

PRIME MINISTER'S PRESENTATION TO WORLD ECONOMIC FORUM
SPECIAL SEMINAR

DAVOS, 30 JANUARY 1987

OPPORTUNITIES FOR NEW ECONOMIC LINKS WITH AUSTRALIA

LADIES AND GENTLEMEN,

THIS MORNING I WANT TO SHARE WITH YOU THE WAY I SEE AUSTRALIA'S ECONOMIC POTENTIAL, AND THE OPPORTUNITIES AVAILABLE TO THOSE WITH AN INTEREST IN FORGING CLOSER ECONOMIC LINKS WITH OUR ECONOMY THROUGH INVESTMENT IN AUSTRALIA.

I AM PLEASED TO SEE THAT THE EMF ORGANISERS HAVE AGAIN MANAGED TO ATTRACT A LARGE AND VERY IMPORTANT BUSINESS AUDIENCE TO DAVOS. FOR OUR PART, THE IMPORTANCE AUSTRALIA ATTACHES TO THIS CONFERENCE IS REFLECTED IN THE FACT THAT I AM SUPPORTED BY MY COLLEAGUE THE MINISTER FOR INDUSTRY, TECHNOLOGY AND COMMERCE, SENATOR JOHN BUTTON AND BY A DISTINGUISHED DELEGATION OF AUSTRALIAN INDUSTRIALISTS. MEMBERS OF THE AUSTRALIAN BUSINESS DELEGATION WILL BE HAPPY TO ASSIST YOU WITH ANY MATTERS RELEVANT TO THEIR FIELD OF INTEREST. ANOTHER OF MY MINISTERS, PRIMARY INDUSTRY MINISTER JOHN KERIN, WILL BE ARRIVING AT DAVOS EARLY NEXT WEEK TO DISCUSS WITH YOU THE AGRICULTURAL TRADE INITIATIVE I LAUNCHED LAST NIGHT.

2.

WITHIN THE CONSTRAINTS OF TIME, AND TO PERMIT AS MANY OF YOUR QUESTIONS AS POSSIBLE, I WILL BEGIN BY OUTLINING THE STRENGTHS OF THE AUSTRALIAN ECONOMY AND THE BROAD ECONOMIC STRATEGY OF MY GOVERNMENT. JOHN BUTTON WILL FOLLOW UP BY DETAILING SOME OF THE SPECIFICS OF AUSTRALIAN INDUSTRY AND INVESTMENT POLICY.

THE AUSTRALIAN ECONOMY HAS CERTAIN STRENGTHS WHICH MAKE IT INHERENTLY ATTRACTIVE TO INVESTORS. WE HAVE A SKILLED WORKFORCE, A RICH NATURAL RESOURCE BASE, AND A WELL-DEVELOPED INFRASTRUCTURE.

WE ARE ALSO CLOSE, IN GEOGRAPHICAL AND POLITICAL TERMS, TO THE MOST DYNAMIC ECONOMIC GROWTH AREA IN THE WORLD, THE WESTERN PACIFIC RIM.

WE ARE POLITICALLY STABLE AND SHARE BROAD BIPARTISANSHIP ON THE ECONOMIC GOALS OF GROWTH THROUGH INVESTMENT.

OUR NATURAL ADVANTAGES HAVE EARNED US THE TAG 'THE LUCKY COUNTRY'. THAT NAME IS APT - WE ARE LUCKY. BUT OUR GOOD FORTUNE HAS ALSO BEEN THE SOURCE OF SOME DIFFICULTIES AND IMBALANCES IN OUR ECONOMY. IT HAD LULLED US INTO COMPLACENCY DURING THE LONG EASY DECADES OF GROWTH AFTER WORLD WAR TWO.

DURING THOSE YEARS, WE RELIED TOO HEAVILY ON THE EFFICIENT PRODUCTION OF AGRICULTURAL STAPLES, SUPPLEMENTED BY AN APPARENTLY ENDLESS ABILITY TO SATISFY WORLD DEMAND FOR RAW MINERALS. OUR MANUFACTURING SECTOR WAS HEAVILY PROTECTED AND WAS ORIENTED LARGELY TOWARDS THE SMALL DOMESTIC MARKET.

WE WERE A LESS RELIABLE SUPPLIER THAN WE SHOULD HAVE BEEN.

OUR ECONOMY AS A WHOLE FAILED TO RECOGNISE, AND WAS NOT STRUCTURED TO CAPITALISE ON, THE POTENTIAL OF OUR NEIGHBOURS IN THE PACIFIC RIM.

THE DANGERS IN THIS APPROACH WERE DRAMATICALLY HIGHLIGHTED FOR US IN 1985/86 WHEN WE SUFFERED A HUGE TURNAROUND IN OUR TERMS OF TRADE. THANKS IN PART TO THE SHARP DROP IN THE PRICES OF THE PRIMARY COMMODITIES WHICH MAKE UP SUCH A LARGE PART OF OUR EXPORTS, WE LOST OVER THE 18 MONTHS FROM EARLY 1985 ABOUT \$A6 BILLION IN NATIONAL INCOME, OR 3% OFF OUR CAPACITY TO MAINTAIN EXISTING LIVING STANDARDS.

THERE HAS BEEN A LARGE DEPRECIATION OF THE AUSTRALIAN DOLLAR OVER THIS PERIOD. WHILE A CORNERSTONE OF THE LONGER-TERM REBUILDING OF THE AUSTRALIAN ECONOMY, THIS DEPRECIATION HAS NONETHELESS BROUGHT SOME SHORT-TERM DIFFICULTIES BY INITIALLY WORSENING OUR BALANCE OF PAYMENTS DIFFICULTIES, WHICH ARE NOW RECEDING, AND BY FUELLING A TEMPORARY RESURGENCE IN INFLATION.

THE REASON WE ARE CONFIDENT ABOUT OUR FUTURE IS THAT WE CAN NOW LOOK ON A VERY DIFFERENT AUSTRALIAN ECONOMY FROM THAT OF FIVE YEARS AGO - ONE WHICH IS SHAKING OFF ITS COMPLACENCY, WHICH IS BECOMING MORE DYNAMIC AND ENTREPRENEURIAL, AND WHICH IS PREPARED TO PROVIDE THE SUSTAINED EFFORT NEEDED TO REDUCE OUR OVER RELIANCE ON THE PRODUCTION AND EXPORT OF PRIMARY COMMODITIES.

