PRIME MINISTER

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ADDRESS AT THE PERTH CHAMBER OF COMMERCE AND CONFEDERATION OF INDUSTRY

I welcome this opportunity to talk to you about the economic progress Australia has made in 1976, this Government's first full year in office, and about the Government's economic policies.

We all remember that under Labor Australia's economic situation was grave, and getting worse. There were no quick and easy solutions to the problems of high inflation, of high unemployment, and declining activity which were besetting Australia a year ago.

The Government's clear goal has been to bring about a sound economic recovery to create the conditions for sustained economic growth and to expand employment opportunities.

As the main stumbling block to the achievement of this goal was the rampant inflation inherited from the previous Government, our first task was to bring all the arms of economic policy - budgetary, monetary, external and wages policy - to bear on combatting inflation.

In the course of last year, we imposed the most rigorous restraint on Government spending, reducing the deficit and providing incentives to industry to resume expansion and getting job opportunities going. We moved to limit the inflationary growth in the money supply. We argued strongly for wage restraint before the Arbitration Commission. We maintained the exchange rate through to November.

1976 was a year of substantial progress in the three-year task we set ourselves of bringing Australia's economic problems under control. The extent of this progress has not been widely recognised. Inflation has been significantly moderated. In the first three quarters of 1976, the C.P.I. rose by 3%, 2½%, and 2.2% compared with an average rise of 4% per quarter in 1974/75. The C.P.I. of course records price movements in only part of the economy.

What has not been generally appreciated is that the downward trend in the rate of inflation is shown similarly or even more markedly by other indicators.

For instance, in the first three quarters of 1976 the deflator for the major components of gross national expenditure rose by 4.0%, 2.7%, 2.2%. This compared with an average rise of over 4% in 1974 and 1975. In the three months to October, the price index of the articles produced by manufacturing industry registered a rise of 2.0% compared with 2.7% and 2.9% in the two preceding three-monthly periods.

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The effects of the changed arrangements for health insurance will of course boost the CPI for the December quarter. Most commentators will focus on this. This "once and for all" effect should not distort our awareness of the steady underlying improvement in the rate of inflation. The more broadly based deflators derived from the national accounts, which will not be affected by Medibank - will provide a much better guide to underlying trends.

Partly because of our success in the fight against inflation other necessary preconditions for sustainable growth have been gradually emerging. The massive distortions caused by the disastrous events of 1974/75 to a number of key economic relationships, particularly the saving ratio and the wage profit share have begun to be corrected. The rise in business profitability is shown by the shift in the ratio of the gross operating surplus of trade companies to gross non-farm product from 10.5% in the final quarter of 1975 to 12.6% in the September quarter of 1976. The September quarter profit share was still below the longer run norm. But an encouraging start has been made.

This restoration of the profit share from the very depressed level to which it was driven in 1974 and 1975, is central to the revival of business confidence, the willingness to invest and ultimately in the creation of more employment. Other indications of economic recovery can be seen in the fact that aggregate expenditures and product began to grow in 1976; the national accounts figures show a 7.5% rise in real gross non-farm product between the December quarter of 1975 and the September quarter of last year. This figure is subject to revision, but it is very much better than the 4% decline during the seven quarters to the end of 1975. I am not suggesting that economic activity is booming. The rise has been uneven, but though recovery has been slower in other areas, it is still apparent. Real consumption expenditure increased moderately in the first nine months of 1976. Private investment in plant and equipment benefited from substantial taxation incentives, particularly in the first half of the year. The depressed non-residential building and construction sector also showed signs of improvement in the second half.

Before we came into office, employment opportunities were declining. We have arrested this trend. The modest increase in private employment is characteristic of the early stages of recovery, during which employers first of all make fuller use of existing employment. The result is that the rise in employment has no more than kept up with the growth in the labor force, so that unemployment has virtually remained unchanged.

At the present high levels of labor costs, an employer will seek out every alternative means of increasing his output before hiring additional full time workers. We have thus seen increases in overtime and part-time employment.

More noticeable progress on the employment front should begin to emerge as the recovery spreads and consolidates. The Government's object is, and must be, to get people back into jobs. Unemployment causes people to lose their dignity and self-confidence and contributes to severe social problems. It also prevents the expansion of living standards and the strengthening of the nation as a whole. The Government is particularly concerned at youth unemployment and has initiated a number of innovative schemes to assist with this problem. Ultimately, the speed with which we can reduce unemployment depends on the degree of wage restraint which is achieved in the course of this year - and I will return to this later.

