PRIME MINISTER

EMBARGOED UNTIL DELIVERY CHECK AGAINST DELIVERY

SPEECH BY THE PRIME MINISTER
COMMITTEE FOR ECONOMIC DEVELOPMENT OF AUSTRALIA
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Ladies and Gentlemen

It is always a pleasure to address CEDA. My own association, and that of my Government, with your organisation has been very important and productive. In fact this is the fourth time that I have had pleasure of speaking to CEDA since becoming Prime Minister. I believe that is the best indication of the importance which I attach to this Forum.

On the last occasion I was with you it was to commemorate CEDA's Silver Jubilee. My Address then recognised CEDA's abiding commitment to longer-term structural and development issues. That commitment, of course, is one which I share.

On that occasion I noted, in particular, that our terms of trade were declining faster than usual and that because of a number of structural changes in the world economy it would be some time before any significant reversal was likely.

Of course that was before the outbreak of the agricultural trade war between the US and the EEC. It also preceded the collapse of the oil market in February, a collapse which has dragged other commodity prices down as well. All of the policy prescriptions which I put forward on that occasion have very much greater relevance now.

Those prescriptions came in two interrelated parts. The first, naturally, was sensible macro-economic policies - I will come back to this issue shortly.

The second part covered a group of longer-term policies to promote structural change : policies to raise the skill levels and flexibility of the work force; policies which recognise the need to foster innovation and managerial flair; policies to encourage a more outward looking, more innovative industrial base, including the winding back of protection; policies to lift the regulatory burden on business and to let Australia get on with the job.

Once again these prescriptions were hardly novel. I and my Ministers have been propounding them consistently now for more than three years.

We have been propounding them for one simple reason. And it is this.

For decades Australian industry generally had been allowed to become tired and complacent. Governments had acquiesced in the general lassitude. Indeed at certain times in the electoral cycle they had even encouraged it.

Australia had been lulled into a false sense of security by a feeling of invincibility. We thought ourselves the lucky country. We thought of ourselves as the natural place for foreigners to turn when they wanted to buy seemingly scarce primary commodities.

And it must be said that there was a failure of political leadership - failure to look beyond the next election and to plan for the longer-term. There was a profound failure of far-sighted vision.

It has fallen to my Government - and I welcome the challenge with zest - to redeem the failure of decades. We have consistently put forward our vision for a better Australia: an Australia which needed to undergo fundamental economic and social change if it was to realise the aspirations which we all legitimately hold.

It was that vision which lay behind my calling of the National Economic Summit and the establishment of consultative bodies such as the various industry councils and EPAC. It is that vision which underpins our approach to industry policy and industry regulation. It is that vision which provides the intellectual basis for the urgency with which we have set out to foster national reconciliation and national reconstruction.

In my Address to the Nation around ten weeks ago, I pointed out the major difficulties facing Australia at the present time because of the unexpectedly sharp change in world trading conditions.

The point is not that there was any sudden realisation that changes were required in Australia's way of doing things. As I say, we have known that for years.

The real point to note is that these new external developments have placed new demands on policy. These include, first, new demands on short-term economic management. They also include, a new urgency for industry policy because the time period available to us to effect long-term structural changes has contracted.

The task of coping with the new environment is daunting enough : just consider how much more difficult it would be if we had not begun some three years ago to give effect to longer-term policies to promote the necessary structural changes.

Throughout our trading history Australia has been an exporter of commodities, mostly some mixture of agricultural products and minerals. For much of this period there has also been a trend decline in the prices of our exports relative to imported manufactured goods.

In the post-war period this decline has been of the order of 1 per cent per annum, a trend that all post-war Governments were content to live with. But since the end of 1984 there has been an abrupt and very sharp decline in the world prices of our exports, resulting in a fall of 15 per cent in our terms of trade.

To put that in perspective, the terms of trade have now fallen to a post-war low in year average terms. The further 8 per cent decline forecast for 1986-87 will mean, if realised, that Australia's terms of trade will have fallen to a level not seen since the 1930's.

The sad truth is that the cost to Australia of our lowered terms of trade is currently about $6 billion per annum.

This development, needless to say, has been most unwelcome. But it is here and adjustment is inevitable.

The Government cannot create the conditions which will enable us to avoid the need to adjust. What this Government can do - and has done - is to create the conditions which will enable Australia to maximize its future growth prospects.

Last week's Budget is an indispensible element in that process.

In a sense, the deterioration in the terms of trade has effectively focussed attention on another longer-term structural issue. Over the last decade or more Australia as a whole has increased the average share of GDP devoted, one way or another, to consumption. This has been at the expense of saving for investing in our future.

Overall domestic saving has fallen from an average of 17.5 per cent of GDP per year in the ten years ended 1973-74 to just 11.4 per cent last year. Last year private savings amounted to 18.3 per cent of GDP, comparable with the average experience over the relevant 10 years. The difference between private and total saving in 1985-86 - at 6.9 per cent of GDP - was devoted to financing, either directly or indirectly, the deficits of Governments and their authorities.

