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PRIME MINISTER

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SPEECH BY THE PRIME MINISTER - HON. R.J.L. HAWKE, AC, MP
STAN KELLY MEMORIAL LECTURE
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I know of Stan Kelly from a mutual friend between our two generations, John Crawford. Sir John's Inaugural Stan Kelly Memorial Lecture in 1977 laid out some ideas on which we later worked together in the Study Group on Structural Adjustment.

I like what I know of Kelly - a farmer who gave much of his life to public administration, including on the Tariff Board in those terrible years from 1929 to 1940, and as an adviser to the Commonwealth Prices Commissioner during and immediately after the war. I like the way that Stan Kelly recognised the dangers of excessive protection in a protectionist era, but sought the moderate and gradual curbing of excesses rather than impractical, radical changes.

There are many ways in which the steady progress we are making today in building a more dynamic Australian economy through increasing its international orientation is indebted to the work of Kelly and a small number of others, who questioned the role of high protection when its tide was still rising in Australian political thought.

One of Stan Kelly's legacies to Australia was, of course his son Bert. Bert Kelly occupied the tragic place in Australian history of a farmer who understood the economic effects of protection, from 1958 sitting on the back bench of a conservative Government whose trade and industry policies were run by Jack McEwen. That he stuck to his guns through all those years with rarely a ray of hope says a great deal for his strength of character or, as Mavis would probably say, for his sheer farm-bred obstinacy!

A gathering like this, organised by the Victorian Branch of the Economic Society, is not an occasion for partisan comment. The only political comment that I will make will be of a scientific kind, involving, for example, the testing of political forecasts.

Five weeks ago I presented the annual forecasting prizes to the New South Wales Branch of the Economic Society. The New South Wales Branch was discreet enough to withhold information on the content of forecasts, but from conversations with participants it seems that the best exchange rate predictions a year ago were those which had our dollar rising by the smallest amounts.

Political forecasting is a bit more accurate. Early this year I predicted that the ideological tensions within the Liberal Party would soon erupt into open disputation about the Leadership. As we all know that prediction, which I shared with others, has been dramatically proven correct today.

It will be of immense interest now to those of us concerned with economic policy to see how the ideological forces which gave rise to today's events manifest themselves in the Opposition's approach to fundamental economic issues.

Over the past few months we have seen the current Opposition support needs-based welfare then oppose the Assets Test; support the introduction of more international market discipline into highly protected Australian industry and then use its numbers in the Senate to defeat the Kerin Dairy Plan; support the free play of market forces and then block legislation designed to take the allocation of petroleum exploration licences out of the hands of bureaucrats into a competitive market; and support lower deficits but oppose attempts to reduce expenditure where it has no strong justification in economic efficiency or equity, such as with the Senate's rejection of our amendments to some more-than-intended Veterans' entitlements resulting from judicial decisions.

These are the sorts of issues which will test the rhetoric of the new Opposition leadership. No doubt we will all watch to see how it acts. Whatever happens in these matters, it has been the policies of this Government which have turned around the economy and restored sustained economic growth. I believe that I am entitled to claim on this record that Australia's hopes of building a new era of sustained economic growth depend on the present Labor Government.

This is a heavy responsibility, and one that we accept as the core of our mandate from the Australian people. Australia can be a successful society only in the context of sustained economic growth. The Labor Government is committed to progress towards ideals that can be broadly described as social democratic - ideals that include equality of

opportunity, the removal of poverty, the raising of living standards for ordinary Australian families, all within a political framework of individual freedom and Parliamentary democracy.

None of this can be advanced far without sustained economic growth.

Only sustained, strong economic growth can reduce unemployment to acceptable levels.

Only sustained economic growth can support adequate provision for Australians who, but for the intervention of Government in directing community resources to them, would live in intolerable poverty.

And only sustained economic growth can deliver rising living standards over time for ordinary Australian families - whether through higher pay, or the provision of the better education, health and social infrastructure that are essential ingredients of genuine equality of opportunity.

While growth is essential for progress towards the goals of Australian social democrats, it is not a goal that divides Australians politically. Our common interest in growth allows us to seek consensus on many issues of economic policy, through analysis of the effectiveness of policies in promoting growth.

