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PRIME MINISTER

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SPEECH BY THE PRIME MINISTER
AUSTRALIAN FINANCE CONFERENCE
CANBERRA - 25 JULY 1984

Ladies and Gentlemen,

Thank you for inviting me to speak to you tonight.

I do so at a time of far reaching change in the Australian financial system.

Not change for its own sake. And not unsettling change without a clear direction. But carefully managed change, directed to ensure that the financial system plays its full part in the dynamic, flexible and productive economy that we are seeking to build in Australia as we move towards the twenty first century.

We are a skilled and resource-rich nation, in the geographic neighbourhood of what are now the world's most dynamic economies: the Japanese economy undergoing continued industrial transformation at the frontier of technology; an increasingly outward-looking China achieving impressive, early success with its modernisation plans; and continued growth at spectacular rates in the Republic of Korea and several of the ASEAN states.

Our challenge, as a nation, is to capitalise on the opportunities which our location and resource endowments provide. The Australian Labor Government is committed to seeing that Australia and its institutions rise to that challenge.

The decisive reversal in our economic fortunes since we took Office - from declining output in the year and a half to the June quarter of 1983, to what the national accounts will probably come to show as the strongest growth ever recorded in the year to the June quarter that has just ended, provides an opportunity for our nation to address long-term structural problems.

And you will be as aware as we are that many of the structural problems that have inhibited Australian economic growth over the last decade have been in financial markets.

Australians clearly wanted a fresh start in March 1983: a fresh approach to the longer-term problems increasingly facing the economy. They wanted a Government which did not bury its head in the sand when faced with difficulties, or make promises which it had little or no chance of delivering on. What was required was imagination, flexibility and creativity. As a Government we owed it to the Australian people to demonstrate these qualities.

Our immediate goal - to generate strong economic recovery - has now been largely achieved. The Prices and Incomes Accord was a major factor in reversing the deteriorating economic performance, and returning us to the path leading to economic stability and growth. Continued public commitment to its principles is vital.

We are confident that the economic recovery will continue, at rates of growth that are impressive by the inadequate standards of Australia in the last decade.

But a short-term economic recovery is not enough. The hardships of years of recession, the burdens borne by the unemployed, and the jobs and careers destroyed for so many of our young people, these have been too great to permit us, as a government and a community, to be satisfied with any mere temporary restoration of economic growth.

We have achieved economic recovery with the support of the trade unions, the business community and the State governments. And we will continue to work with the whole Australian community as we consolidate the gains that have been made and implement the reforms that are necessary to lift our long-term economic growth performance.

The permanent lifting of our growth performance, to sustained rates that support full employment for an increasing population at rising living standards, requires firm management and reform in a wide range of economic, social and political areas.

None is more important than the maintenance of favourable conditions in financial markets.

Now that private investment is clearly lifting itself out of the trough associated with the collapse of the resources boom, all levels of Government must find ways of reducing their demands upon private savings. Otherwise a combination of high interest and exchange rates will threaten the recovery we have all striven so hard to bring about.

Paul Keating and I obtained the State Governments' acceptance of this essential message at the June meeting of the Premiers' Conference and Loan Council. The Loan Council agreed upon a new approach to the setting of borrowing limits for statutory authorities. The aim is to achieve agreement between Heads of Government on the level of total borrowings which is appropriate to current economic conditions. At the same time the Loan Council has abandoned much of its outmoded regulatory role, providing authorities with greater flexibility in arranging their financing.

Aggregate global limits in 1984-85 will be about the same in nominal terms as actual raisings in 1983-84, a substantial decline in real terms and as a proportion of GDP. Further, under the global approach which we proposed - and which the States have accepted on a trial basis - all borrowing is out in the open. Markets need no longer fear substantial authorities' borrowings beyond those discussed in Loan Council.

The forthcoming Budget will also be important. I can tell you now, from the perspective of the current deliberations of Budget cabinet, that the simultaneous achievement of a lower budget deficit, and the provision of a meaningful personal income tax cut, while providing adequately for social welfare services to the genuinely needy, is enormously difficult.

Despite the strong economic growth of the last year, and our good prospects for continued growth, we simply cannot afford to address all of our policy objectives to the extent that we would wish. In this process the interests of particular sections of the community have to be weighed against the overall interests of the nation. And there is no doubt that when the social welfare obligation and demands on the Government have increased, the choices are more difficult.

And the essential first priority - the condition that is necesary for the Government to achieve all of its long-term social and economic goals - is sustaining the recovery.

In sustaining the recovery the interests of all Australians require us to maintain our simultaneous attack on the twin evils of unemployment and inflation. Accordingly, our Government's economic strategy must reflect a fine balance between the fiscal stimulus that is useful to support expansion, and the restraint on that expansion which is necessary to keep inflation and interest rates on a downward path.

We will find the right balance this year, just as we did last year.

In achieving this outcome the Government will not shirk the hard decisions that are required by our commitment to find the right fiscal balance.

While for some this will mean disappointment, it is essential for long-term national prosperity.

