciation of the Australian dollar. Real depreciation - if maintained - will provide an impetus to expansion of exports and substitution of domestic production for imports, which should add progressively to output growth over the next year or two. The dollar depreciation has other less favourable effects to which I will return. But first I would like to say more about the facts that justify confidence that the recovery in the real economy is on course.

National Accounts estimates for the December quarter are not expected for another month. However, partial indicators point to a strengthening in private sector demand in the December quarter and to the continuing good prospects for the remainder of this financial year and through 1985-86.

The value of retail sales rose 2.9 per cent in the December quarter (perhaps as much as 1.5 per cent in real terms), following a 2.4 per cent rise in September (1.1 per cent in real terms). Another significant component of private final consumption expenditure that is not covered by the retail sales series is motor vehicles, and vehicle registrations grew by 3.5 per cent in the December quarter.

You will recall that the Budget forecasts provided only for 2 3/4 per cent volume growth in private consumption after abstracting from the impact of Medicare on the measurement of that aggregate. The recent data confirm the Government's comments during the election campaign that this forecast seems likely to be comfortably exceeded.

Following a fall in the September quarter, business investment appears to be strengthening on a path that will see the Budget forecasts exceeded, and that will provide further strong growth in 1985-86. The latest ABS survey figures, covering around 85 per cent of business investment, indicate 3.8 per cent growth in investment in the December quarter, with even stronger growth projected over the remainder of 1984-85 and into next financial year, again as was indicated during the election campaign.

Housing activity led the recovery in 1983 and remains strong. Today's figures on building approvals show continuing strength through to January. Commencements grew by 2.1 per cent in the September quarter, and looks set to meet or exceed the total of 145,000 mentioned in the Policy Speech. A flattening out in the vicinity of this high level is desirable, and consistent with the Government's expectations of continued strong overall private sector growth in the next financial year.

Employment growth had been extraordinarily strong through 1983-84 but, as measured in the ABS survey, weakened early in this financial year. Since then, there has been a return to strong growth in employment. One hundred and ten thousand jobs have now been created in the first eight months of this financial year. The Jeremiahs seized with glee the weaker figures early in the financial year as indicating that the budget forecasts were wildly over-optimistic. With today's figures from the Statistician, employment has already expanded by almost 2 per cent in the first 8 months of the year, and the Budget forecast of about 2 1/2 per cent now seems well within range.

Today's Labour Force figures bring total employment growth in the twenty two months since we changed the course of Australian economic history at the National Economic Summit Conference to 360,000. We are running ahead of our target of half a million new jobs in our first three years of office.

The dramatic contrast between the experience of employment growth under the Labor Government, and that under the conservative government which we replaced, is a measure of the relative success of the two governments' approaches to economic policy.

In less than two years under our policies, 360,000 new jobs have been created. In seven years and four months, a total of 340,000 new jobs were created under the policies of our predecessors.

Perhaps this is not a fair test of the performance of a conservative government that was dedicated to fighting inflation first, and which explicitly allocated lower priority to expanding employment and reducing unemployment.

Unfortunately for the conservatives, the comparison of performance on inflation is equally favourable to the Labor Government. The conservative administration, after over seven years of fighting inflation first, left Australia with an annual inflation rate over 11 per cent or about twice the OECD average. After two years of fighting unemployment and inflation at the same time, the inflation rate has fallen by half, to a level close to the OECD average.

Through the recent period of strong growth there has been one weakness in the real economy : the growing deficit in the current account of the balance of payments. A surprisingly high proportion of the growth in domestic demand has been flowing into imported goods and services, as reflected particularly in rising shares of imports in domestic demand for manufactured goods. At the same time, after strong growth in 1983-8, export growth, particularly for manufactured goods, has slowed appreciably in recent months. Concern about this weakness came into sharp focus with the publication of the December quarter balance of payments statistics, which contained substantial upward revisions to previous estimates of imports. This weakness, together with anxieties about a temporary break in the improved industrial relations that have generally prevailed since the change in Government two years ago, and other sources of uncertainty, combined to generate sudden weakness in foreign exchange and, less markedly, bond markets. Some observers have seen this combination of events as threatening recovery, particularly through their potential for rekindling inflation.

