OECD
ECONOMIC SURVEYS
1984/1985

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

AUSTRALIA

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

JUNE 1985

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to article 1 of the Convention signed in Paris on 14th December, 1960, and which came into force on 30th September, 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The Signatories of the Convention on the OECD are Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries acceded subsequently to this Convention (the dates are those on which the instruments of accession were deposited): Japan (28th April, 1964), Finland (28th January, 1969), Australia (7th June, 1971) and New Zealand (29th May, 1973).

The Socialist Federal Republic of Yugoslavia takes part in certain work of the OECD (agreement of 28th October, 1961).

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BASIC STATISTICS OF AUSTRALIA

THE LAND

Area (1 000 sq. km)	7 682.3	Urban population, 30.6.1981, % of total (cities over 100 000)	69
Agricultural area, 1980, % of total	64.6	Population of major cities, 30.6.1981 (1 000):	
		Sydney	3 281
		Melbourne	2 804
		Brisbane	1 086
		Adelaide	953
		Perth	918

THE PEOPLE

Population, 2nd Qr 1984 (1 000)	15 544	Civilian employment, 1st Qr 1985 (1 000)	6 635
No. of inhabitants per sq. km	2.0	*of which:* Agriculture	405
Natural increase, 1983-84 (1 000)	129	Industry[1]	1 855
Net migration, 1983-84 (1 000)	35	Other activities	4 375

PARLIAMENT AND GOVERNMENT

Composition of Parliament following latest elections:

Party	Senate	House of Representatives
Australian Democrats	7	–
Australian Labor Party	34	82
Independent	1	–
Liberal Party of Australia	28	45
National Party of Australia	5	21
Nuclear Disarmament Party	1	–
Total	76	148

Present Government: Australian Labour Party
Next general elections for House of Representatives: at the latest February 1988

PRODUCTION[2]

Gross Domestic Product, 1984 ($ A million)	187 196	Gross fixed capital formation, 1984: Percentage of GDP	21.7

THE PUBLIC SECTOR % OF GDP IN 1984[2]

Expenditure on goods and services[3]	20.3	Current revenue	32.7
Current transfers	13.1	*of which:* Direct taxes	16.4

FOREIGN TRADE

Main exports in 1983-84, % of total:		Main imports in 1983-84, % of total:	
Food and beverages	23.8	Food and beverages	4.9
Industrial raw materials	42.3	Industrial raw materials	26.6
Fuels and lubricants	20.9	Fuels and lubricants	8.8
Capital goods	4.2	Capital goods	23.5
Transport equipment	2.5	Transport equipment	14.6
Consumer goods	1.9	Consumer goods	16.8

THE CURRENCY

Monetary unit: Australian dollar	Currency unit per US dollar, average of daily figures:	
	Year 1984	1.1406
	June 1985	1.5037

1. Including mining, electricity, gas and water and construction.
2. Fiscal year ended 30th June.
3. Current and capital expenditure.

Note: An international comparison of certain basic statistics is given in an annex table.

This Survey is based on the Secretariat's study prepared for the annual review of Australia by the Economic and Development Review Committee on 10th June 1985.

After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 24th June 1985.

INTRODUCTION

The Australian economy has experienced one of the strongest recoveries from recession since mid-1983 of all the OECD countries. This has been accompanied by decelerating inflation and a fall in unemployment. GDP grew by 6.5 per cent in 1984 after only 0.5 per cent in 1983 while inflation decelerated from 10 per cent in the first half of 1983 to around 5 to 5½ per cent at the end of 1984 or at about the OECD average as measured by the consumer price index. During this period, the Government has followed a policy aimed at reducing inflation and unemployment simultaneously within a context of consultation and consensus – an approach which differs markedly from that adopted during the late 1970s and early 1980s in Australia and currently in most other OECD countries. Part I of this Survey briefly describes the current policy framework at this juncture and problems which may emerge as the recovery proceeds.