While economic growth is a platform upon which we can all stand, in a democratic society like Australia, many interest groups, and coalitions within the electorate, have the power to determine what is possible in the way of policy innovation - legitimately, if often inconveniently, and sometimes outrageously, to the detriment of economic growth.

I believe that a social democratic Government - in Australia, a Labor Government - is better able to appeal to the broad national interest in fairness, as well as the national interest in economic growth, to defeat vested interests and other barriers to progress. Various groups in society will use their democratic powers and rights to veto change that is essential for growth unless there is widespread acceptance and understanding that the benefits of growth are distributed equitably.

For this condition to be met, there must be mechanisms - often fiscal and other mechanisms directed by Government - to distribute equitably the benefits of growth. And there must also be mechanisms for community discussion and consultation within which widespread community

support - if you like, consensus - can be built for growth-oriented policies.

So far, the Government's record stands up pretty well. This looks set to be the third successive year during which non-farm economic activity has expanded by 5 per cent or more. Non-farm growth did not reach 5 per cent during any one of our Liberal National Party predecessors' years in office. By the end of this year, the economy will have expanded more in three years than in seven and a half years under our predecessors.

So far so good.

But the real test is whether strong growth can be sustained over the long period necessary permanently to cut the evil of unemployment down to manageable proportions, and to give all Australians the higher living standards that our resources and skills have placed within our reach.

Tonight I will describe some of our thinking about policies for growth; where we have got to in implementing new policies; and something of the agenda for future action. But first I would like to say something about where we have come from.

Past Performance

Even during what now seem to have been halcyon days of economic prosperity between the end of the Second World War and the early 1970s, Australia's growth in real GDP per capita was unimpressive on a world scale.

During the 1970s Australia's economic performance deteriorated markedly. Growth in real GDP per capita averaged only 1.3 per cent for the period 1973 to 1979 and then a bare 0.1 per cent per annum between 1979 and 1982. Simultaneously our inflation and unemployment rose sharply, proportionately more than in most OECD countries.

The economic environment in Australia in the postwar period, and particularly since the early 1970s, has not been conducive to strong and sustained growth in our capital stock, employment and productivity.

It is now clear that even the relatively modest growth performance of the 1950s and 1960s was purchased partly at the expense of future growth potential. A significant part of our growth in the early postwar decades derived from investment to supply protected domestic markets. The adverse consequences of this were not evident while the investment itself was taking

place. But it locked much of Australian industry into fragmented production, high costs, and insulation from competitive pressures.

In other industrial countries, liberalisation of manufactured goods trade in the 1960s made these industries more sensitive to opportunities for expansion based on exports, for application of superior technology, and for managerial improvement more generally.

We can all now see that the inward-looking postwar development strategies were a mistake.

One of the lessons of the past decade is that we can no longer carry the costs of mistakes of this kind.

The era of steady strong expansion of total world demand for the output of our most productive industries, for example in agriculture and mining, is long past.

There are still opportunities for us in the international economy which, if utilised effectively, can support sustained strong growth at home.

But we cannot rely on a rapidly growing world economy or the discovery of new natural resources to lift our performance sufficiently to make concerted inroads into unemployment while, at the same time, maintaining the living standards of the employed. If ever we were "The Lucky Country", we cannot afford to remain the Happy-go-Lucky Country that Donald Horne described two decades ago. We must work to create our own success.

Improving Australia's Performance

Sustained strong growth requires consistent and mutually supportive macro-economic and resource allocation policies. Both are essential. Weakness in one can destroy any achievements in the other.

Macroeconomic Environment

The Labor Government set out to lift Australia's long-term performance at a time when there were major macro-economic imbalances in the economy.

We deliberately turned our backs on prescriptions that depended on first correcting these imbalances. We deliberately rejected fighting inflation first.

As the Treasurer likes to say, we set our sails for growth, believing that we could best address the structural imbalances in the process of on-going growth.

But we never did kid ourselves that the structural imbalances were unimportant.

First, there was the huge prospective budget deficit amounting to about 5 per cent of prospective GDP for 1983-84.