THE AUSTRALIAN GOVERNMENT AND PEOPLE HAVE TAKEN THE NECESSARY STEPS TO MAKE THE AUSTRALIAN ECONOMY MORE COMPETITIVE AND TO ENSURE THAT IT REMAINS SO. WE ARE PREPARED, AS A COMMUNITY, TO MAINTAIN OUR EFFORT FOR AS LONG AS IT TAKES.

I WANT TO BRIEFLY COVER THE MAIN FEATURES OF OUR MACROECONOMIC POLICY AND OUR INDUSTRY REVITALISATION POLICIES.

I WILL SAY MORE LATER ABOUT OUR APPROACH TO THE TRADITIONAL MACROECONOMIC INSTRUMENTS OF MONETARY AND FISCAL POLICY. LET ME TURN FIRST TO AN AREA IN WHICH WE HAVE BEEN QUITE INNOVATIVE.

5.

ONE OF OUR FIRST TASKS IN GOVERNMENT WAS THE DEVELOPMENT OF AN EFFECTIVE INCOMES POLICY THROUGH A CO-OPERATIVE ACCORD BETWEEN THE GOVERNMENT AND THE TRADE UNION MOVEMENT. UNDER THIS HISTORIC AGREEMENT, THE UNION MOVEMENT AGREED TO WAGE MODERATION AND GREATLY IMPROVED INDUSTRIAL HARMONY. THIS AGREEMENT HAS ENABLED REAL WAGES TO FALL SUBSTANTIALLY OVER THE LAST THREE YEARS, WITHOUT INDUSTRIAL STRIFE, DESPITE A STRONG ECONOMIC RECOVERY.

IN RETURN THE UNION MOVEMENT SOUGHT IMPROVEMENTS IN THE SOCIAL WAGE THROUGH, FOR EXAMPLE, BETTER MEDICAL INSURANCE ARRANGEMENTS AND INCOME TAX CUTS. AND OF COURSE, THE UNIONS LOOKED TOWARDS THE GREATER JOB SECURITY AND IMPROVEMENTS IN EMPLOYMENT PROSPECTS THAT WAGE RESTRAINT OFFERED.

THE RESULTS HAVE BEEN OUTSTANDING: IN THE 44 MONTHS SINCE THE EMPLOYMENT TROUGH OF APRIL 1983, 752,000 NEW JOBS HAVE BEEN CREATED.

ACCOMPANYING OUR MACROECONOMIC POLICIES WAS A PROGRAM OF REFORMS DESIGNED TO SECURE STRUCTURAL ADJUSTMENT AND TO MAKE THE ECONOMY MORE RESPONSIVE TO THE TRADE AND INVESTMENT OPPORTUNITIES IN OUR PART OF THE WORLD TO WHICH I HAVE JUST REFERRED.

WE MADE AN EARLY DECISION TO FLOAT THE AUSTRALIAN DOLLAR AND TO DEREGULATE FINANCIAL MARKETS. AN OVER-VALUED EXCHANGE RATE IN THE LATE 1970S AND EARLY 1980S HAD IMPAIRED THE COMPETITIVENESS OF AUSTRALIAN INDUSTRY.

WE SET IN PLACE PLANS FOR PHASING DOWN THE PROTECTION OF OUR MANUFACTURING INDUSTRIES AND ENCOURAGED THEM TO BECOME INTERNATIONALLY COMPETITIVE, EXPORT ORIENTED AND INNOVATIVE.

WE REMOVED OR EASED THE CONTROLS ON A NUMBER OF IMPORTANT EXPORTS. WE DEREGULATED OTHER PARTS OF THE AUSTRALIAN ECONOMY. WE REFORMED THE AUSTRALIAN TAXATION SYSTEM. AND WE LIBERALISED FOREIGN INVESTMENT GUIDELINES.

WE WERE ALREADY BUILDING A MORE FLEXIBLE, OPEN ECONOMY, AND THESE ENDEAVOURS STOOD US IN GOOD STEAD WHEN OUR TERMS OF TRADE TURNED AGAINST US IN 1985/86.

BUT THE SIZE OF THE EXTERNAL PROBLEM CALLED FOR FURTHER POLICY ADJUSTMENTS.

MONETARY POLICY WAS TIGHTENED TO CURB IMPORT DEMAND AND TO COUNTER THE INFLATIONARY EFFECTS OF THE WEAKENING AUSTRALIAN DOLLAR. HOWEVER, SOLE RELIANCE ON MONETARY POLICY FOR ANY LENGTH OF TIME WOULD HAVE HAD INTOLERABLE EFFECTS ON BUSINESS CONFIDENCE AND INVESTMENT, WHICH WOULD BE INIMICAL TO LONGER-TERM STRUCTURAL ADJUSTMENT. SO, IN ADDITION, THE GOVERNMENT HAS STEPPED UP ITS EFFORTS TO REDUCE ITS FISCAL DEFICIT AS A SHARE OF GDP AND TO RESTRAIN NOMINAL WAGES GROWTH.

7.

THROUGH CURTAILED PAYMENTS TO STATE GOVERNMENTS, MORE SEVERE LIMITATIONS ON THEIR BORROWING CAPACITY AND AN EXTREMELY AUSTERE 1986/87 FEDERAL BUDGET, THE GOVERNMENT ACTED LAST YEAR TO GREATLY REDUCE THE PUBLIC SECTOR BORROWING REQUIREMENT. THE FEDERAL BUDGET DEFICIT HAS BEEN REDUCED TO AROUND ONE AND A HALF PER CENT OF GDP, COMPARED WITH 5 PER CENT OF GDP IN PROSPECT WHEN WE CAME TO OFFICE IN 1983. I ASK WHAT COMPARABLE COUNTRY CAN BOAST OF THAT DEGREE OF FISCAL ADJUSTMENT OVER THE PERIOD?