Part II reviews the process of deregulation that has been occurring in financial markets in recent years. The result of this process is likely to be a more efficient and innovative financial sector and one in which the position of the banking sector will be strengthened after a long period of decline. The operations of monetary policy have also undergone some changes, away from quantitative controls to a more market-oriented approach. Deregulation is, however, causing shorter-run problems for monetary management and the interpretation of the stance of policy because of the impact on the growth rates of monetary aggregates. Part III begins with a discussion of monetary conditions in a deregulated environment. It then turns to fiscal policy. The expansionary FY 1982/83 and FY 1983/84 Budgets[1] have given way to a more neutral stance in FY 1984/85 when a number of expansionary measures were balanced by particularly buoyant revenues. The public sector borrowing requirement now stands at around 6.5 per cent of GDP for the current fiscal year. With the expansion in the private sector gathering pace, the Government has announced three-year fiscal objectives and substantial expenditure cuts from its forward estimates which will constrain outlays and reduce the Commonwealth government borrowing requirement. With fiscal policy being expansionary, the major instrument in restraining inflation in the past two years has been prices and incomes policy which succeeded in restraining wage growth and helped in restoring profits. These developments as well as major issues facing such policy are discussed in Part IV.

Part V reviews the current economic situation and the short-term outlook. Much of the initial stimulus to growth reflected higher government spending, but it has also resulted from the sharp swing in stocks, the end of the drought and higher exports. These factors, combined with lower interest rates, have led, as the recovery has progressed, to a strengthening of private consumption and housing investment. A significant proportion of the increase in demand has spilled over into imports, and this has been partly responsible for the large current account deficit, one of the factors giving rise to a sharp fall in the value of the Australian dollar in early 1985. Over the coming two years a further strengthening in final domestic demand is foreseen. Private consumption appears to be expanding further and surveys indicate a revival in business fixed investment. The recent fall in the Australian dollar, if maintained, should lead to a positive contribution from the foreign balance, particularly in 1986 and to some narrowing in the current account deficit. However, the stock of foreign debt has been rising rapidly and this is being reflected in increased interest payments abroad. The conclusions, presented in Part VI of the report, assess the results of the current economic policies as being positive. It points out, however, that the consolidation of these results will call for careful economic management combining a sizeable reduction in the public sector borrowing requirement, non-accommodating monetary policy and an effective application of the wage-fixing principles.

I. THE AUSTRALIAN POLICY FRAMEWORK

The current policy approach in Australia differs from that followed in the late 1970s and early 1980s both in Australia and in most other OECD countries. The orthodox approach has stressed the need to reduce fiscal deficits, re-establish external equilibrium and to fight wage and price inflation through tight fiscal and monetary policies. Incomes policy has been regarded as self-defeating over the longer run and there has been general concern that expansionary demand-management policies would lead to an acceleration of wage increases at higher levels of unemployment than in the past. The current Australian Government has opted for a set of policies to fight unemployment and inflation simultaneously which had been developed over a number of years before the Australian Labor Party was elected to government in March 1983. On coming to power, the Government convened a National Economic Summit to enable a broad range of participants to exchange views and discuss the possibility of reaching "consensus on issues important to the current and future well-being" of Australia. This led to agreement in a certain number of areas regarding prices and incomes policies, the role of demand-management policies, the need to institutionalise the consultation procedures and to reform the Australian taxation system. Policies implemented in the subsequent period contained the following elements.