The investment share fell a little between these periods - by about 2 percentage points. The remaining gap between domestic saving and our total financing requirement was met by increasing our dependence on overseas savings.

In 1985-86 Australia spent about 6 per cent more than it earned. The difference was borrowed overseas. This came at a time when the foreign currency value of our foreign debt had already been doubled over two years, partly reflecting the sharp depreciation of early 1985.

The present size of the current account deficit - around 6 per cent of GDP and bloated by the adverse shift in the terms of trade - is simply not sustainable. Put bluntly, we must take our hands out of foreigners' pockets and learn to better live within our means.

In effect, we are going to need to reduce our consumption level below where it otherwise would be and increase our national rate of saving.

And as an essential part of that adjustment, we are going to have to increase the capacity of our traded goods industries and to diversify them.

As I say, that general prescription will not come as a surprise to any of you. It has been a consistent theme of my Government over these past three years. It is neither more nor less than the message of my Address to the Nation.

At that time I indicated unequivocally that my Government would address the new circumstances directly through prices and incomes policy, accompanied by complementary fiscal restraint.

My Government's actions subsequently have demonstrated our capacity to respond to the new policy imperatives. Last week's Budget produced a degree of fiscal restraint that went beyond the reasonable expectations of market commentators.

Last week's Budget - and its associated policies - provides Australia with a substantial instalment in a medium term strategy for negotiating this transitional period while Australia adjusts to the new economic realities. As a consequence, last week's Budget offers a real prospect for enhancing our long-term growth potential.

Central to the Budget is a very substantial degree of restraint on outlays.

At 6.9 per cent, the growth is nominal outlays is lower than the outcome in any year since 1968-69. The Budget provides for no growth in real terms in 1986-87, compared to an average rise over the past decade of 3.2 per cent.

Bringing outlays growth to a standstill in real terms has not been an easy task. It has required us to take a number of measures which otherwise we would not have wanted to take. However, the Government has had no real alternative.

We have sought to apportion cuts fairly, with the least burden borne by those least capable of supporting it.

Gross savings totalling well over $3 billion have been achieved since January 1985, with cuts in all functional areas.

Defence spending growth has been cut to 1 per cent in 1986-87, a significant reduction on the 3.75 per cent allowed for in the Five Year Defence Program. However, I note that average real growth in defence spending under my Government remains greater than under our predecessors.

Inevitably, significant cuts have been required in the health, education and social security areas. Our first priority, of course, has been to exclude from benefits those not in genuine need. We have achieved this by tightening eligibility criteria and administration.

For example, the administration of unemployment benefits is to be modified in a number of ways. Additional staff will be undertaking selective reviews of recipients on a regional basis to identify and disqualify those wrongfully in receipt of benefit. These arrangements will also enable a better service to be provided to the older and longer-term unemployed.

In addition recipients of unemployment benefit will now be required to remain registered with the CES and to lodge income statements personally. Similarly recipients of supporting parents benefits will be required to report on their circumstances at least quarterly and to attend for interview after 3 months on benefit. Those and similar measures will save $77m in 1986-87.

They also give the lie to glib assertions by the Opposition that substantial further savings can be found by legitimate administrative means.

Having taken all of those measures it was still necessary to effect further savings in this area.

It was for this reason that the pension adjustments which usually occur in November and May of each year have been each postponed for a period of 6 weeks. It is the Government's intention ultimately to restore the previous arrangements, but not until it is economically responsible to do so.

I would add that, even though significant cuts have been made the Government continues to accord the highest priority to the needy. This priority is reflected in the fact that the share of outlays devoted to social security and welfare payments is budgeted to rise by 0.4 percentage points to 27.8 per cent in this year. The shares of other elements of the social wage remain broadly unchanged.

Tax reform remains central to this Government's agenda. Personal tax cuts will be delivered on 1 December, with a final tranche on 1 July 1987. Our commitment to this second tranche is to be reflected in legislation, to be introduced for passage this Session.

Even after allowing for the greater contribution to health care funding which our circumstances now require from the Medicare levy, ordinary wage earners will receive a tax cut from 1 December of about $6 per week. The value of the tax cuts by 1987-88 will be 3 times the additional revenue raised in the tax package.

Some administrative arrangments which affect the timing of tax payments by some of our largest companies have been changed to ensure more equitable treatment as between companies. But there are no new direct imposts on business in this Budget.

This Government has accepted an unprecedented degree of fiscal planning discipline, represented by the fiscal trilogy. Outlays have declined as a proportion of GDP in each of the 1985-86 and the 1986-87 Budgets.

It remains our objective to reduce tax receipts to 25 per cent of GDP, the "trilogy limit". However, it is our view that, as we need to increase domestic saving in present conditions, it would be inappropriate to move in that direction in 1986-87. On the contrary, additional tax revenue has been sought.

