

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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Statement by Mr. Prowse on Australia
Executive Board Meeting 81/82
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The Australian authorities are in general agreement with the Staff Report for the 1981 Consultations with Australia, which they commend as a perceptive and thoroughly competent analysis of the Australian economic situation and prospects. In particular they agree with the staff views in respect of greater emphasis on fiscal restraint and of preference for reductions in protection rather than exchange rate appreciation. Accordingly, this statement is limited to some brief remarks on overall economic policy and on some recent policy initiatives.

In recent years economic policy in Australia has had the premise that sustained economic growth can be achieved only through control of inflation and a strengthening of the private sector. In pursuit of this objective the Australian Government has pursued firm fiscal, monetary, wages and external policies directed at curbing inflation and removing fundamental constraints to recovery. This policy has involved deceleration in Commonwealth Government outlays, reduction in the Commonwealth budget deficit, control of the growth in monetary aggregates and strong advocacy of wage restraint.

In the event, inflation has been reduced, demand and activity have increased, business confidence has been bolstered and there is now more optimism for the future. The rise in activity is clearly outlined in the report, and I merely note here that the 4.3 per cent rise in non-farm product in the twelve months to the December quarter 1980 is a strong performance, particularly when much of the rest of the world is showing little or no economic growth.

It may be said that such growth is not surprising given Australia's abundant resource endowment, but as the staff report points out, a rich endowment of resources is no guarantee of good economic performance. The staff report goes on to comment that the anti-inflation policy pursued in recent years has enabled Australia to be in a position to take advantage of its resource base and favourable circumstances.

Australia has, indeed, reduced its inflation rate in recent years and it is currently below the average rate for OECD countries. This performance may be relatively good by international standards but the Australian authorities do not regard the present inflation rate in Australia as an adequate basis for sustainable growth, and their concern regarding the acceleration in the underlying inflation rate is greater than is evident in the report. Consequently, they see a need for restraint in all aspects of policy and are more sanguine than the staff regarding the short-term growth potential of the Australian economy. In particular, since the

mission's visit to Australia, the first investment anticipations data for 1981-82 have become available, and these show even stronger prospects than was shown by the corresponding survey for 1980-81. Taking this with the strength of consumer demand, it is evident that the acceleration in private domestic demand is widespread and the task of "making room" for it via public sector constraint accordingly more important.

The basic philosophy of the Government towards economic policy of course remains unchanged. In order to maximise the opportunities presented, inflation must be controlled. Policies will continue to be directed towards "making room" for productive private sector activity in a manner consistent with further sustained progress in reducing the rate of inflation.

Recent Policy Actions

A number of significant policy steps have been implemented since the Staff mission to Australia.

On April 30, 1980 the Government announced the results of a recent review of Government functions. In brief, the Federal Government announced a number of steps to reduce its own call on resources by transferring some operations to the private sector and by abolishing some services. It is also moving to significant de-regulation of industry. The review will entail an overall reduction in public sector employment of 17,000 and a reduction in Commonwealth budget outlays of about \$560 million (1.5 per cent of estimated outlays for 1980/81).

In addition, a number of subsidies and financial concessions will be removed in support of the principle that the "user" should pay the full cost of any service.

These measures do not represent a single, isolated event. The Government will be making continuing efforts leading up to the Budget in August 1981 to effect further savings in outlays.

In pursuit of further reductions in the budget deficit via restraint in outlays, the Government also has announced significant changes to its health policy. Previously the Commonwealth Government and the States shared equally the financing of hospitals. On April 29, 1981 the Commonwealth announced that it was ending the cost-sharing hospital funding arrangements and absorbing its funding of hospitals into its general revenue grants to the States. At the same time, it announced it was reducing the level of funding and plans to gradually reduce it further. The effect is that the States will now have to raise, through higher charges or taxes, the funds to meet the gap left by the reduction in Commonwealth funding.

The Government's recent moves in this area, however, are not limited to the developments outlined above and probably more importantly there were announced on May 4, 1981 significant changes to the financial arrangements between the Commonwealth and State Governments.

It is relevant that during the Article IV consultation in January 1980, several Directors suggested that the Commonwealth Government's firm resolve

towards fiscal restraint might be curtailed by limitations on its ability to exercise firm control over total public sector expenditure, in particular over the expenditure of the State Governments. However, the Commonwealth Government has consistently stressed that in this regard it is the overall public sector deficit that is ultimately important. Whether it is a semi-government authority or the Commonwealth Government financing its own departmental activities, it constitutes the same competition for resources with a growing private sector.

In recent years the Commonwealth Government's success in reducing its outlays had not been matched by similar restraint on the part of State and local Governments. In an attempt to reduce overall public sector outlays the Commonwealth Government has now limited its "general revenue" grants to the State Governments for 1981-82. The grants are the principal source of funds provided to the States. The outcome of the May 4 conference between the Commonwealth and the State Governments was that for 1981-82 there will be a 10 per cent increase in total funds going to the States, which could well represent a decline in real terms. This should force State Governments to restrain the growth in their outlays and to finance a larger part of their expenditure from their own sources of revenue from taxes and charges.

In reviewing these developments, it is worth recalling the warning note in the staff report that difficulties may be encountered if there is excessive reliance on monetary policy and the recommendation that fiscal policy must bear a larger share of the anti-inflation strategy. As I say, my authorities endorse this view as is evidenced by these recent policy initiatives. It is evidence of their commitment to the fiscal objective that the authorities now expect that the government will reach its financial targets in the current financial year ending on June 30th including the first Budget surplus in seven years.

The Report makes reference to the "present system of wage determination" and the problems it could create by translating wage differentials that might, and should, emerge in the course of resource development into generalised wage acceleration. The authorities in Australia are very well aware of the problems associated with a centralised system of wage determination and on May 4, 1981 a National Inquiry into Wage Determination and Industrial Relations was announced. This will be the first such inquiry (i.e. outside of the institutional system) since Federation and it will serve inter alia as a full review of the effects of the present "system" and the constraints it imposes on the proper functioning of labour markets.

There is one other aspect of the staff report that requires a brief comment, and that concerns the question of protectionism.

The Government has committed itself to a gradual lowering of protection with advance notice to be given to industry in order to facilitate the adjustment process. Nevertheless the liberalization of protective measures can be a difficult political process. Considerations with respect to the "protection of jobs" cannot be easily disregarded, but there has been in recent years a change in the content of the debate about policy in this regard and in the community's attitude toward protection. The issue is being increasingly debated and there is a growing awareness of the high cost to be paid for the maintenance of jobs via protection as the cost of this becomes increasingly apparent.

To conclude, I would like to pass on my authorities thanks for the very useful and constructive discussions in Australia last March, as well as for the very informative papers before us.