First, fiscal policy has been broadly expansionary. The already expansionary stance evident in the FY 1982/83 Commonwealth budget of the previous Government has been largely maintained. This led to a rise in the public sector borrowing requirement from around 4 per cent in FY 1981/82 to 7.3 per cent in FY 1983/84 with a slight cyclical fall to around 6.5 per cent expected in FY 1984/85. Second, a prices and incomes policy was established to last at least until the end of 1985. This was reflected in the wage fixation principles established by the Australian Conciliation and Arbitration Commission which will last until September 1985 when they will be reviewed. The current system of wage fixation was preceded by a wage pause introduced by the previous Government at the end of 1982 and intended to last for six months[2]. Subsequently, the Accord between the Australian Labor Party and the Australian Council of Trade Unions agreed on a return to a centralised wage bargaining system under the auspices of the Australian Conciliation and Arbitration Commission, with real wage maintenance as its guiding principle[3]. To aid the prices and incomes agreements, a Prices Surveillance Authority was established to monitor prices in nationally significant areas of limited competition but not to control them. Third, monetary policy was set "to promote an environment of sustainably lower inflation while allowing the expected pick-up in demand to proceed". Consequently money supply growth was projected to be less than expected growth in nominal GDP[4]. The control of liquidity was enhanced with the floating of the dollar after short-term capital inflows led to a sharp rise in monetary aggregates towards the end of 1983.

Greater reliance is now being placed on open-market operations for the control of liquidity. The conditional projection for M3 growth for the current fiscal year has recently been suspended as the influence of financial deregulation has made the interpretation of monetary aggregates difficult. Nevertheless, monetary conditions have firmed in recent months partly because of policy moves and the Government has stated its intention to maintain a firm stance.

Fourth, there have been moves towards a deregulation of the economy, notably in the financial sector. Exchange controls have been removed, a number of new banking authorities – mainly foreign – have been granted or are imminent, and almost all constraints on the lending and borrowing rates of banks have been eliminated. Outside the financial sector decontrol has been slow. The government has expressed a longer-term intention to reduce protectionism and raise the exposure of industry to foreign competition. The Government has been actively resisting further demands for protection and existing barriers are to be gradually reduced over time. It has embarked on a number of industrial sectoral plans, primarily in the highly protected areas such as automobiles and textiles, clothing and footwear. It has also begun a process of review of business regulation in general in consultation with the business community. Finally, the current tax structure is coming under a wide-ranging review. A Taxation Summit is being convened in July 1985 to establish a consensus on both the need for reform and the direction that it should take to make the system more equitable and efficient.

These policies have achieved a considerable degree of success. Helped by bumper crops, the international recovery and a turnaround in the stock cycle, current policies have contributed to a rise in demand and a decline in unemployment. Price inflation has been reduced by half, and the current wage determination system appears broadly successful in restraining wage increases. With these achievements in hand, policies must now confront a different economic environment. Private final demand appears to be rising more strongly and this is forecast to continue. Inflation has stabilised at roughly 5 to 5½ per cent and inflationary pressures are building up from a number of sources including higher import prices associated with the recent weakening of the exchange rate and demands for productivity-related benefits. The possible impact of an increase in indirect taxes on subsequent wage demands will also be a question for economic management. At the same time, the current external deficit has widened substantially, partly reflecting deteriorating terms of trade and the rise in invisibles debits. But it has also resulted from a sharp rise in import volumes which, in turn, reflects both weaker competitiveness and more rapid growth in domestic demand. Interest rates have tended to rise in response to strong public and private sector demand for funds, thereby attracting adequate capital inflows which, until early 1985, avoided downward pressures on the exchange rate. High interest rates increase the risk that part of the rise in private sector demand may be choked off. In this context, policies have already begun to evolve and the Government within the context of the "Trilogy"[5] is now committed to reducing the Commonwealth deficit in money terms in the next fiscal year. More recently, cuts in government expenditure have already been announced for FY 1985/86. The early implementation of such policies would appear crucial if the economy is to achieve a smooth transition towards higher private sector demand and to prevent crowding-out in financial markets. However, a reconsideration of the priorities of the various objectives outlined in the Accord may also be essential if the present achievements on inflation are not to be lost. Higher prices would lead to a reacceleration in wages with the risk of a subsequent squeeze on profit shares and a decline in confidence. Against this background the Survey now turns to the examination of financial deregulation and its implications for efficiency gains, social goals and macroeconomic policy.