ON THE WAGES FRONT, WITH THE CO-OPERATION OF THE TRADE UNION MOVEMENT, WE ARE EXPECTING TO ACHIEVE AN OUTCOME FOR WAGES GROWTH IN THIS YEAR THAT IS BROADLY IN LINE WITH THAT OF OUR MAJOR TRADING PARTNERS : AND THUS SUBSTANTIALLY TO PRESERVE THE ENORMOUS COMPETITIVE FILLIP PROVIDED BY THE DEPRECIATION.

BUT IN ADDITION TO RESTRAINING LABOUR COSTS, THE GOVERNMENT HAS INITIATED MEASURES DESIGNED TO BOOST LABOUR PRODUCTIVITY DIRECTLY. TRADE UNIONS AND BUSINESS ARE CURRENTLY ENGAGED IN A JOINT EXAMINATION OF OUTDATED, RESTRICTIVE WORK AND MANAGEMENT PRACTICES. PROGRESS IS BEING MADE IN EASING THESE PRODUCTIVITY-DESTROYING PRACTICES IN A SPIRIT OF CO-OPERATION AND CONCERN BY ALL PARTIES SO AS TO MAKE AUSTRALIAN INDUSTRY MORE EFFICIENT, MORE FLEXIBLE, MORE COMPETITIVE.

8.

AUSTRALIA NOW HAS A SOUND INDUSTRIAL RELATIONS SYSTEM :
IT HAS A RESPONSIBLE WORKFORCE THAT RECOGNISES THE BENEFITS
OF WAGE MODERATION, OF GREATER PRODUCTIVITY AND OF GREATER
INDUSTRIAL HARMONY.

THROUGH OUR MACROECONOMIC MANAGEMENT POLICIES WE HAVE
CONVERTED A LARGE DEPRECIATION OF THE AUSTRALIAN DOLLAR
INTO STRONG AND WE EXPECT SUSTAINED, REAL GAINS IN
INTERNATIONAL COMPETITIVENESS FOR AUSTRALIAN INDUSTRY.

THE OUTCOME OF THIS ECONOMIC STRATEGY IS THAT AUSTRALIA IS
NOW WELL PLACED TO CAPITALISE UPON THE TRADE AND INVESTMENT
OPPORTUNITIES IN THE WESTERN PACIFIC AND FURTHER AFIELD.

THERE ARE ALREADY ENCOURAGING SIGNS THAT OUR INDUSTRIES ARE
RESPONDING TO THE IMPROVEMENTS IN THEIR COMPETITIVENESS
AND WINNING NEW CONTRACTS AT HOME AND ABROAD. RECENT
BALANCE OF PAYMENTS FIGURES INDICATE THAT THE CURRENT ACCOUNT
DEFICIT IS FALLING: IN FACT AUSTRALIA RECORDED A MERCHANDISE
TRADE SURPLUS LAST MONTH, THE FIRST IN 16 MONTHS.

IT PERHAPS NEEDS TO BE STRESSED TO AN AUDIENCE IN EUROPE
JUST HOW FAR THE FOCUS OF DYNAMIC ECONOMIC GROWTH HAS SHIFTED
TO THE PACIFIC REGION.

LET ME GIVE YOU JUST A COUPLE OF INDICATORS OF THE VITALITY OF OUR REGION: TWO YEARS AGO, TRANS-PACIFIC TRADE SURPASSED THAT OF TRANS-ATLANTIC TRADE FOR THE FIRST TIME; AND EAST ASIA'S SHARE OF WORLD GNP HAS ALMOST TRIPLED SINCE THE LAST QUARTER CENTURY. AUSTRALIAN INDUSTRY FOR THE REMAINDER OF THE CENTURY IS WELL POISED TO COMPETE IN THIS REGION.

I WANT BRIEFLY TO SKETCH HOW I SEE CHANGES IN TWO OF THE REGION'S LARGEST ECONOMIES ASSISTING US IN THIS.

JAPAN IS ON THE THRESHOLD OF A NATURAL RESTRUCTURING PROCESS WHICH OFFERS THE PROSPECT OF LARGE IMPORTS OF MANUFACTURES UTILISING STANDARDISED TECHNOLOGY, INCLUDING COMPONENTS, AND A RANGE OF SERVICES INCLUDING OVERSEAS TOURISM.

AUSTRALIA'S OWN RESTRUCTURING PROCESS WILL BE COMPLEMENTARY TO THE CHANGES IN JAPAN. NOWHERE IS THIS MORE EVIDENT THAN IN BASIC METAL PRODUCTION. JAPANESE BASIC METAL PRODUCTION HAS BEEN CONTRACTING SLOWLY UNDER COMPETITIVE PRESSURE FOR MORE THAN A DECADE WHILE AUSTRALIA HAS A STRONG COMPARATIVE ADVANTAGE IN THESE INDUSTRIES. AS JAPANESE EXPORTS OF STEEL AND NON-FERROUS METALS LOSE THEIR COMPETITIVENESS, AUSTRALIA WILL BE WELL POSITIONED TO STEP INTO THE BREACH.

THE OTHER MAJOR ECONOMIC FORCE IN OUR REGION IS CHINA. THE MODERNISATION PROGRAM OF THE CHINESE LEADERSHIP IS CREATING HIGHLY ATTRACTIVE OPPORTUNITIES FOR TRADE AND INVESTMENT.

WHILE THE PACE OF CHINA'S MODERNISATION IS NOW BEING CONSTRAINED BY THE COUNTRY'S EXTERNAL IMBALANCES, GROWTH CONTINUES AT RATES WELL ABOVE INTERNATIONAL AVERAGES.

THE SHEER SIZE OF THE MODERNISATION PROGRAM AND THE DEMAND FOR CONSTRUCTION MATERIALS SUCH AS FINISHED STEEL THAT THIS IS CALLING FORTH, ARE CREATING OPPORTUNITIES FOR SUBSTANTIAL NEW INVESTMENTS IN COUNTRIES CAPABLE OF MEETING THAT DEMAND.