Second, there was a lack of international competitiveness across large parts of our export and import-competing industries, reflecting the combined effects of entrenched high inflation, deliberate over-valuation of the Australian dollar (as acknowledged by former Prime Minister Malcolm Fraser), and mediocre productivity performance.

And reflecting all of these factors, there was a huge current account deficit, at 3.9 per cent of GDP in 1982-83, one of the highest in the OECD, even when demand was exceptionally weak in the depths of recession. The large current account deficit was associated with increases in foreign debt which threatened sooner or later to become unsustainable.

Closely related to these structural weaknesses were high interest rates and high real unit labour costs, contributing to historically low rates of investment.

All of these factors were in the minds of Paul Keating and myself, alongside the short-term foreign exchange crisis, when the dollar was devalued by 10 per cent two days after our election to office. Starting with a large current account deficit, our competitiveness had to improve if we were to get the economy moving with expansionary policies.

Under the managed exchange rate system that we inherited, the initial depreciation did not hold. That pointed to a weakness in that system, which was removed decisively with the floating of the dollar in December 1983.

The floating dollar has facilitated the adjustments in competitiveness that were necessary to support sustained growth in the Australian economy at rates faster than in the rest of the world.

Of course, dollar depreciation only converts a balance of payments problem into both a balance of payments and an inflation problem, without any sustained improvement in competitiveness, unless it is supported by moderate wages growth.

The agreement announced yesterday between the A.C.T.U. and the Government provides the basis for the necessary

wage moderation, including through discounting the 1985 C.P.I. increases for indexation purposes by two percentage points, and delaying and moderating the claims made in the national productivity case.

Moderate wages growth along these lines is absolutely necessary to the maintenance of strong growth in our current circumstances.

Moderate wages growth along these lines is good for all Australians, but especially those who benefit directly from the creation of half a million jobs in three years and continued strong employment growth after that - an economic benefit unrivalled in our history.

Moderate wage growth along these lines represents an outcome that would be impossible under any alternative approach to economic policy in Australia, without the Prices and Incomes Accord.

The improvements in competitiveness resulting from depreciation and wage moderation should allow continued strengthening of the current account of the balance of payments in the course of strong growth.

It was our confidence in the Accord that permitted us to embark on expansionary, growth-oriented fiscal and monetary policies when we came to office.

But from the beginning, it was recognised that the large fiscal stimulus would need to be hauled in as recovery strengthened and broadened to the private sector. This is reflected in the progress we have made in reducing the budget deficit, by over half to little more than 2 per cent of GDP in the two years to 1985-86.

This progress on the Commonwealth deficit has been supported by co-operation with the States in the Premiers' Conference and Loan Council, to reduce the total public sector borrowing requirement as a proportion of GDP by over two and a half percentage points in two years.

Monetary policy has been designed consistently to support strong growth but not any acceleration of inflation. The floating dollar has greatly assisted the implementation of monetary policy towards these objectives.

Some doubts were expressed earlier this year about whether monetary policy really was consistent with our anti-inflationary objectives. The doubts derived mainly from the distortions that financial deregulation has introduced into measurement of the monetary aggregates. The Treasurer and I have put some effort into explaining our firm monetary policy in recent

times, and the doubts have diminished.

Events are vindicating our decision to address structural imbalances in the course of growth rather than as a precondition for expansionary policies.

This is evident in the gains that have already been made on the Budget deficit and competitiveness. Real unit labour costs are back to the levels of one and a half decades ago. Interest rates remain high, but at least the pressures exerted by Government borrowing are diminishing.

The framework of macro-economic policy that has been established, incorporating the Accord, the floating dollar and the Trilogy of fiscal commitments, are delivering settings of wages, monetary and fiscal policy that are consistent with sustained growth.

It has also removed major areas of uncertainty and arbitrariness from crucial areas of macro-economic policy, and thus contributed to a more stable environment for investment and production decisions.

Private investment remains too low, but is responding to the improved business environment.

Micro-economic Environment

In addition to the more stable macro-economic conditions to which I have already referred, there is no doubt that the low levels of disputation in the context of the Prices and Incomes Accord have allowed underlying economic realities to play their proper role in investment and production decisions.

Most importantly of all, the dramatic recent improvements in international competitiveness provide Australia with a unique historical opportunity to lift its manufacturing and service sectors out of inward-looking production into the international economy.