The same longer-term view underpins the emphasis we have given to the need for a sound approach to the restructuring of Australia's industrial base. We see an effective industry policy as critical to realisation of the Government's objectives of sustained economic growth, sustained growth in employment and reduction in unemployment.

The rebuilding of the Australian economy to provide secure full employment, and rising Australian living standards, inevitably involves structural change. It involves the shift of resources into activities in which Australians are most productive.

Inevitable as such change might be, its implications must be fully understood and accepted by all concerned. Hence the importance we have attached to widespread consultation amongst Commonwealth and State Governments, unions, business and the wider community on the issues involved.

Already we have some runs on the board. Imaginative, programs are already in place in respect of the steel, motor vehicles and computer industries, directed at strengthening the competitive position of those industries while keeping them open to the stimulus of international competition and avoiding increasing costs to users of their products.

And alongside these initiatives in manufacturing industry, our reforms of the financial system have a crucial role.

The finance industry plays a vital role, as you would all appreciate, in facilitating the economic growth we as a nation need. An efficient financial sector will direct resources at least cost to the most productive areas of the economy and thus assist in raising the wealth and living standards of all Australians.

Regrettably, the Australian finance industry has been operating at less than its full potential. In part this is because of lack of competition, itself partly the result of artifical restrictions imposed by Governments.

The Campbell Report presented a thorough-going analysis of the issues involved. The response of the previous Government was half-hearted. There were some changes to the savings bank regulations to enable them to compete more effectively, and the suggestion to move to competitive tenders for treasury bonds was taken up. There was long vacillation about the more difficult recommendations - in the areas of foreign bank entry, financial deregulation and exchange rate management.

By contrast the Australian Labor Government is committed firmly to a clear course of reform of the financial system. This commitment does not arise from any blind faith in the inevitable virtues of the free market.

Rather, it stems from our recognition of the practical necessity to promote restructuring and innovation in order to advance the economic and social well being of all Australians.

To advance this task of reform, the Government commissioned in May last year a group headed by Vic Martin to examine and report on the financial system in the light of the Campbell Report and Labor's own objectives and values.

Of course, as events unfolded, one major change in the system of financial regulation could not wait for the Martin Report. Late last year we were confronted with large capital inflows and rapidly increasing foreign exchange reserves in the wake of speculation on the authorities' management of the exchange rate.

These large inflows had the effect of pumping up our domestic money supply and threatening a renewed outbreak of inflation. We were not prepared to allow our strategy for economic recovery to be jeopardised in this way.

The decision to float the Australian dollar and abolish most exchange controls on 9 December last was a clear indication that, when circumstances demand it, this Government is prepared to act quickly, decisively and effectively.

The float has since proved most successful. The exchange rate is now free to settle at the levels required to clear the market. And we have a greater capacity to maintain monetary conditions appropriate to domestic needs.

In this context, it is pleasing to note that monetary growth in the financial year that has just ended fell within our monetary projection, as revised in December in recognition of higher rates of real economic growth without increased inflation. This would not have been possible without the float.

For the future, it is no longer possible for the financial system as a whole to approach overseas markets to obtain additional Australian cash reserves to support domestic operations. Better control of the domestic cash base will permit better control of domestic monetary conditions. Of course, the process of deregulation and the move to the floating of the $A has raised a number of issues which monetary policy will need to address in 1984/85. One of these is the need to interpret carefully movements in M3 as a monetary indicator at a time of structural change.

If deregulation increases deposits with the trading banks at the expense of other financial assets, the measure of monetary growth upon which we have placed greatest emphasis, M3, will be artifically inflated. As a result, any given rate of M3 growth would represent tighter monetary policy than would otherwise be the case.

We will need to take this fully into account in formulating our 1984-85 monetary projections. We will also need to be prepared to review the target in the light of relative movements in financial assets as well as in the light of developments in real economic and financial conditions.

The Martin group's Report was published last February. In the relatively short time since, the Government has taken several initiatives in the reform of the financial system. Martin has pointed the way. But we have not always followed Martin to the letter.

Among the major initiatives since the report was released has been a reorganisation of the Commonwealth Banking Corporation to place it on a more equal footing with the private banks.

The structure of the Corporation Banks has been modernised, bringing it into line with the practices of private banking groups. This will permit a more effective organisation of the Banks' resources, including its capital. In addition the Government has injected $15 million of capital into the bank and changed policy to enable it to retain more of its earnings. In future, the savings bank, development bank and the corporation itself will pay tax, in line with the obligations of all private banks.

We have also freed up access to foreign exchange dealing, enabling many merchant banks and finance companies to enter the long-standing bank preserve in that market.

The logic of the floating of the Australian dollar calls for a competitive and efficient foreign exchange market. Over 30 new dealerships have been authorised; many of them have already begun to operate. Further applications are being considered. Banks have also been empowered to write forward contracts to cover capital transactions, a facility previously available only in the hedge market.

We have as well abolished all maturity and interest rate controls on bank deposits, commencing from 1 August.