AUSTRALIA IS SUCH A COUNTRY. IN ADDITION TO OUR GEOGRAPHICAL LOCATION AND OUR RESOURCE ENDOWMENTS, THE WARM RELATIONSHIPS THAT HAVE DEVELOPED BETWEEN MY GOVERNMENT AND THE CHINESE LEADERSHIP HAVE POSITIONED AUSTRALIA AS A HIGHLY ADVANTAGEOUS LOCATION FOR FOREIGN INVESTMENT AIMED AT SATISFYING THE CHINESE MARKET.

IN FACT I DOUBT THAT ANY OTHER GOVERNMENT ENJOYS SUCH CLOSE RELATIONSHIP WITH THE CHINESE LEADERSHIP AS THE PRESENT AUSTRALIAN GOVERNMENT.

AS WELL AS POSSESSING COMPETITIVE STRENGTH IN INDUSTRIES WHICH ADD VALUE TO OUR ABUNDANT NATURAL RESOURCES, AUSTRALIA HAS A COMPETITIVE SPRINGBOARD INTO THE REGION THROUGH ITS HIGH QUALITY SCIENTIFIC AND TECHNOLOGICAL CAPACITIES.

11.

THESE HAVE CREATED A NUMBER OF SMALL, INNOVATIVE COMPANIES USING NEW, SOPHISTICATED TECHNOLOGIES - ESPECIALLY IN THE AREAS OF COMPUTER SOFTWARE, MEDICAL AND SCIENTIFIC EQUIPMENT AND BIOTECHNOLOGY. THESE COMPANIES SPEND A HIGH PROPORTION OF THEIR TURNOVER ON R AND D AND ARE HIGHLY EXPORT ORIENTED.

MANY ARE LOOKING TO FORM STRATEGIC ALLIANCES WITH OVERSEAS FIRMS IN ORDER TO FULLY REALISE THEIR DEVELOPMENT POTENTIAL.

THE REAL DEPRECIATION OF THE AUSTRALIAN DOLLAR HAS ALSO IMPROVED SUBSTANTIALLY THE COMPETITIVE POSITION OF AUSTRALIA'S TRADED SERVICES INDUSTRIES, INCLUDING THE TOURIST INDUSTRY. THE POTENTIAL FOR GROWTH OF THE TOURIST INDUSTRY, NOT THE LEAST IN TERMS OF TOURISM FROM JAPAN TO AUSTRALIA, IS ENORMOUS.

ULTIMATELY IT WILL BE FOR BUSINESSMEN LIKE YOURSELVES TO JUDGE THE COMMERCIAL ATTRACTIVENESS OF INVESTING IN AUSTRALIA. MY GOVERNMENT IS DETERMINED TO MAINTAIN THE GREATLY IMPROVED COMPETITIVENESS OF AUSTRALIAN INDUSTRY.

THE TRADE UNION MOVEMENT HAS A POSITIVE COMMITMENT TO THE EXPANSION OF EXPORT-ORIENTED INDUSTRIES. I HAVE DISCUSSED THIS WITH THE TRADE UNION LEADERSHIP AND I CAN TELL YOU NOW THAT THE AUSTRALIAN TRADE UNION MOVEMENT WILL BE HAPPY TO HAVE CONSULTATIONS WITH POTENTIAL INVESTORS IN AUSTRALIA SO AS TO ASSURE THE NECESSARY CO-OPERATION BETWEEN EMPLOYER AND THE WORKFORCE IN PROSPECTIVE PROJECTS.

12.

AUSTRALIA IS WELL PLACED BOTH GEOGRAPHICALLY AND POLITICALLY
IN THE MOST DYNAMIC REGION OF THE WORLD. WE WELCOME FOREIGN
INVESTMENT AND I INVITE YOU TO AUSTRALIA TO MAKE YOUR OWN
ASSESSMENTS OF INVESTMENT OPPORTUNITIES IN OUR COUNTRY.

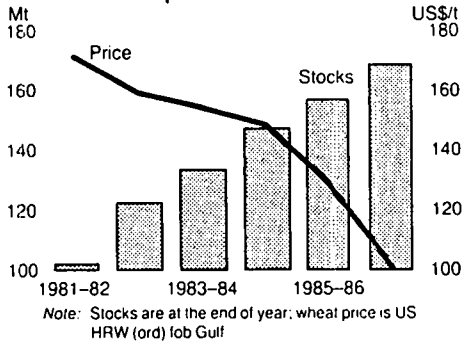
I NOW PASS YOU TO JOHN BUTTON, AUSTRALIA'S INDUSTRY MINISTER.



Resolving the World Agricultural Crisis: An Australian Proposal

Australian Government, January 1987

Chart 1: World price and stocks: wheat



The world agricultural crisis is placing serious stress on international economic and political relationships. This paper advances an Australian proposal to help resolve the crisis.

World agriculture has not been in a worse position since the Great Depression. Commodity prices have been plummeting, seriously eroding and often ruining the financial position of farmers in many countries. The costs of farm programs have soared, imposing greatly increased burdens on taxpayers. At the same time, consumers in some advanced countries have been required to pay highly inflated food prices.

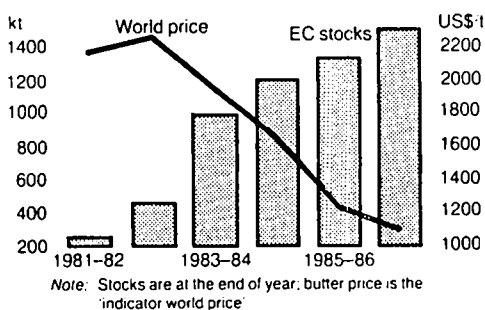
The debt problems of many less-developed countries have been accentuated, casting a shadow over the international monetary system. Many of the world's poor have been deprived of a livelihood. Unemployment has risen, especially in rural areas. Traditional international political alliances have been placed under strain.

Budget costs tell only half the story. Consumer prices in Japan and the EC, and for some products in the US, are administered at levels much higher than world prices. This additional transfer paid to farmers by the public when they buy their food amounts in some cases to much more than the subsidies paid from taxation revenues.

Taxpayer subsidies and consumer transfers in the EC are together costing more than US\$900 each year for each non-farm European family. In the US, each non-farm family is paying around US\$700 of its annual taxes in subsidies to farmers, with additional significant consumer transfers. The figures for Japan per full-time farmer would be significantly higher than these.