Your State's economic performance in 1976 was better than that of Australia as a whole. This is an impressive record of achievement and is a tribute to the sound economic management which Sir Charles Court's Government has given to your State. Western Australia's economic activity is more export-oriented than in most other states, and on that account you have been reaping benefits - particularly in the minerals area. Devaluation will further strengthen this trend. Last year the residential construction sector recovered strongly in Western Australia - new dwelling approvals increased 23%. Registration of new motor vehicles in 1976 grew by 9% in Western Australia compared with the national figure of just over 2%. The value of non-residential building approvals in the three months to November stood 90% above the level of the same period in 1975 - again much better than Australia as a whole.

The State's unemployment rate of 4.6% at the end of December was the second lowest among all the States, and represented a slight decline since December 1975.

Major expansion of iron ore developments in the Pilbara is projected. The Agnew Nickel Project and smelter expansion near Kalgoorlie, the Alco-Reynolds Bauxite/Alumina project south of Perth, and of course the massive north west shelf natural gas project.

Several hundred million dollars is likely to be spent in this State in the next 2/3 years. An audience of businessmen from this State would be well aware that the development of mineral resources is not something which can be turned on quickly. The development phase must be preceded by a long lasting preliminary phase of exploration - not less than five years, and usually much more. We recognise this fact and have done a great deal to restore the incentives necessary to revive exploration. This will contribute significantly to overcoming Labor's policies which not only held up development, but stamped out exploration. We have adopted a more flexible policy towards foreign investment. The co-operation of the States has been actively sought towards issuing permits over vacant off-shore areas. The $2 a barrel levy on oil from new discoveries has been removed, and generous taxation incentives were announced in the 1976 Budget.

I am glad to say that exploration is recovering. Last year, 21 exploration wells were drilled throughout Australia. Only 6 of these were in Western Australia. This year, the number of exploration wells is expected to be up to 44. Up to 19 of them will be in Western Australia. This threefold anticipated increase in exploration drilling in this State is particularly encouraging. The discovery of additional reserves of petroleum ranks high amongst the objectives of my Government.

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I am also pleased to say that base-metal exploration has begun to revive, and that in parts of this State, valuable discoveries continue to be made. A key element in our philosophy of Government is that economic progress does not depend upon Government owning and actively carrying out the work of exploration, mining and processing.

We believe that if the Government provides the right climate, the private sector, at times together with overseas partners, can be entrusted to develop Australia's resources, and that the fruits of this development will be of benefit to the economy as a whole.

The policies and philosophy of both your State Government and the Commonwealth Government have created the conditions for mineral exploration to start again in Australia. The extent of progress made is as much as we could reasonably have hoped for.

Australia's overall economic performance has followed the course the Government has charted - a decline in the inflation rate, combined with a progressive recovery in activity which have laid the groundwork for future improvements.

Managing the economy is a continuous process and the balance between the different arms of policy must be constantly kept under review.

Towards the end of 1976 a modification was required in the exchange rate. The immediate background to this was the persistent speculation against the Australian dollar. The position had been reached where continued and substantial Government borrowings overseas to offset the drain on the reserves would have been counter productive. There was a risk that such borrowing would have advertised the vulnerability of the existing rate and heightened speculation. This was not, of course, a new development. It was one of the first problems we encountered upon coming into Government. Speculation was based on the fact that under the previous Government, Australians costs and prices had risen well above those of competing countries.

The costs of maintaining the exchange rate in such circumstances were high. It meant the continuing displacement of some Australian production by imports, with resulting difficulties in maintaining employment opportunities. It was aggravating the position of some parts of the rural sector.

As 1976 proceeded, it also became clear that, at the existing exchange rate, a range of major mineral projects would be of doubtful economic viability. Generally, investment decisions were being postponed. While speculation continued about the exchange rate, Australian industry faced severe difficulties in raising new funds from overseas sources.

Nevertheless, we decided to maintain the existing trade-weighted parity of the Australian dollar, through most of 1976 in the overriding cause of maintaining downward pressure on inflation.

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But the point was reached where the escalating outflow of our reserves, and the disadvantages which stemmed from the overvaluation of the dollar made change inevitable. This change did not mean that our objective of breaking inflation was changed or altered. What was involved was a necessary adjustment of policy to see that there would be a broad based recovery across a wide range of Australian industry.

Our export and import competing industries were bearing a disproportionate burden and some sections of manufacturing industry in particular just did not have a chance under the old exchange rate of the Australian dollar.