A network of maturity and interest rate controls on trading and saving bank deposits had been part of the regulatory structure since the Banking Act was passed in 1945. These restrictions on bank deposits have limited competition and restricted the range of financial services offered by banks. For example, they have prevented the payment of interest on cheque accounts. Also the short-term maturity controls have arbitrarily prevented banks from competing in the short-term money markets and go a long way to explaining the present domination of those markets by the progressive and innovative merchant banking industry. The removal of this restriction will enable the banks and their customers to benefit from closer competition with these innovators.

Long-term maturity controls limit banks' incentives to provide long-term loans. This restriction has tended to discourage finance for investment projects with long lead times - projects that must play a major part in the more productive, internationally-oriented economy that we are seeking to build.

As another step, we have established the Australian Payments System Council to oversee developments in the payments system, starting with access of non-banks to the cheque clearance system.

Access to the domestic payments system has in the past conferred a significant competitive advantage on banks, offset to some extent by regulations not imposed on non-bank intermediaries. The payments system in the past has been dominated by cheques and, more recently, by bankcard. However, the development of payments systems in the future is likely to be dominated by exciting technical achievements enabling the transfer of funds electronically. The Martin Group argued that these development should be supervised by a body concerned to ensure fair competition in access to these facilities. This body was also intended to promote the application of uniform technical standards to take maximum advantage of the very considerable economies of scale associated with EFT technology. The Payments Council has been set up to undertake these tasks.

We have also supported in the National Companies and Securities Commission a proposal to allow finance companies to issue short form prospectuses. This will allow those companies considerably more flexibility in organising approaches to the market for funds.

In short, we have already done in a few short months a great deal to restructure the financial system. As a result of close consultations with all concerned, this transition to a less regulated environment has been achieved in a stable and orderly fashion. All Australians stand to gain from such carefully managed change.

The major item of unfinished business is the matter of granting additional banking licences, including to foreign equity interests.

While the Campbell report recommended in favour of fairly unrestricted access to the Australian banking industry, the Martin Group accepted the traditional Australian attitude in favour of local participation in any major venture. Accordingly, the formula developed by the Martin Group was to allow a limited number of new entrants to the banking industry with up to 50 per cent foreign participation in any new entrant.

For several months now, Paul Keating, other members of the Government, some State Premiers, and I have actively explored the principle of foreign bank entry.

Following a series of mergers over several years, the banking industry has become increasingly concentrated. Desirable as this development may be by certain criteria of efficiency, it has not served to maximise competition. Additionally the exclusion of foreign banks has begun to inhibit the capacity of our banks to operate in some key overseas economies, whose Governments demand reciprocal rights of access to the Australian market.

This has limited the capacity of our banks to provide full banking services to Australian industry, including in respect of finance for exports.

It was for these reasons that we were able to persuade our 36th National Labor Party Conference held earlier this month to change our Party's policy platform to permit the entry of a limited number of foreign participants in banking. Following the Conference, the Government will be moving quickly to promote the establishment of new banks in Australia. Foreign entry will be subject to a number of conditions, including that every effort is made to ensure 50 per cent local participation in any new banking venture and that new banks do not concentrate their efforts in the low-employment areas of wholesale banking. We will also insist on a history of very sound prudential management of depositors' funds.

But, most importantly, we will be looking to new banks with foreign equity to provide a competitive edge and a range of improved services to bank customers.

Foreign banks with a history of providing finance to promote new ventures, emerging industries, restructuring initiatives and other new opportunities for growth and development will be particularly well regarded.

Our attitude to new wholly domestically-owned banks remains unchanged - although we will be considering the Martin recommendation to increase maximum shareholdings from 10 per cent to 15 per cent. Expressions of interest from suitably qualified domestic entities will, naturally, be welcome.

But one of the main reasons identified by the Martin Group for permitting foreign participation in new banking ventures was the limited number of suitably qualified domestic partners, and we need to be realistic about further expansion.

Through our reforms, we aim to tap the verve and competitiveness of the non-bank sector and to channel those energies also into providing heightened competition in the banking area.

Some financial activities could well be inconsistent with the broader, pivotal role which banks play in the financial system. In a world of specialisation, even in the provision of financial services, there will always be a need for entities other than banks.

We do not intend to favour banks at the expense of other financial institutions. We want an efficient financial sector overall: one which is responsive to the economic and social needs of Australia; and one which is based on fair competition amongst a number of efficient and effective participants.

Our achievements in this crucial financial sector of the Australian economy are, I believe, by any measure impressive. I sometimes hear the observation - in praise from some of your quarters, in anguish from some of mine, that this is the best Liberal Government in memory. The observation is quaint but of itself unrevealing.

Our changes do not derive from some profound political philosophy. They are based squarely upon, first, clear, level-headed perceptions of what is necessary to create the conditions appropriate for optimum growth and, second, a commitment to take the action required to give effect to those conditions.

Our predecessors may have had the perceptions; they certainly lacked the commitment. We have demonstrated that we have both - and it will be to the enduring benefit of the whole Australian community.

There are many other important issues raised by the Martin Group to which the Government will respond in coming months.