PRIME MINISTER

TRANSCRIPT OF THE PRIME MINISTER, THE HON P.J. KEATING MP OPENING REMARKS, PREMIERS CONFERENCE, PARLIAMENT HOUSE, CANBERRA, FRIDAY, 25 MARCH 1994

I would like to declare our meeting open and to welcome everybody to it. It is not that long since we met at the Council of Australian Governments and we are all pleased to be able to say at the conclusion of that discussion that it was a good co-operative outcome and that we are able to advance a number of major things in the economy and the country in a way that some of the sceptics thought we might not be able to do.

It is an innovation separating the financial Premiers Conference and the issues of finance from other issues between the Commonwealth and the States in areas, say, of the micro-economy; in the things which we have been doing in technical and further education; or in water; or in gas; or in electricity because in years past while some of these items came on the agenda of the Premiers Conference given that it often took us time to get through the financial discussions there was not the opportunity to be able to range over the things that we are doing together and need to do together of the variety I just mentioned.

It seems that the Council of Australian Governments structure and the division of discussion between the financial meeting and the policy meeting, if you like, is working for us and we are getting a much better co-operative understanding between us and we are able to do things that we might not have been able to do individually or have been able to do together.

So, we meet with at least a new structure now starting to gather in some maturity about itself and we meet also at a time which is, I think, pretty obvious that we have a fairly strongly improving economy, at a time when we can look forward to a pick up in growth and activity and with concomitant low inflation. This is something we have not been able to look forward to - any of us - during most of our political lives and this happens to be true at the moment. There was quite a bit of comfort to be taken from last quarter's National Accounts - the December quarter National Accounts - published a week or so ago. Apart from the growth figure of 4 per cent and the acceleration in growth over the course of the year, what I thought was most compelling about the numbers was that on the broadest measure of inflation, the non-farm GDP deflator, broader even than the CPI, we had inflation sitting at 1.4 or 1.5 per cent which was pretty encouraging. Now, a pick up in commodity prices which feeds into the non-farm deflator will lift that a bit, but with the CPI running at under 2 per cent and the non-farm deflator running at 1.5 per cent it is fair to say that we have got a very solid scene on inflation and that has given us a fairly solid scene on interest rates which is important to all of us because we know the influence the interest rates have in the economy.

There has been some talk about interest rates and movements in interests rates and the Treasurer has made a couple of points that are probably worth remarking here about the United States. It is true that the United States have lifted their bank rate or discount rate by a quarter of a per cent and there is some speculation that there is a further quarter or half per cent in the pipe line. But, it is worth recalling that their rate is now down to three and one quarter per cent and they have lifted it to three and a half per cent. So they are barely covering the inflation rate; their interest rates are barely covering the inflation rate. It is almost like it was in the 1970s where you had negative rates of interest, there were people able to borrow at less than the inflation rate. Well, in the United States it is barely above the inflation rate and the other thing is the United States has got unemployment now down to around 6.5 per cent and in the US full employment is somewhere between, probably, 5 and 6 per cent. Some would say full employment, structural employment in the US is 6 per cent, so the United States is in a position where it is nearing full employment and there is not too much spare capacity in plant and equipment. Because a large part of the weight of American public economic policy is on monetary policy and not on fiscal policy despite the success of President Clinton introducing a diminishing budget deficit, there is still a huge financing task in the funding of the American deficits and the American Federal Reserve Bank is still carrying a lot of the weight.

This is not true in Australia because of the good financial scene we have had in the 1980s, federally and with the states, and our fiscal scene is much, much better so the balance between fiscal and monetary policy in this country is so much better than is the case in the United States.

So, it is not therefore unlikely that the American Federal Reserve Bank and its Governor would keep a weathered on eye on inflation and look at interest rates. That does not mean that the parallels with Australia should immediately be drawn because we are a long way from full employment in this country, with unemployment running with a 10 in front of it - 10 per cent something - and with full employment at least down where the Americans regard it as being, we have got a lot of spare resources in people and we have got a lot of spare resources in terms of plant and equipment. Our capacity utilisation levels are still relatively low. There was a lot of invested capacity put in in the 1980s, so we have got a lot of spare capacity in plant and equipment and we have got a lot of spare capacity in the labour market. All that means to us, that if we can keep the inflation rate down where we have it, we have a very good opportunity of having attendant interest rates which will keep the recovery going.