Beyond these ways in which macro-economic outcomes affect micro-economic performances, we are taking steps to:

- . improve the environment for productivity growth,
- . improve the efficiency and effectiveness of the public sector, and
- . develop a more outward looking industry policy.

While each of these may be examined separately there are a number of strong linkages between them. In the past

the productivity performance of Australian industry has been substantially conditioned by an excessively inward orientation.

The effect of this has been to mute the incentives to find and exploit world markets which have the greatest growth potential. It has impeded productivity growth and led to a decline in competitiveness. It has also discouraged the development of new products, new production techniques and new work practices.

Finally it has discouraged flexibility and adaptation in the organisation of many of our industries. Introduction of these innovative and dynamic qualities will provide an impetus to productivity growth.

At the same time industry policy has provided incentives to pursue profit opportunities by seeking to obtain the benefits of Government assistance, at the expense of the creation of new wealth through economically productive activities.

IMPROVING THE ENVIRONMENT FOR PRODUCTIVITY GROWTH

Human Capital Formation and Application

The formation and application of human capital are vital elements in any strategy to improve and enhance our economic growth performance. Advances in these areas are intimately linked to the quality and flexibility of the labour which is available for use by industry : a workforce which is highly educated and trained will facilitate the development, adaptation and diffusion of more productive techniques and the more flexible and efficient utilisation of labour and capital by industry.

Changes to our educational and vocational training systems are necessary. Major reforms initially will focus on the school sector.

The Karmel Report has emphasised that changes in curricula, course content, progression and certification processes are needed if schools are adequately to fulfill their critical role in the nation's social and economic development.

The Report acknowledges that a much greater proportion of young Australians have to complete full secondary schooling and receive a broad general education, if young people are to realise their potential and fulfill their key role in the further social, cultural and economic development of Australia. A broader school based education is essential.

The implementation of Karmel's recommendations for the school system will complement our traineeship initiative, announced in the Budget. To complement both these measures my Government has taken action to reduce the chances that young people will be precluded for financial reasons from participating in post compulsory schooling or training.

Supporting these initiatives, the Government has taken steps to increase the number of places and improve and increase the relevance of training within the TAFE sector and across the range of tertiary institutions.

Innovation, Research and Development

Innovation, technical progress and the development of export markets depends in large measure on Research and Development and technology transfer.

Aggregate spending on R&D in Australia is low. While the Government contribution is commensurate with other developed countries, industry funding and performance of R&D is small. The proportion of research funds devoted to experimental development is low.

Australia has some important advantages in research and development activity. The education system produces capable research workers. The cost of R&D in Australia is not high.

To break down longstanding weaknesses in our applied research effort, for five years from 1 July this year, 150 per cent of expenditure within Australia will be deductible for taxation purposes.

We are seeking to improve the manner in which some of the direct public assistance is provided. Efforts are being made to increase interaction between industry and the public research institutions, such as CSIRO and universities.

Remaining weaknesses in our applied technological effort have much to do with the past development of an inward looking industrial structure. This has dulled competitive pressures for adoption of superior technology.

Labour Market

We all agree that adaptable labour markets can assist in promoting efficient use of capital and labour resources and their more rapid accommodation to economic change.

The setting of wage differentials has the potential to influence the efficiency and adaptability of the labour market. But flexibility in these differentials is less

important the more mobile and flexible is the labour force itself.

In contemplating labour market reform, we are wise to recognise that increased wage flexibility contains a real risk of destabilising aggregate wages and the conduct of macroeconomic policy. If necessary, we are prepared to give away the small advantages of marginally increased relative wage flexibility to preserve the greater benefit of overall wage moderation.

Taxation and Growth

In the first of my trifecta of Economic Society speeches this year, to the Canberra Branch in March, I said that tax reform directed towards improvement in our growth performance must come to grips with four flaws in the current taxation system.

To quote from that speech, which was published in the Economic Record in June:

"[The tax review] must address the widespread avoidance and evasion, especially by people with income well above the Australian average..... It must address poverty traps..... The tax 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 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."

While the Government's preferred option did not survive the Tax Summit, the tax package to be announced soon will make substantial progress towards these objectives. It will significantly improve the environment for economic growth in Australia.