These industries can now play their part in providing important new investment and expanded employment opportunities. Their success in finding growing markets for their products will largely determine the pace of the continuing recovery and rising productivity. This will, in turn, allow economies in unit labour costs and ease inflationary pressures.

Once we had made the inevitable decision to devalue there were a number of options open to us on the extent of devaluation and on the form of the new exchange rate system.

1. We could have moved to a new fixed rate which would, at some future time perhaps require a further significant alteration in the exchange rate. A move, which, as the devaluation demonstrated, is attended by major public concern.

2. We could have a market determined rate which would make fluctuations possible on a daily basis similar to the majority of OECD countries.

3. We could have an administered and controlled management of the exchange rate which would avoid daily fluctuations but still leave us with the ability to make gradual adjustments in the rate.

A further question requiring very careful consideration was the magnitude of the initial change in the rate which would be made.

The choice before us was either to make a move which would decisively end further speculation against the downward movement of the dollar. Or, on the other hand, a move which would leave the way open for speculation about a further devaluation perhaps in the not too distant future.

The Government took the view that it was essential to end definitively further speculation against the dollar, and to establish a regime which would in future permit the exchange rate to adjust to changing circumstances.

The benefits of devaluation are clear: increased opportunity for Australian manufacturing industry to compete against imports in the domestic market; the bringing forward of some major resource projects; and an improvement in the position of primary industry.

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Devaluation will also facilitate capital raisings by industry and the Government has deliberately exempted longer term borrowings for high priority capital investment from the capital inflow control.

We intend that resource development projects of the kind proceeding in your State should have the benefit of the lower cost of capital overseas and the special facilities available in overseas markets for borrowing long term capital. Mining companies with existing contracts expressed in overseas currency will benefit from devaluation through improved cash flows. With these additional funds they will be in a sounder position to finance their new development projects.

The advantages of devaluation are many and can bring great rewards, but there are also dangers if the other arms of economic policy are relaxed. We intend to retain the benefits of devaluation by making the appropriate adjustments in the other arms of policy.

There will be some moderate direct price and cost effects from devaluation. These will register in the broad price indexes, primarily in the March and June quarters. But this needs to be seen in the context of the fall in inflation in 1976 and the further potential for recovery in profitability.

The Government will not countenance any reversal of the underlying downward trend in inflation which was established last year.

Let me be quite clear on this point. The fact the Government has been forced to take a decision which has some inflationary consequences can not be adduced as evidence that the anti-inflationary strategy has been abandoned. In balancing the arms of policy, the Government considered and still considers inflation as the number one impediment to economic recovery and thus the number one priority.

But we have never intended that it was the only priority. What is now required is that we do not relax our efforts to get on top of inflation. If we did relax, the substantial progress in achieving economic recovery I outlined earlier would be quickly undone, and the potential benefits of devaluation would not be realised.

This will happen if first-round effects were permitted to snowball, through wage indexation and a lax fiscal and monetary environment, into a renewed inflationary surge. We will ensure that the total anti-inflationary thrust of all the main arms of policy is not diminished.

Let me outline the steps already taken. In budgetary policy: the Government has announced further savings in outlays for the current financial year of $250 million; for 1977/78 outlays will be kept to within zero "real" growth and the deficit will be reduced further; Commonwealth Public Service ceilings will be reduced by another 700 as at June 1977.

In monetary policy: the Government has moved to prevent excessive easing in monetary conditions, the Reserve Bank has increased statutory reserve deposits; bank lending has been contained within firm guidelines; lending by non-bank institutions is being watched closely so that it will not be excessive.

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While carrying out these steps, monetary management has been concerned to ensure an orderly June quarter. The authorities have been counselling the need for adequate preparation in anticipation of the seasonal tax collections.

Indications are that substantial preparation has been made. The more attractive terms offered for Treasury Notes have resulted in an increase of more than $2 billion in non-official holdings since early September.

Measures also aimed at slowing growth in the domestic money supply have been taken to restrain the inflow of capital from abroad. It might be asked why we are concerned about excessive capital inflow. The answer is that excessive capital inflow can give rise to excessive liquidity in the economy and fuel inflation in much the same way as a budget deficit.

The reason for the high rate of capital inflow is clear. Capital can be obtained overseas at interest rates which are very low by Australian standards. Hence, there is a major incentive - perhaps in some cases amounting to up to a 50% saving in interest - for Australian-based companies to borrow overseas.