"Taxpayer subsidies and consumer transfers . . . are . . . costing more than US\$900 each year for each non-farm European family."

Chart 2: World price and stocks: butter



Important Indicators of the Crisis

The crisis in world agriculture is shown in stark terms at Charts 1-3. In summary, since the beginning of the decade:

- world wheat prices have fallen 50 per cent and stocks have risen by more than 70 per cent;
- world sugar prices are down 80 per cent and stockpiles are 45 per cent higher;
- butter prices have fallen about 50 per cent and stocks have increased to a massive 1.7m tonnes;
- EC stocks of beef have risen to over 600,000 tonnes — about three times the usual level;
- feedgrains, rice and oilseeds have suffered similarly precipitous price declines and serious overproduction.

The direct costs of farm programs have risen enormously: in the US to around US\$26 billion from US\$3-5 billion early in the decade; in the EC costs have doubled in the past 5 years reaching US\$23 billion this year (excluding direct expenditures by national governments); and in Japan taxpayers in 1985 paid US\$10.5 billion in farm subsidies.

Surpluses to Continue

In the absence of substantial policy changes, the crisis in world agriculture will be with us into the 1990s (see Chart 4). Despite the fact that world grain stocks have risen to the equivalent of two-and-a-half years of total world trade, Australian projections show that, if current policies continue, stocks will rise further before slightly declining.

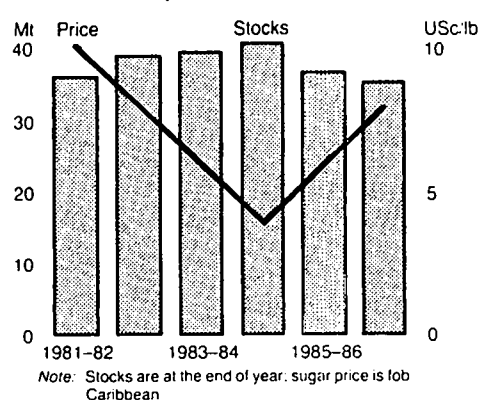
Causes of the World Crisis

Factors on both the demand side and the supply side led to the current huge surpluses of farm products. In the decade ending 1982, the volume of world trade in agricultural commodities grew by 35 per cent. Most of this growth came from the developing countries. The early 1980s saw the period of buoyant world trade and economic growth come to an end. Developing country demand stagnated both because of slow international economic growth (with the associated international debt crisis) and because of the effectiveness of their own agricultural development programs.

Most importantly, however, the agricultural policies of the leading industrialised nations reduced the incentive for farmers to adjust to the changed world demand conditions. The outcome is depicted in Chart 5. A massive wedge of stocks accumulated as supply and demand diverged.

The substitution of US Government payments for declining market returns is shown in Chart 6. As market prices fell, target prices moved in the opposite direction. For the EC and Japan (Charts 7 and 8) consumer transfers and direct subsidies were used increasingly to insulate farmers' returns from falling world market prices.

Chart 3: World price and stocks: sugar



"The direct costs of farm programs have risen . . . in the US to around US\$26 billion . . . in the EC . . . (to) . . . US\$23 billion this year"

The Heart of the Problem

The incentive to produce given by farm programs is causing supply to massively outstrip likely demand. This problem is compounded by the rigidity of these incentives and the rapid rate of growth in agricultural productivity. The magnitude of the excessive incentive to produce cereals, sugar, butter and beef in Japan, the US and the EC is shown in Charts 9-12.

It can be seen from the charts that Japan pays its rice, sugar and butter producers around eight times the world market price. The benefits it has received from access to world manufactures' markets have not been met by reciprocal access for exporters of agricultural products to the Japanese market.

The Price Adjustment Gap

The graphs in Chart 9 show the ratio of internal administered prices to world market prices. The Price Adjustment Gap (PAG) is equal to the extent to which that ratio exceeds unity. Direct and indirect subsidies are important determinants of this gap.

The PAG can be closed from below as well as from above. If the incentive to produce was reduced through reductions in administered prices paid to farmers, the resultant reduced world supplies would facilitate recovery in international market prices.

"The incentive to produce given by farm programs is causing supply to massively outstrip likely demand."

Reduction of the PAG to zero is, in the foreseeable future, an unrealistic objective. Equally unrealistic, however, is the preservation of the gap at its current level. The aim is therefore to reduce the gap as fast as possible. A PAG of greater than 0.3 (ie internal administered prices more than 30 per cent higher than world prices) should not be regarded as acceptable domestically, or internationally, in advanced industrial nations.

Supply Control and Stock Management

Reducing administered internal prices is one way to encourage convergence of international and domestic prices. There are, however, other ways to work towards this objective. Some may wish to manage markets not only nationally but also internationally. About 40 International Commodity Agreements (ICAs) covering 13 commodities have been introduced since 1931. However, their record of success is very poor.

"Japan pays its rice, sugar and butter producers around eight times the world market price."

Direct supply controls face practical problems in effective administration, can inflate costs faced by producers and constrain improved efficiency through technological change.

Supply control and market management are thus poor substitutes for the discipline needed to attack the underlying cause of the problem, namely high administered internal prices and associated trade restrictions. These must be the focus of farm policy reform. Nevertheless there are two areas where direct supply controls have a potential role to play.

"supply controls can be a temporary substitute for deferred further reductions in administered prices."

First, where the PAG is inordinately wide, reductions in internal prices will have to be phased in over a long period. In the early stages, direct supply controls can be a temporary substitute for deferred further reductions in administered prices. Such supply controls are the clear responsibility of the countries unable to reduce quickly their large PAGs.

Second, while current enormous surplus stocks of grain, sugar, dairy products and beef overhang markets, world prices will be very slow to rise. There is a need to quarantine surplus stocks from the market, only releasing them in line with the success in reducing current production. Responsibility for the management and disposal of surplus stocks rests with the countries that accumulate them.

Farm Incomes

Governments are understandably reluctant to reduce support prices for farmers because of the possible consequences for farm incomes. Government payments, for example, currently constitute about one half of the net cash incomes of US farmers. Subsidies and consumer transfers in the EC and Japan make up an even higher proportion of farm returns.