IMPROVING THE EFFICIENCY AND EFFECTIVENESS OF THE PUBLIC SECTOR

Quite apart from its role in establishing the macro-economic and regulatory environment, the public sector is such an important feature of the Australian economy that the efficiency of its own operations has significant implications for our overall economic performance.

I believe that this Government has gone further than any

of its predecessors in scrutinising public expenditures, with a view to testing their contribution to improved efficiency in the economy, and improved equity.

The issue of efficiency in public expenditure is separate from the issue of size. Nevertheless, as a Government which believes that public expenditure is necessary for progress towards its key objectives, we have found the constraints that the trilogy commitments have imposed on size useful in concentrating attention on efficiency.

Finance Minister Peter Walsh has made several detailed statements on our approach so far, and I do not have time tonight to traverse that ground.

But I believe that I can assert that this year's budget, with the lowest growth in real outlays for six years, and reducing the share of Commonwealth expenditure by a full percentage point, has contributed more to genuine equity than many more expansive budgets in past years.

The efficiency of public enterprises is also a major factor in the overall performance of the Australian economy.

Significant progress has been made in rationalising activities and reducing costs in several major Commonwealth commercial enterprises. This is the real task. The issue of "privatisation" is a diversion from this task.

Commonwealth public enterprises are quantitatively less important than those of the States.

In recent years the Australian community has been more critical of charges for electricity, rail and other services provided by the States, as well as by the Commonwealth.

This is a promising development.

I believe that the Commonwealth Government has contributed to this change in the climate of community opinion. We have also made direct representations to the States on these issues.

One result is a substantially lower rate of increase in charges, through containment of costs, without increases in the deficits of State enterprises.

TOWARDS A MORE DYNAMIC AND OUTWARD LOOKING ECONOMY

It will be clear from what I have already said that I attach prime importance to increasing the international orientation of the Australian economy.

Major progress has been made in these last two years, and the continuation of progress will be a major focus of our efforts in the years ahead.

Our work in this area has many inter-related strands.

One strand is the re-orientation of Australian business, trade union and community attitudes towards greater awareness of international opportunities.

I have seen this as one of my special responsibilities as Prime Minister, and have pursued it in every possible forum at home and abroad.

It has been assisted by discussion within the Economic Planning Advisory Council and the Australian Manufacturing Council.

Community attitudes had begun to change in favourable ways some years ago, but there has been a major acceleration under this Government.

A second strand has been the reform of the regulatory environment which had placed so many inhibitions on international transactions in the past.

The abolition of exchange controls at the time we floated the dollar had far-reaching implications for trade, the full extent of which is poorly understood.

It facilitated the development of new hedging arrangements, which reduced the risk of specialisation in production for export.

The floating of the dollar itself reduced uncertainty in production for export, by providing greater confidence that any movements in Australian costs that were out of line with international developments would be counteracted by currency depreciation.

The entry of new banks with foreign equity, and the internationalisation of the operations of established Australian banks, are widening the channels through which Australian producers are informed of export opportunities.

We have also taken significant steps towards liberalisation of import trade. Our approach so far has

been to address issues industry by industry.

The plans for the passenger motor vehicle, textile, clothing, footwear and steel industries all involve substantial liberalisation.

The decisions to use bounties, rather than tariffs, to protect the production of steel, agricultural harvesters, machine tools and computers improve the form and visibility of assistance to those activities.

The deregulation, proposed or underway, of the marketing arrangements for milk and dairy products, eggs and dried vine fruit will reduce assistance to industries which have been very highly protected in the past. The voluntary restraints on the exports of colour television sets to this country were abolished last year.

In the service sector, our new guidelines for the provision of education services to overseas students on a fee-paying basis open the way for the development of a new export industry.

The progress in some of these areas has been considerable.

The removal, on 1 January 1984, of the temporary import quotas imposed on a range of steel products in 1982, was a major break from the earlier Australian experience with temporary quotas becoming permanent. Together with other elements of the industry plan, it has helped to make steel production in Australia internationally competitive, and has opened prospects for expansion through exports.

