PRIME MINISTER

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ADDRESS BY THE PRIME MINISTER
ECONOMIC PLANNING ADVISORY COUNCIL
MELBOURNE - 17 NOVEMBER 1989

ECONOMIC CONDITIONS

The limited economic data that have become available since the September EPAC meeting are broadly consistent with the Budget-time forecasts for economic developments over the course of 1989-90.

While at this stage we do not have National Accounts information for the September quarter, other useful statistics are available.

It is clear that demand and activity in the housing sector have declined significantly.

House prices in some areas are already falling, in part unwinding the sharp rises of recent years.

The number of building approvals for new private dwellings fell by 21 per cent in the September quarter, to be around 26 per cent below the peak reached in late 1988.

The latest projection of the Indicative Planning Council is that total commencements will fall to around 133,000 in 1989-90, 24 per cent lower than the unsustainable level of 175,000 in 1988-89.

The non-dwelling construction sector also appears to be weakening from its recent high with a 16 per cent fall in the value of building approvals evident in the September quarter.

We are witnessing, therefore, a fairly general contraction in the building sector, which is broadly consistent with Budget projections and our strategy for slowing excessive demand growth.

The contraction underway in the building sector will affect consumer durable expenditures, as will the direct impact of interest rates.

At constant prices seasonally adjusted retail trade rose 0.9% in the September quarter, consistent with budget projections. Monthly growth is slowing on a trend basis, which appears to be supported by anecdotal evidence.

While business surveys suggest investment expectations remain generally buoyant, some scaling back of intentions was evident in the CAI/Westpac survey of business trends released in September.
As demand growth weakens investment intentions may be wound back generally, to more sustainable levels.

In the labour market, we have some evidence of easing, particularly declines in job vacancies.

Turning points are notoriously difficult to predict with precision and I do not want to draw too much out of the data.

The main conclusion I want to leave with you, however, is that, on the basis of the limited number of indicators available to date, the Government has no reason to believe that domestic demand and employment growth will not unfold in a manner broadly consistent with Budget forecasts.

While demand is forecast to fall significantly, overall product growth should be sufficient to protect the employment gains of recent years.

None of this, of course, suggests that conditions have arrived at this stage which would allow a moderation in the stance of monetary policy.

Monetary policy easing can only be considered when clear economic evidence points to such a conclusion. To act otherwise would be self-defeating from all perspectives.

On the external side, the current account deficit figures for August and September are consistent with the Budget-time view that the improvement in the current account over the course of 1989-90 will be concentrated in the second half of the year.

PRICES AND INCOMES

On present indications, the September quarter consumer price index indicated that the peak in inflationary pressures has been passed.

As expected, the rate of increase in consumer prices in the September quarter continued to reflect mortgage interest charges, the lagged effects on fresh fruit and vegetables prices from major flooding in the eastern States earlier this year and the effects of changes to compulsory third party insurance in New South Wales.

As the effects of those influences wane in the quarters ahead, and domestic demand pressures ease, we expect to observe a steady reduction in inflation.

With the first wage increase available under the Structural Efficiency Principle now flowing smoothly through the workforce, the prospects are not only for a continuation of responsible wage outcomes but for substantial workplace reform via award restructuring.

To a significant extent, the success of award restructuring has been and remains dependent on the initiative shown by management in fully exploring the opportunities offered under the current system.

No-one is suggesting that the negotiation of change is easy.

Clearly it is not - particularly when employers are confronted with a multitude of unions and awards that often bear little relationship to the needs of individual enterprises.

But this is no excuse for inaction.

The Industrial Relations Commission has made it perfectly clear that the award restructuring processes can themselves be used as a vehicle for reforming award and union coverage.

Looking beyond that, broader mechanisms are already in place, with the full support and co-operation of the ACTU, for a more concerted move away from inter-industry or occupational awards and fragmented, craft based unions to arrangements which better reflect the needs of individual industries and enterprises.

While there is a widespread recognition that wage negotiations must have an increasing enterprise focus there is also an acceptance that this process must be underpinned by a continuing role for the Accord to ensure effective aggregate wage outcomes.

I have already foreshadowed that the Government next year will be looking once again to discussing aggregate wage outcomes with the ACTU.

Both parties will be able to enter these discussions with the confidence that the Accord has survived the threat posed to it by the unjustified pay demands of the Australian Federation of Air Pilots (AFAP).

It is worth recalling that barely a few months ago many commentators were contemplating the impact on the Australian economy of a wages break-out led by the AFAP.

Today it is widely recognised that the threat has been turned back.

Of course the Government does not pretend for an instant that this has been without costs.

Early this week we attempted to address some of those costs with the announcement of the assistance package to the tourism industry.