"If administered prices are reduced by a number of countries acting in concert and if stocks are quarantined and managed, steady improvements in market prices will help compensate for reduced subsidies"

Chart 4: US and world grain stocks

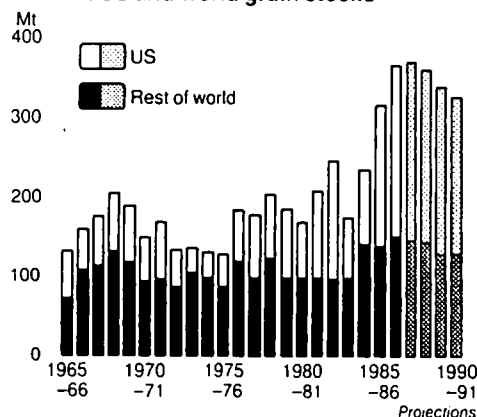


Chart 5: Representation of world agricultural trade and stocks

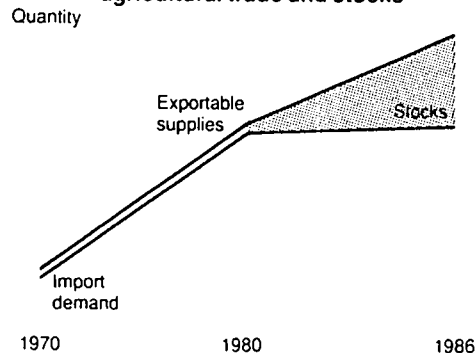


Chart 6: US loan rate, target price and average market price for wheat

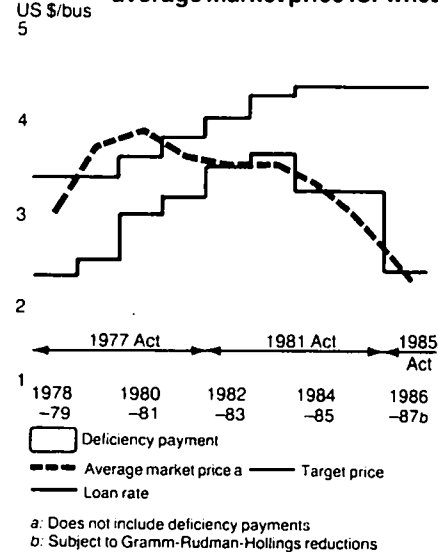


Chart 7: EC administered and market prices for soft wheat

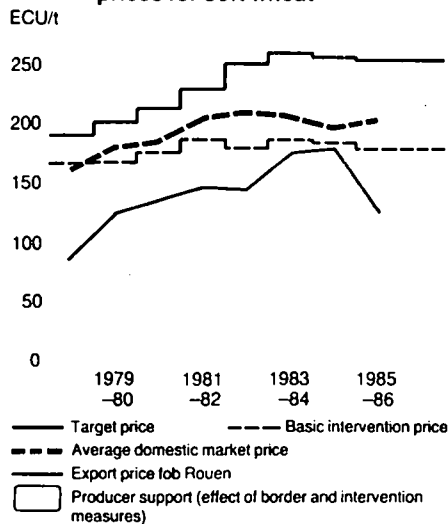


Chart 8: Administered Japanese prices and world prices for rice

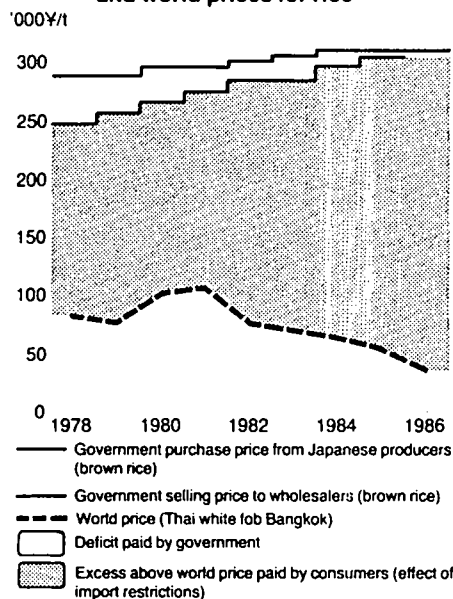
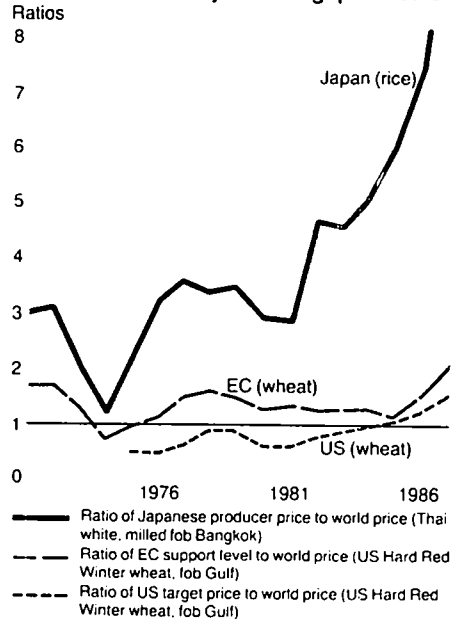


Chart 9: A: Price adjustment gap: cereals



If administered prices are reduced by a number of countries acting in concert and if stocks are quarantined and managed, steady improvements in market prices will help compensate for reduced subsidies and transfers. Nevertheless, farm incomes would fall in the short term, necessitating support and adjustment measures.

While inevitably income support measures will have some impact on the level of output, this impact can be minimised by separating income support from the prices received by farmers for their production.

Achieving Change: Internal Timetables

The next several months will be a very active period of domestic agricultural policy decision making.

The US agenda includes an expected Congressional debate on farm policy, triggered by the recent Presidential proposals to reform some provisions of the Farm Bill. Program decisions, including loan rates, target prices and set-aside provisions, will begin to be announced in June, with the wheat program, and will continue through October.

"The next several months will be a very active period of domestic agricultural policy decision-making."

In the EC, the Commission's price proposals for 1987-88 are expected to be debated in the Council of Ministers until decisions are announced, most likely in April.