Certainly the combination of a weak Australian dollar, and a return to unsustainable rates of wage increase, would have the potential for rekindling inflation and undermining recovery. The Government recognises the risk and is committed to ensuring that this challenge to recovery is effectively met.

The fall in the international value of the Australian dollar in itself is not a threat to recovery. Indeed, it is the most effective instrument for correcting the rapidly expanding current account deficit. The rapid increases in the import shares of many categories of domestic demand and the disappointingly weak export performance of the manufacturing sector are clear indications that the depreciation in Australia's real effective exchange rate through 1983 and 1984 had not been large enough to remove the huge deterioration in our international competitiveness that had occurred through the period of the wages explosion and artificially high exchange rates in the early 1980s. This would seem to be part of the explanation for the apparently low (although positive) manufacturing output growth over the past year.

I should add in passing that the major adjustment which has occurred relatively painlessly this year under the floating exchange rate, could have been achieved only with great trauma, domestic financial instability and economic disruption under the old managed system which we inherited in March 1983 and abandoned nine months later.

If the recent real depreciation is sustained, it will have a major effect in strengthening our international competitiveness, including in manufacturing.

At the same time, the depreciation will raise the price of a range of imported, exportable and import-competing goods, directly raising the average domestic price level. This price effect is an inevitable accompaniment of depreciation, and in itself does nothing to impair the associated improvement in competitiveness. It will lead to higher CPI increases than would otherwise have been observed over the next year or so.

The important challenge for the maintenance of recovery, is to ensure that this initial rise in consumer prices does not initiate a debilitating upward spiral of costs and prices. We will be working to ensure that the depreciation does not reduce the substantial gains that we have made in lowering the underlying inflation rate.

Much public discussion of this issue has focussed narrowly on the possibility of discounting wage indexation for the component of inflation that is contributed directly by the price increases associated with the depreciation.

The Accord provides a cooperative forum within which appropriate responses to problems like the current threat of a resurgence in inflation can be discussed. If the Government came to believe that the discounting of wage indexation increases for the direct price effects of depreciation was the most effective way of responding to this prospect it would raise the matter within the consultative processes of the Accord.

But as I said in the Parliament two weeks ago, the discounting of wage increases is only one of a number of ways of ensuring that the depreciation does not ignite a new inflationary spiral.

Strict compliance with wage increases determined within the centralised system is obviously more important than ever. In this context, some reassurance can be drawn from the fact that the dispute involving public service unions was the only one of the major industrial disputes which we experienced earlier this year which involved a direct challenge to the centralised approach to wages policy within the Prices and Incomes Accord. Now that the public service dispute is back before the Arbitration Commission, all of the influence and power of Government will be applied to ensure that the Commission's decision is effective.

The inflationary threat, the need to preserve the recent improvement in Australia's international competitiveness, and the deterioration in Australia's terms of trade which was one of the underlying causes of the Australian dollar's depreciation, are all relevant to the deliberations of the Arbitration Commission in any future productivity hearing.

In preventing the depreciation from leading to an increase in the underlying rate of inflation, the Government will explore every option available to it to ensure that the depreciation does not lead to a continuing spiral of increases in business costs and inflation.

Since the first relevant wage indexation increase will not occur for over six months, there is time for the Government carefully to weigh the alternatives. But you should know that the Government is determined to preserve the competitive benefits of any sustained depreciation, and to prevent the depreciation leading to a new inflationary spiral.

Looking to longer term economic performance, nothing is more important than the review of the taxation system that is now in process.

As a minimum, the review must come to grips with four flaws in the current taxation system.

It must address the widespread avoidance and evasion, especially by people with income well above the Australian average, which has caused a large proportion of the Australian community to believe that the system is unfair.

It must address poverty traps. I refer to the difficulty for people dependent on welfare payments to earn additional after-tax income, and the associated disincentive to work, resulting from the interaction of substantial marginal tax rates at low levels of income with the social security system.

The review must address the unfairness and the associated effects on work effort of workers on average incomes paying the current 46 per cent marginal tax rate on incomes above $19,500.

And while the evidence is more ambiguous on disincentives to incremental work effort high in the income scale, the review must address the powerful distortions to resource allocation inherent in a 60 per cent marginal tax rate cutting in at less than twice average weekly earnings, within a system that provides ways for turning taxable income into untaxed benefits.