But the damage incurred by refusing to meet the AFAP's demands has been only a fraction of the economic misery that would have resulted if the Government had caved-in.

Instead the Australian community has successfully defended a wages system that has secured over 1.5 million new jobs in the last 6 years and internationally competitive wage outcomes.

The only certain element in the new wages system from the Government's point of view is that it must continue to deliver aggregate wage outcomes compatible with maintaining Australia's international competitiveness.

Above all else, the Government will continue to stress in these discussions that the reduction of Australia's external imbalance must remain our paramount economic policy objective.

That is the only way we as a nation will be able to secure sustainable declines in interest rates and affordable increases in living standards.

In this context, the Government welcomes the initiative of the Business Council of Australia this week in seeking to draw more attention to ways Australia can improve its external imbalance.

If the BCA's initiative leads to greater understanding, good can only come from it.

MANUFACTURING SECTOR PERFORMANCE

Of course, labour market reform is just one aspect of the Government's multifaceted microeconomic reform agenda.

Another area is industry policy.

An important part of our industry policy strategy is to expose industries to international competition by reducing assistance and dismantling impediments elsewhere in the economy which affect international competitiveness.

Of course structural reform takes time.

I have already this week commented on pessimistic views concerning Australia's manufacturing industry.

The facts just do not support gloomy prognosis.

A study by the Bureau of Industry Economics on the trade performance of manufacturing released earlier this year concluded that:

> "Manufacturing has undergone major structural change over the last few years, with a significant re-orientation to international markets. Manufacturers have exported an increasing share of their output, and the rate of growth in import penetration has slowed."

More recent figures indicate that, over the two years to the June quarter 1989, manufacturing export volumes grew by 15 per cent.

Over the two years to the June quarter 1989, the growth in manufacturing output averaged 6.3 per cent a year, compared with 5.3 per cent a year for the economy as a whole. Productivity growth in manufacturing over that period, averaging 2.3 per cent a year, was twice as great as that for the whole economy.

Investment in manufacturing has been strong. Over the past five years manufacturing investment has grown at an average rate of 13.2 per cent a year, a stark contrast with the story in the preceding five years.

This growth has not only been devoted to replacing old capital, but also to expanding capacity in new product areas.

A recent BIE survey of large manufacturers indicates that current investments are leading to significant increases in capacity (6.3 per cent growth in capacity is expected in 1989-90) and reductions in unit costs (a 2.5 per cent reduction is expected in 1989-90).

This investment surge is spread over a wide range of manufacturers, including key sectors such as chemicals, paper and printing, steel, transport, equipment and food processing.

We are, of course, far from having completed our goal of achieving a truly internationally competitive manufacturing sector.

We are still a long way from completely dismantling the structure of past interventions that have protected much of industry from the full force of competition and have stifled the growth of well-managed and efficient industries, eager to take their place in world markets.

But as I have already outlined, the groundwork is being laid and companies are beginning to react.

We will be pressing forward on a broad front on microeconomic reform tackling the removal of distortions and the enhancement of the capabilities of the economy to adjust to change. An important catalyst for change will be the inquiries and reports of the new Industry Commission. It is being given a broad charter, and the first five references of a wide-ranging work program have already commenced.

Finally, in some areas of economic reform it is not only necessary to make further advances, but also to defend our gains to date.

It is instructive to appreciate that recent statements by the Opposition mean that there is now a measure of consensus on a wide range of fundamental tax reforms.

These include the previously contentious fringe benefits tax, the denial of deductibility for entertainment, the tax file number system and the removal of the income tax exemption for gold mining.

These reforms are an accepted part of the taxation structure, not only making the system fairer and more efficient, but also funding significantly lower corporate and personal income tax rates.

A significant remaining reform of contention is the capital gains tax.

Today there is virtually unanimous agreement amongst informed commentators that the CGT is a necessary tax on anti-avoidance, equity and efficiency grounds.

My point in raising this issue is that I hope that the business community will take the mature, longer term view when assessing this issue.

Obviously, some in business, as major owners of capital, may be tempted to think of the superficial advantages to them of the abolition of the capital gains tax.

I am suggesting there are much broader issues at stake.

We must recognise the important efficiency considerations at issue. Removal of capital gains tax will bias investment towards assets that earn income predominantly from capital gains, so perverting the proud achievement of this Government in attaining the highest ever recorded level of business investment to GDP.

We must also consider whether the community will be prepared to put up with a tax system which not only funds a reduction in the corporate tax rate to 39 per cent, full dividend imputation, and a large cut in the top personal rate, but also allows capital gains to be tax-free.

It is in the long term interests of Australian business that the tax system be socially sustainable and economically efficient.

I do not believe that the alternative proposed meets these basic tests.

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