In Japan, the Diet has the 1987-88 budget, including farm spending, under review at the present time. Livestock price decisions are due in March and crop prices in the period July through September.

If early significant reform is to be achieved, it must be reflected in the decisions taken in this timetable.

Achieving Change: International Timetables

Concerted changes in farm policies in many countries are needed to share equitably the burden of adjustment. While the requisite immediate decisions are a matter for national decision making, the climate for change can be improved if nations act in concert. A broad international accord is therefore needed.

A series of important international meetings are scheduled for the first half of 1987, including:

- a meeting of wheat exporters in the US in February;
- the meeting of Trade Ministers scheduled for New Zealand in March;
- the Ministerial Council Meeting of the OECD in May;

- the meeting of the World Food Council in June;
- a critically important meeting of Western leaders at the Economic Summit scheduled for Venice, also in June.

Each of these meetings should add to the momentum for reform of farm policies and agricultural trade and interact with the domestic farm policy timetable discussed above.

The Need for Immediate Action

The crisis cannot be allowed to persist, yet the MTN negotiating process will inevitably be protracted.

Early reform would facilitate progress during the MTN by removing important obstacles to the negotiation of new rules for the conduct of agricultural trade. It would also encourage wider MTN progress by example, and by the incentive given to countries which, while badly affected by agricultural protectionism themselves, protect their own sensitive areas.

Australia's Commitment

Australia's rural sector is, of course, not highly protected: rural policy in Australia will continue to facilitate the responsiveness of our farmers to changing international prices. Australia does, however, have relatively high tariffs in some manufacturing sectors.

During 1986 Australia took action to increase the competitive pressures on its textile, clothing and footwear and chemicals and plastics industries, two important manufacturing sectors. Similar action has been taken in our motor vehicle and steel industries. Australia has recognised the costs of insulating important sectors from international competition and has not waited for the finalisation of MTN negotiations to take action.

Australia is committed to making the MTN round a success. To demonstrate this commitment Australia is prepared to state its willingness to negotiate the binding of tariff levels in all sectors of Australia's tariff regime. This is a significant commitment given that Australia in the past has bound only a very low portion of its tariff.

The Uruguay Round and Agriculture

In September 1986 the GATT Contracting Parties agreed, in the Ministerial Declaration launching the Uruguay Round, to aim for agricultural trade liberalisation and to strengthen GATT rules and disciplines affecting agricultural trade.

"A series of important international meetings are scheduled for the first half of 1987"

In the spirit of the Uruguay Declaration, the Australian Minister for Trade has explored, with several of the major trading countries, the concept of a 'ceasefire' on subsidies directly or indirectly affecting agricultural trade. A 'ceasefire' would provide a necessary breathing space and a stable basis for the negotiated rolling back of these subsidies.

There seems considerable in-principle support for the ceasefire concept. Discussion has focused on the best means for effective implementation and monitoring. One simple and effective means to implement the ceasefire is for it to be applied to a measure which reflects important farm subsidies, namely the gap between administered internal prices and international prices. A subsidy ceasefire and a progressive reduction in the PAG, initiated by a reduction in administered domestic support prices, would reduce three important forms of subsidy. They are deficiency payments, consumer transfers and export restitutions.

"One simple and effective means to implement the ceasefire is . . . (by narrowing) . . . the gap between administered internal prices and international prices."

In order to facilitate a harmonious reduction in the PAG and to provide a reasonable assurance that the burden of change is being appropriately shared, it would be useful if domestic policies could be reformed against the background of an accepted set of general principles.

The OECD has been working on a Ministerial Mandate on Agricultural Trade for some four years. The Organisation has accumulated a comprehensive picture of the agricultural policies in all leading member countries, including the quantification of the net subsidy equivalent of the various measures deployed. The OECD is therefore well placed to develop a set of guiding principles and to monitor farm policy reform.

Action Already in Train

The Australian proposal has been developed in full knowledge of moves towards reform in Japan, the US and the EC. The coming months, however, provide the opportunity for greater, co-ordinated progress.

"changes already in train . . . will not make a sufficient contribution . . ."

Recent EC moves include modification to the grain regime, agreements to reduce dairy supplies and to change the beef intervention system, and a slowdown in the rate of administered price increases.

However, changes already in train, important as they are, will not make a sufficient contribution to the resolution of EC budget problems and the international agricultural crisis.

In Japan, the Agricultural Policy Review Council has recently enunciated new guidelines for the administration of farm policy. These include an enhanced role for international market prices in determining internal prices. Price increases have been constrained in recent years, with the pivotal rice price having been frozen in 1986-87. Nevertheless the gap between Japan's internal prices and world prices remains very large.

"it is important that . . . national proposals and decisions add progressively to . . . constructive change."

In the United States, the President has recently advanced proposals for substantial reform, including cuts in target prices. The attitude of the US Congress to these proposals will undoubtedly be influenced by the EC price decisions.

If genuine progress is to be made in 1987, it is important that these national proposals and decisions add progressively to the creation of an international environment conducive to constructive change. The sequence of international meetings already discussed provides an opportunity to capitalise on that environment, to develop an accord on agricultural policy and trade reform and to propel progress in the critically important Uruguay Round of Multilateral Trade Negotiations.

"The OECD is . . . well placed to develop a set of guiding principles and to monitor farm policy reform."

The plan described below requires simultaneous decisions from a number of leading countries in order to spread the burden of adjustment. This initiative is intended to be catalytic. It attempts to point out a path leading to continuing progress. To achieve progress, clear leadership from the US, the EC and Japan is vital. Without hard decisions and strong leadership the problems associated with the world agricultural crisis will deepen.

The proposal is advanced by Australia as a contribution to resolving the crisis in world agriculture. The Australian Government recognises that others may wish to advance alternative proposals. Australia is willing to participate in discussions which attempt resolution of the problem from other perspectives. Nevertheless the proposal now advanced provides a basis for resolution of the problem. Australia commends it to other nations for evaluation.