It has been clear from the first discussion of tax reform in EPAC nearly two years ago, that reform would have to focus on integrated packages to be considered as a whole, which are likely to commend themselves to broad sections of the community. No doubt every interest group would prefer to exclude or vary some elements of any such package. But there is no way that we will achieve community understanding and agreement if debate focuses on single components and does not address overall packages, and their total effects.

Over the next couple of months, the Government will be considering the components of possible packages of reform measures consistent with the Nine Principles. In deciding among these the Government will be concerned to promote economic efficiency, fairness and simplicity.

We are not engaged in a search for some simple technical solution to the tax problem. We know that no single, unambiguously best answer to the great taxation questions is waiting to be grasped. It is our intention to move us as far as possible towards efficiency, fairness and simplicity according to the perceptions of a large proportion of Australians. And the perceptions of Australians will develop through the process of discussion which will occur through this year.

In our efforts to reform the tax system, we are aware that it is dangerous to allow the best to become the enemy of the good. It would be a tragedy for Australia if there were no tax reform at all because every political group and every interest group, each from its own entrenched position, was insisting on its version of the best package, even when this package was unable to win widespread community support during the period within which the taxation issue must be debated and settled.

We do not underestimate the magnitude of the task.

We are fully aware that the main reason why tax reform has so long been ignored, is that it is hard. We know that even this time, with the Government committed to reforms that make Australia a fairer society better able to realise its potential for strong economic growth, reform might not be possible.

We are very much aware of the constraints on policy imposed by established perceptions and the political and vested interests to which I referred in the opening paragraphs of this speech.

We cannot hold out for the nirvana of unanimous agreement in this difficult area, but, unless we can win broad-based community support, the package will be denied the foundation it needs for effective implementation.

As we see it, the challenge presented by the need for tax reform is not just for the Government.

It is a challenge for the whole Australian community.

The debate surrounding tax reform as we approach the Summit in early July will be a test of the maturity of the Australian political process, and of our ability to approach complex issues calmly and analytically.

The community debate is a serious and major part of the decision-making process on tax reform.

Through this meeting, I would like to affirm with the Australian people, the undertaking that I gave during the election campaign and which is embodied in the Nine Principles : the Government will not proceed with the legislation of a taxation reform package which does not have broad community support.

In return for this commitment I seek from Australians a climate of rational, calm discussion and genuine examination of proposals. I ask that any components of alternative packages be examined as part of the whole and not in isolation and, above all, that people avoid pre-judging either the process or the issues until the facts have been presented comprehensively.

Certainly the degree of consensus within the Australian community on tax reform will be greater the more tax reform represents some reduction in total taxation levels. We have made a firm commitment to the Australian people that we will not increase the overall tax burden. We will be working to ensure that there is some reduction in the overall tax burden for most Australians. This can most readily be achieved if we make a comprehensive assault on tax avoidance and evasion as part of a reform package. But whatever approach is taken it seems likely that ordinary Australians will win on some components of a reform package, lose on others, and overall come out on top.

The debate about the overall tax burden also has to be put in perspective. In the end it can only be effectively contained through expenditure restraint. It will be a major test of how serious the Opposition is about reducing taxes while reducing the deficit, to see whether they support the hard measures on expenditure that we will be implementing in the coming Budget and if they oppose these, to see whether they suggest substantial alternatives.

Successful tax reform, with broad community support, is important to economic efficiency, to equity, and to restoring a sense of common purpose to the Australian community. It stands beside, and in some ways above, the other structural reforms that we are undertaking to lift Australia's performance as a dynamic economy and society offering full opportunities for participation to all its citizens : the efforts to increase the availability, quality and relevance of education; the review of labour market, training and related youth programs; the industry policies directed at building on our competitive strengths and reducing reliance on barriers to imports; the active trade policy, directed particularly at making the most of opportunities in the dynamic Western Pacific region; the financial sector reforms; and the redirection of social security expenditure towards Australians in genuine need.

Successful tax reform will require broad community support. In particular, if it is to avoid igniting an inflationary spiral of huge and unsustainable proportions, it will require the active cooperation of the trade union movement.

I will be looking for the same sort of cooperation from the Australian community that has been given so readily over the past two years, to the great task of economic recovery.

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