II. FINANCIAL DEREGULATION

The nature of regulation

Financial markets in Australia have had a long history of extensive government intervention. The system of measures in force at the end of the 1970s had largely been conceived some decades ago in very different circumstances. The original objectives of specific measures are sometimes difficult to discern but a number of broad social and economic objectives are evident. First, many of the interest rate controls and portfolio restrictions on both banks and non-bank financial intermediaries (NBFIs) were seen as necessary to assist in the operations of monetary policy and to aid the sale of government securities. The mode of operation of monetary policy required that the authorities be able to promote the sale of securities to the non-bank private sector but to limit the extent to which banks could adjust their holdings of liquid assets and government securities (LGS) at least in the short run. Secondly, there has always been a strong commitment to the protection of investors and the maintenance of confidence in the stability of financial markets and institutions. This has manifested itself in a range of regulatory measures including entry and portfolio restrictions which in providing stability have probably limited competition and reduced returns to investors. Finally, direct regulation has often been used to promote certain social and sectoral objectives, in particular the availability of funds for housing at favourable interest rates. By the end of the 1970s, it was clear that many of the regulations had outlived their usefulness and were not contributing to the attainment of the social and economic goals for which they were conceived. Market-related developments including financial innovations, technological change and greater integration of world financial markets, as well as changed perceptions about the operations of policy were placing increasing pressure on markets for change, both of a structural and a regulatory nature.

To understand the nature of innovation and the process of deregulation that has been occurring in the past few years, it is important to bear in mind the clear legal distinction that has always been made between banks and non-bank financial intermediaries. The principal distinguishing feature of Australian banks has been their monopoly position with regard to the supply of current account facilities and the related payments system. This distinction is now becoming blurred as other financial institutions gain access to the payments system, at least on an agency basis. In future, the distinction will be better seen from the point of view of risk exposure with banks operating at the relatively low risk end of the spectrum. Banks have been perceived as virtually risk-free institutions by the public because of the special relationship that exists between them and the Reserve Bank. While bank deposits are not explicitly guaranteed by the Government, the Reserve Bank does have a statutory obligation to use the powers given to it under legislation to protect the interests of the depositors of the banks licenced under the Banking Act. Apart from the abolition of exchange control and the floating of the dollar, the majority of deregulatory moves have been aimed at the banking sector, principally because this was previously the most regulated sector of the financial markets. Nevertheless, specific measures relating to the non-bank sector have been taken and others, including access to the domestic payments system, are under consideration. One overall objective in the deregulatory process is to arrive, as far as is practicable, at a financial sector within which firms are able to compete unimpeded by regulatory measures which are non-neutral between firms.

The direct controls over bank activities have taken a number of forms. First, the entry of new banks has been strictly controlled. For a period of about thirty-five years prior to 1981, no new trading bank authorities were issued while the only new savings bank authorities were issued to existing banking institutions. During that period, the only serious approaches made to the Government were from foreign corporations and it was official policy not to grant licences to non-residents. Requests from domestic applicants might have been viewed more favourably but this was not tested until 1981 when the Australian Bank Limited was granted a trading bank authority. Limitations also applied to the equity interests of individuals or corporations in banks. At the end of the 1970s, there were ten trading banks, thirteen savings banks and six other banks with special status operating in the country. Banking was, however, dominated by seven major trading banks and their associated savings bank subsidiaries. In a series of mergers in the early 1980s, the number of major trading banks was reduced to four, which together accounted for more than 85 per cent of all trading bank assets.

The second set of restrictions related to bank deposit and lending rates. Ceilings were applied to a wide range of lending rates by a variety of direct and indirect controls. Deposit rates with savings banks, for example, were directly controlled, while trading banks could not pay interest on current accounts and could only take term deposits with a minimum maturity of three months (reduced to thirty days in August 1981). Thirdly, the banks had to comply with certain restrictions on their portfolios. Trading banks, for example, were required to hold a designated proportion of all deposits as statutory reserves with the Reserve Bank (the SRD ratio), receiving in return a rate of interest well below the market rate. A further proportion of deposits (usually 18 per cent) was required to be held as liquid assets or government securities, the so-called LGS convention. Savings banks had to hold 100 per cent of their portfolios (recently reduced to 94 per cent) in prescribed form, mainly housing loans and government securities. Finally, the Reserve Bank did at times use moral suasion to restrict new bank lending. Although this did not represent a statutory restriction, it has generally been felt that the banks took note of such requests even though the impact on lending may have been small.