So, therefore, fiscal policy will remain important in the 1990s as it was in the 1980s and it is the reason why we are now talking about bringing the Budget deficit down to around 1 per cent of GDP by 1996 because as the recovery picks up, as private investment picks up, it has got to be funded from the national pool of savings somewhere and the best way to augment that pool is to diminish the Government's call on that savings pool and hence our objective of trying to get that down.

The other significant thing worth mentioning in the Accounts was that exports grew 6.5 per cent over the year and imports grew by 3 per cent. So, what has happened in the 1980s is as we opened the economy up, as we broke the tariff wall down, as we made it capable of having a much more open product market there was a big pick up in imports - as the import penetration ratio rose, as it has done in every other country where such openings occur - but, once it gets to an optimum, in a sense then which happened in the course of the 1980s, now it is a matter for judgement about where in a recovery those imports will run.

Well, in a recovery today, exports as I say are growing 6.5 per cent over the year, imports by 3 per cent, the other statistic worth remembering is that the debt service ratio - the thing that has occupied us perhaps most as Premiers and Treasurers in the last half dozen years, that was the current account deficit and the attendant debt - the debt service component of our exports, that is the proportion of our exports which we used to service the debt the nation has, has fallen from 21 per cent in 1986 to 11 per cent today. So, there is a very large change in the debt service component of our exports. Our exports are growing and they are growing in these areas of elaborately transformed goods.

As well as that, the accounts also had 200,000 job growth across the year which means we are well and truely on the way of getting a bit of growth moving.

Now, all of that means that we are in an upswing in the cycle, we do need to keep our eye on inflation, fiscal policy has got a player role, monetary policy at the moment certainly should basically encourage more investment in the economy and any outcome of anything we decide here today and the Budget subsequently will help in that result.

Can I say that therefore the relationship we have and we have engendered together is important to giving confidence in the community and particularly the business community about where we are going and what we are doing. We are getting a lot of things done, I mean, the National Training Authority which we put into place a couple of years ago is now becoming very significant. It's very clear to all of us, I think, that in terms of training and education in the community and the economy that TAFE, formerly the Cinderella of Australian education, is going to play a much stronger role and it's because we've been able to do these things. Or the National Rail Coporation, for the first time we're going to have a national rail highway which we've not had before, which is going to take pressure off the roads and put competition back into transport. Or electricity or any of the other things we've been talking about - gas and water etc.

So, it is a time, I think, where we've all recognised that none of us can do these things alone, that we've got to do them together. And that means that we have to have a total relationship and I don't want to pull anyone's leg by trying to overblow it, by talking about a new relationship here or new federalism or anything else. But, I think a good cooperative is what we need. So, therefore, at this meeting the Commonwealth government has taken some notice, substantial notice I might say, of the things you've said to us about certainty and assurity in Commonwealth payments to the states. And, what we have proposed here to you, today, is a funding formula we've never had before and that is that we offer the states a real terms per capita guarantee. That is, that we offer the states a funding formula based on real terms funding with a national population factor in the pool. And that population factor will expand the pool and therefore then the distribution of that pool will then devolve to population shifts within Australia as measured by the Grants Commission under its formulae and the distribution will depend upon relativities which the Grants Commission will recommend from time to time. But the pool will be bigger by virtue of the fact that it has a per capita guarantee.

Now, I know that some have argued, well look what we really need is a share of Commonwealth income tax. Could I just say from our point of view, we don't think that's been argued very hard. And the reason we don't think that's been argued very hard is because we think most of you are pretty smart and you know what that means. What it means is - and what it would have meant in the last couple of years is - that the states would have lost two to three billion in revenue through the recession. And, whatever any of us think of your budgets there is no way the states could wear a funding hit of that proportion. Now, if we'd had it there, I think one wouldn't be exaggerating by saying if we had a share of tax revenue sitting there and we had in any offer document, as a consequence of that, very large reductions in payments to the states not unreasonably premiers and treasurers would be saying to us, "Look, we can't run our budgets with this sort of a loss. So, at least you're going to have to give us the same nominal or the same real as last year." And we'd say, "Well, hang on you signed up to a formula and the formula is running very much against the states," that we'd be facing the practicality of the delivery of your services, as you would be and the likelihood is that we'd come to some agreement about the within year problem.