The decision regarding the tax share of GDP in the 1987-88 Budget will be taken in the light of circumstances at that time.

Fiscal restraint is only one element of the necessary adjustment process. A second key element is to restrain increases in domestic costs in order to preserve substantially the enormous improvement in our competitiveness resulting from the depreciation of the exchange rate since early 1985.

That depreciation has meant that Australian industries are now more competitive on a cost basis than at any time for about 20 years. But at the same time the sharp decline in the exchange rate - around 40 per cent in TWI terms - has imparted a very substantial inflationary stimulus. The acceleration of inflation in 1985-86 was due to the depreciation, not to increased wages costs. Wages growth in Australia was not much different from our trading partners.

Indeed it is worth remembering the wages policy achievements of the Accord. Our supposedly inflexible centralised wages fixing system has in fact delivered a degree of real wage flexibility which few countries can match. Over the past 3 years real wages have fallen 5 per cent in Australia. But in the US the fall was only 1 per cent and in the UK there was a real rise of 10 per cent.

Clearly wages have not been the cause of the increase in inflation. But that upsurge in inflation must not be built into our cost structure. That would simply compound our problems - not help to solve the problem but to build the problem in.

In addition, the growth in household incomes will also have to share the burden of the loss in national income due to the deterioration in the terms of trade.

Accordingly at the next National Wage Case, the Government will argue for a 2 per cent discount. The Government will also seek a further adjustment of the wage increase in the case commencing around April next year, if economic conditions applying at the time warrant it.

This Government's main focus will continue to be on Australia's ongoing competitive position and our terms of trade performance.

On current figuring a 2 per cent discount will mean that wages are expected to grow at around the same moderate rates as in 1985-86. Then, award wages grew by $4\frac{1}{2}$ per cent and average earnings by around $6\frac{1}{4}$ per cent. Such an outcome would enable Australia to broadly maintain our competitiveness.

Adjustment based on fiscal restraint and cost restraint offers the best prospect for resuming sustained and sizeable rates of growth. It will allow monetary policy to carry a lesser burden than it has over the past year.

Interest rates have risen recently to underpin our currency.

The fiscal restraint embodied in this Budget will mean that the net bond selling task is zero. The gross public sector borrowing requirement is set to fall from around 6 per cent of GDP in 1985-86 to 4.4 per cent in 1986-87. That will reduce the direct claim on financial markets and thus free a higher proportion of domestic savings to finance investment without recourse to foreign borrowing.

It should help to ease pressure off interest rates and improve the capacity of business to invest in the capital equipment necessary to diversify and enhance our traded goods industries.

Ladies and gentlemen, the macro-economic setting is but part of the adjustment that this economy must make.

The depreciation provides a major incentive for firms to take advantage of the freer, more open industrial structure which our policies have been creating over these past three years. The Government has laid the groundwork in many ways. Let me give just some examples:

- Deregulation of the financial sector;
- Positive incentives to increase research and development;
- Introduction of tax imputation to remove the double taxation of dividends;
- The establishment of AUSTRADE;
- Expansion of AIDC;
- The removal of State purchasing preferences;
- Relaxation of foreign investment guidelines; and
- Moves towards the adoption of uniform regulations across States.

More needs to be done in changing Australian attitudes and improving efficiency. My recent Address to the Nation outlined some measures to achieve both these objectives. Work is proceeding on these within Government.

Ladies and gentlemen, such is the nature of our present crisis that it will take the efforts of the community as a whole to put the economy squarely on track for sustained economic growth.

This Government is prepared to provide the necessary leadership and to implement the policies which are necessary (even at the cost of some short-term popularity).

The Budget, to quote the Australian Financial Review, is economically responsible and politically honest.

It is the Budget which we need, in conjunction with our other policies, to give us the best chance to rebuild Australia's prosperity. The effort must engage us all.

Mr Chairman

At the outset today, I referred to the previous occasions I have had the honour to address your members.

With your indulgence, may I quote briefly from my Address to your Melbourne colleagues a week before the election of March 1983.

I said then:

> "This is not a challenge for the Government alone. It is a challenge for the entire Australian community.
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> We will provide the leadership and take the initiatives which it is the responsibility of the elected national Government and the Government alone to provide and take.
>
> We seek, from the whole Australian community their co-operation, their sense of the common challenge and their common interests in meeting and bearing the crisis - a crisis of the Australian economy and a crisis of the Australian spirit - which we all face together as Australians."

May I suggest, Mr Chairman, that there is a double relevance in those words today.

We face, once again, a time of tremendous challenge.

But even more relevant is the way we <u>did</u>, as a Government and as a people, meet and beat the crisis of 1983. The Australian community - all sectors of it - did respond, in the manner we had sought.

A new challenge lies before us all. Given the same response and spirit, I am absolutely confident of our capacity as a nation to meet it triumphantly.

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