Since the mid-1970s, the greatest problems of high protection in Australia have been in the textiles clothing and footwear and passenger motor vehicle industries.

In these industries, improvements in Australia's general competitive position through depreciation, gradual liberalisation of imports, and major rationalisation and increased productivity at home have substantially reduced protection over the last year.

This is reflected in large reductions in the premium paid on quota sold by tender.

The third strand in our efforts to increase the international orientation of Australian industry has been our active trade policy, designed to build a climate of confidence in which Australian and overseas enterprises can interact with each other.

Some of our activities have been defensive, as we have sought to minimise the damage that the trade policies of the European Economic Community has imposed on our efficient rural industries, and to ward off United States pressures upon Japan to divert imports from efficient Australian suppliers.

The representations that John Kerin and I made in Brussels early this year were successful in holding the line against subsidised European beef in our established Western Pacific markets. We can be reasonably satisfied with the way Japan has maintained the international trade rules against bilateral pressures, although we would like to have done better with beef.

More positively, we have invested considerable effort in building confidence in trading relationships within our own region. I myself have been closely involved in discussions on trade with Heads of Government in all major countries in our region.

There has been special progress in our relationship with China. We have been working to build new layers to our trading relationship with Japan as Japanese industry's appetite for raw materials has become less voracious. Significant steps have been taken to build closer economic ties with the ASEAN countries, the Republic of Korea, and the developing countries of the South Pacific Forum. Like the ASEAN countries, we have had to think about possible responses to suggestions for new free trade areas that have emanated from the office of the Special Trade Representative in the United States.

We have established a firm base from which to use effectively the new competitiveness conferred by the depreciation of the dollar and the associated commitment to wage moderation.

The circumstances have come together for us to make now a permanent break over these next few years with the inward-looking policies that have been holding us back.

With a new round of Multilateral Trade Negotiations (MTN) on the horizon, we need to prepare ourselves to contribute to its successful progression. Admittedly the benefits we have obtained from previous MTN rounds have not been encouraging. But this was due in considerable measure to our lack of credibility in arguing for general trade liberalisation while seeking to maintain our own trade barriers.

One of the ways in which we have been preparing for a new round of negotiations is through the regional consultations amongst Western Pacific countries which

followed suggestions that I made in a speech in Bangkok in November 1983. The third regional meeting of Senior Trade officials will take place in Seoul next week. There is general agreement within the region that these consultations have been helpful in identifying regional interests and opportunities for co-operation.

A demonstrated commitment to continue steadily with domestic liberalisation will greatly add to our credibility and negotiating position in any MTN round. Such an approach could be complemented by a preparedness to pursue trade policy initiatives involving particular countries or products.

The continuation of domestic liberalisation is in any case fully justified by the domestic benefits, independently of the trade policy rewards which it makes possible.

Consistently with our established approach, further liberalisation, whether it were within a program of general reductions in assistance or industry by industry, would be gradual, would be complemented by appropriate adjustment measures, and might need to be supported by positive measures to encourage expansion of more productive activities.

Conclusions

We have come a long way in these last two and a half years, but we do not delude ourselves that we are near the end of our journey.

A new approach to macro-economic policy, based on fighting inflation and unemployment at the same time within the framework of the Prices and Incomes Accord, has brought back strong growth after a decade of stagnation and decline.

The return of growth has given Australians the heart to tackle longstanding structural impediments to growth.

We have begun the huge task of reform, guided by our recognition of the reality that if change is to be substantial and permanent, it must be gradual, its consequences must be well understood in the community, and the whole structure of social and economic policy must care for Australians who are unable to defend themselves in the market place.

As I have said, by the end of this year the Australian economy will have expanded more in three years than in the preceding eight years.

Our current forecasts suggest that by the time the Labor Government has been in office half as long as its predecessor, it will have presided over the creation of twice as many jobs.

But we must go further yet.

The Labor Government, and this generation of Australians, must expect to be judged in history not by our success in promoting three or five years of economic growth stronger than the rest of the world.

The final test of our worth is whether we succeed, gradually but inexorably, in so transforming the environment of economic life in Australia, that sustained growth becomes entrenched, even in these difficult times for the world economy.

On our performance so far, I reckon that Stan Kelly would expect us to pass this test.