All that leads us to believe that the Commonwealth would carry the down side but the states would then carry away the upside revenue growth in the years of recovery, as now. Except for this one point and that is that the Commonwealth is carrying the natural stabilisers in the economy. This budget has shifted from a budget surplus of $8 billion to a budget deficit of $14 billion. It's a $22 billion dollar shift. And that $22 billion dollar shift has put a great cushioning into the economy and one of the reasons we're growing faster now than most countries - bar for a decimal point - as fast as any country in the world is because, I think, that the natural stabilisers and the stance of fiscal policy has worked. Therefore, the Commonwealth has got to be in a position to be able to meet the deficit accumulations in the good times, when the good times come. Whereas the fluctuations in Commonwealth revenue are not mirrored in the same amplitude in state budgets.

So, we think what the states need, not unreasonably, is a set of payments which have a predictability about them and also have some growth about them. And, real terms and population seems, to us, to get to that point and then the upsides which might come and which all governments look forward to, will come in your revenue base which will reflect the growing improvement in the economy across a whole range of state taxes and charges. So, there will be a buoyancy in state revenues, as there will be this year but the Commonwealth payments as part of those revenues should be reasonably certain, at least maintained in real terms and at least covering the population growth in the country. This will cost us, over the course of this three years, more than a real terms guarantee would have cost us - if it's in for three the likelihood of it not being then the permanent funding formula or at least the base into the future is, I think, is a very diminished likelihood. That is, that the real terms per capita guarantee becomes the norm.

Now, Ralph (Willis) had a number he mentioned to me yesterday, over a period of ten years it amounts to $9 billion additional funding in the financial assistance grants but net of the capital it's $6 billion. So, therefore, we think it's got some value to it and we hope you do as well. But, more than that we hope you think we've listened to what you've had to say and tried to come to something reasonable about it. Can I just say in terms of year three of the current formula - year three adds about $220 million to our forward estimates because of the formula. So, the result is total net payments to the states - excluding TAFE and special debt repayments - increase by 2.1 percent nominal this year. And, this is a year when your revenues are going to pick up fairly strongly.

Part of the offer, and Ralph will probably come to this, is the capital works program, rolling the capital works program into the financial assistance grants. Now, this does affect people advantageously in some respects, disadvantageously in others. But, this program came from the 1930s, it came from a time when some states were not able to borrow at home or abroad and the Commonwealth borrowed for them and then sent proceeds on to them. When I became Treasurer 11 years ago this program was worth the better part of $1.5 to $2 billion dollars; it's now down to $333 million in a FAGS pool of about $14 billion. So, it has no relevance today - the historic shares of the capital works program or the on budget loan program or the governmental program, it has had different names over the years - the historic shares today mean nought in terms of the realities in terms of say, a Grants Commission recommendation. So we think this is the time to basically roll it into FAGS because it has got to go at some time and try and deal with the attendant effects. So, then at least we're only talking about Financial Assistance Grants and we can apply then the real terms per capita formula to that pool into the future. So, it's something that probably should have been done in the past, better late than never and probably better now as we're going to go to a longer term funding formula with population.

So, could I complete my remarks by, again, saying how much I appreciated the atmospherics of our last meeting, the cooperative we've done - particularly the work on Hilmer - and look forward to the work that will come back to us in August for that. I hope that, as a result of these arrangements we can go from here on to a funding formula which is less about a discussion here annually about money because you'll pretty well know what it is before you come. And, the discussion will then be about, really, Grants Commission relativities. Now, there's a big influence on Grants Commission reports now, I understand that. Part of that is the return of funds to the larger states of NSW and Victoria. They claim, and they have claimed for years in here, that they were, to use the colloquialism, dudded by the formula over the years. There was a review of the formula and the methodology and as a consequence of that there's been a shift back in that, as indeed, there are different population effects taking place and different population movements.

So, I guess that the Grants Commission matter will be on the table whenever a Grants Commission report is presented, about the distribution of the pool. But, at least we ought to get to a point where the pool itself is not under examination and discussion every year - that we know what the pool formula is going to be and that's, I think, the certainty which the offer today brings to you probably for the first time certainly in the last 11 years. So, could I conclude on those notes, welcome you again to the meeting, each and every one of you. I think the Treasurer would like to add to my remarks and then I would invite you all to respond. Thank you Ralph.

Ends.