There could be no assurance that conventional monetary policy techniques would be sufficient to prevent this while interest rate differentials remain as large as they are.

If the Australian exchange rate were adjusted so as to neutralise interest rate differentials between Australia and overseas capital markets, some Australian manufacturing industries would again find it difficult to compete and jobs would be exported overseas.

Thus the new capital controls were necessary in the present circumstances to assist the overall task of firm restraint on money supply growth. This is not a matter of achieving a numerical objective for the money supply for its own sake. It is a concern with the broader implications of an over rapid expansion of credit and the availability of finance in the economy.

In the long run, of course, the best way of removing this differential and easing the threat to domestic monetary management will be to further reduce the rate of inflation in Australia. This, as I have already outlined, remains a major objective of policy.

On the wages front, the Commonwealth will intensify its efforts to convince the Conciliation and Arbitration Commission of the absolute economic necessity in present circumstances of considerably less than full wage indexation. Nothing would more quickly and surely undermine the progress we have already made than a flow-on of the full C.P.I. increase into wages. This would increase the problem of inflation. It would increase the problem of unemployment. It would erode the benefits of devaluation - the increased investment, more healthy growth and increased job opportunities.

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In this area, the Government cannot achieve success on its own - it will need the support of the community at large. I believe that this support exists in the community, and amongst most of the rank and file unionists who realise the costs inflation is having on employment opportunities.

Those union leaders who refuse to face reality and keep demanding excessive wage increases aro, in the current economic environment, putting men out of work.

Finally, I must comment upon the many calls for cuts in taxation. The Government is committed to taxation reforms. This commitment is demonstrated by the number and significance of the reforms already made. There is tax indexation - the most important reform in the history of our taxation system; the new arrangements for Commonwealth Estate Duty; new system of income equalisation deposits; the 40% investment allowances; incentives for the mining industry; the easing of distribution requirements for private companies; the trading stock valuations and investment. In terms of revenue forgone, these amount to very large taxation reductions - over $3000 million by 1977/78.

(See Attachment 8a)

1976/77		COST 1977/78
990	Tax indexation - the most important reform in the history of our taxation system	1050
2	The new arrangements for Commonwealth estate duty	10
2	New system of income equalisation deposits	4
200	The 40% investment allowances	550
0	Incentives for the mining industry	40
1	The easing of distribution requirements for private companies	25
0	The trading stock valuations and investment	400
1195	- Total -	2079

We are committed to reform of the taxation system. We have made substantive reforms and will go further in reforming the personal tax area when it is responsible to do so.

The one question which must be asked of those demanding further immediate tax cuts is: how is the resulting increase in the deficit to be financed?

There are, as you know, only four ways. First, through a reduction in Government spending by an amount sufficient to cover the costs of the tax cuts. Although we have made very substantial cuts in Government expenditure. I have head no one advocate cuts of this magnitude.

Second, through an increase in other taxes - and we have heard of no suggestions for this.

Third, by an increase in Government borrowings from the private non-bank sector. But this would be at the expense of the funds available to finance investment by the private sector and would involve a significant increase in interest rates.

None of the proponents of tax reductions have advocated these policies. Some have even suggested that interest rates should be reduced at the same time as tax was lowered.

But even if it were suggested that interest rates should rise in order to fund the deficit through higher bond sales, it would be necessary to think through the implications for building societies (financial intermediaries) the housing and building industries, and business generally.

The momentum behind the call for the immediate tax cuts could quickly subside if it were realised that its consequence is higher interest rates. But those calling for tax cuts do not mention the need for higher interest rates. That leaves only one other way of funding a higher deficit. By borrowing from the Reserve Bank. That is, by printing money.

When it is put this way, how many people would concede that this is what they are asking for. There is no surer, faster way to national disaster. We have no intention of taking this path.

Against this background, the Government decided a fortnight ago that tax cuts would be quite inappropriate at this time. The Government's decision to keep Government outlays to within zero real growth and to further reduce the deficit is designed to provide the maximum room to make further income tax reforms, as is appropriate.

People have made their preference for tax cuts over increases in Government expenditure well known and we intend to move as quickly as is responsible on this path. As I have said before, the inevitable consequence of several years of gross mismanagement of the economy is that it will take an equal period of time to recover our equilibrium.

In the last year, we have been able to make a substantial progress in righting the economy. This year, we have set out policies in position to fight inflation and to continue this progress. But policies do not work by themselves - no Government can be successful if its policies do not get the support of the community. I believe that we have this support - we will be successful.