Chart 10: Price adjustment gap: sugar

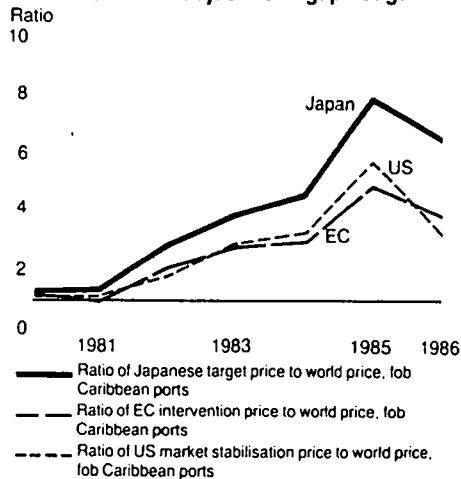


Chart 11: Price adjustment gap: butter

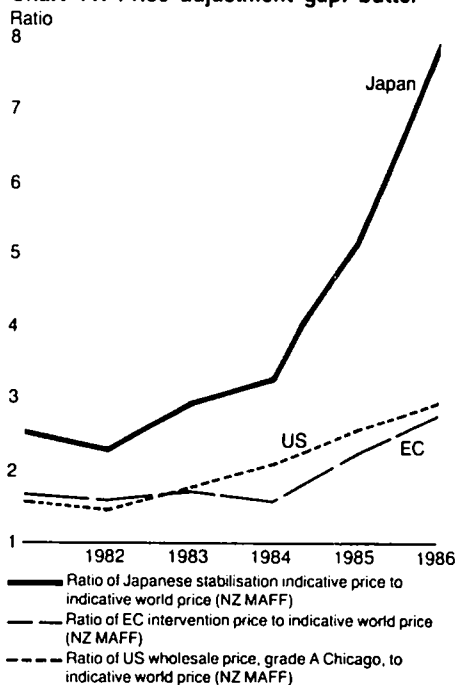
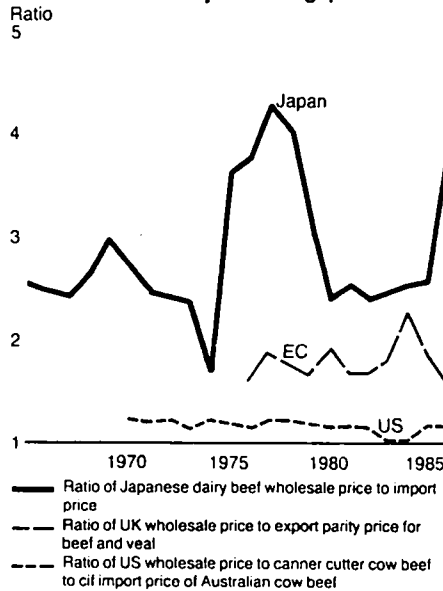


Chart 12: Price adjustment gap: beef



Elements of the Proposal

1. *A commitment to halt subsidy escalation and freeze and progressively reduce the gap between administered internal prices and international market prices for farm products.*

Such a commitment would be consistent with the intent of the Uruguay Declaration. Australia proposes such a commitment be advanced by agriculture and trade Ministers at an early opportunity.

2. *An early reduction in internal administered producer prices for 1987-88. The Seven Economic Summit Countries should provide the leadership.*

Prices could, for example, be reduced by 10 per cent for all commodities where the gap between internal administered prices and international prices is greater than 30 per cent. Such a proposal could be implemented by the US, the EC and Japan in forthcoming price reviews and budget processes and by other countries at similarly appropriate opportunities. A commitment along these lines could be affirmed at the Economic Summit in Venice, along with a commitment for further reductions until the gap narrows substantially.

3. *The narrowing of the price gap be expedited by interim measures aimed at containing supplies and quarantining stockpiles in those countries where internal administered prices remain significantly higher than international prices.*

Surplus stocks have generally been accumulated in those exporting countries where the levels of farm price subsidies and other market-related assistance are at the highest levels. Consequently these countries are themselves primarily responsible for them and should adopt measures to contain and quarantine them. Progress in restoring international balance in agricultural markets would be disrupted if there were fears that surpluses might be released in an undisciplined manner onto world markets.

4. *Farm income support measures be separated, wherever possible, from producer prices for farm output.*

In order to facilitate the reform of administered prices, farm adjustment measures, social welfare assistance and direct income support policies should be further developed in those countries where large PAGs exist.

5. *The development of an accepted set of principles to liberalise world agricultural trade through reform of domestic agricultural policies by national governments.*

Such a set of principles would assure individual nations that their actions are part of a wider movement towards reform. The OECD is well placed to develop and advance such a set of principles. They could be considered by the Ministerial Council Meeting in May and endorsed by the Economic Summit in Venice in June.

6. *An accord on international agricultural reform be agreed at the Economic Summit in Venice in June.*

Last year's Economic Summit Declaration marked a turning point in international attitudes to the agricultural crisis. This was reinforced by the GATT Uruguay Round Declaration. The 1987 Economic Summit provides a further opportunity to broaden the commitment to international agricultural reform encompassing the above principles and concepts.

7. *Negotiations on agriculture within the Uruguay Round of: effective disciplines on the operation of direct and indirect agricultural subsidies and price support programs; and increased market access.*

Expeditious strengthening of the GATT rules and disciplines in relation to agriculture is critical if the momentum towards reform is to lead to permanent improvements in the operation of international agricultural markets.

Elements of the Proposal

- 1.** A commitment to halt subsidy escalation and freeze and progressively reduce the gap between administered internal prices and international market prices for farm products.
- 2.** An early reduction in internal administered producer prices for 1987–88. The Seven Economic Summit Countries should provide the leadership.
- 3.** The narrowing of the price gap be expedited by interim measures aimed at containing supplies and quarantining stockpiles in those countries where internal administered prices remain significantly higher than international prices.
- 4.** Farm income support measures be separated, wherever possible, from producer prices for farm output.
- 5.** The development of an accepted set of principles to liberalise world agricultural trade through reform of domestic agricultural policies by national governments.
- 6.** An accord on international agricultural reform be agreed at the Economic Summit in Venice in June.
- 7.** Negotiations on agriculture within the Uruguay Round of: effective disciplines on the operation of direct and indirect agricultural subsidies and price support programs; and increased market access.