The impact of regulation

The precise impact of control on financial markets and on the economy as a whole is difficult to assess because of many changes that were occurring simultaneously, often at a very rapid pace, with regard to the supply of financial services. However, a number of observations can be made relating to developments which were at least partly symptomatic of the highly regulated financial environment. First, the market share of banks declined significantly between the 1950s and the early part of this decade (Table 1). In 1953, for example, the assets of trading and savings banks together represented about 81 per cent of all assets of financial institutions (excluding the Reserve Bank and insurance corporations). By 1978, this share had fallen to only 59 per cent, including a steady decline in the trading banks' share until the early 1970s and a decline in the savings bank share during the 1970s. The major beneficiaries of these shifts were the finance companies, building societies and money market corporations, reflecting both a shift in demand towards housing and consumer durables but also an inability of banks to compete in certain areas because of restrictions on their borrowing and lending rates and on their deposits[6].

Secondly, interest rate restrictions on banks have at times caused them to constrain their participation in certain areas. On the other hand, banks have benefited from their predominant position in having direct access to the payments system. In this way they have been able to achieve above-average profitability but may also have developed inefficient cost structures. Although the evidence is not clear, there is some suggestion that this may have reflected an over-provision of certain services such as small chequing accounts for which only minimal charges were made. Extensive retail structures also grew up, some of which are now

Table 1. **Financial intermediaries: assets growth and share of total financing**[1]

	As at June				
	1953	1963	1973	1978	1984[2]
Trading banks					
Total assets ($ billion)	3.1	4.6	12.9	25.0	64.0
Share of total	53.4	42.2	33.5	33.3	35.8
Savings banks					
Total assets ($ billion)	2.0	4.1	10.7	19.0	37.6
Share of total	34.5	37.6	27.4	25.3	21.0
Permanent building societies					
Total assets ($ billion)	0.2	0.2	2.9	7.5	17.5
Share of total	3.4	1.8	7.5	10.0	9.8
Money market corporations					
Total assets ($ billion)	–	–	2.4	3.9	16.6
Share of total	–	–	6.2	5.2	9.3
Finance companies and general financiers					
Total assets ($ billion)	0.2	1.3	7.6	15.9	31.8
Share of total	3.4	11.9	19.7	21.2	17.8
Other NBFI[3]					
Total assets ($ billion)	0.3	0.7	2.0	3.7	11.4
Share of total	5.2	6.4	5.2	4.9	6.4
Total					
Total assets ($ billion)	5.8	10.9	38.5	75.0	178.9

1. Data on total assets and market shares in this table are to some extent limited by consolidation problems reflecting unidentified flows within the financial sector.
2. Preliminary.
3. Refers only to non-bank financial intermediaries which, as of 1984, were reporting under the Financial Corporations Act: it therefore excludes pension funds, insurance offices and a number of other groups.

Source: Reserve Bank of Australia, *Statistical Bulletin, Financial Flows Supplement*, 1953/54 – 1979/80, and April 1985.

being rationalised to reduce costs and improve efficiency. In those areas where bank participation was limited, other financial institutions have grown up, specialising in activities such as housing, consumer credit or corporate financing. Financial innovation and competition have tended to be stronger in these areas than in the heavily regulated banking sector, although this has changed over recent years as banks have sought to adjust to intensified competition. Frequently, financial institutions have found ways to get around regulatory measures but at some cost. Thus, while inefficiencies have arisen, it would be difficult to ascertain the magnitude of the efficiency losses involved.

Thirdly, with the increasing sophistication of financial markets, the operations of monetary policy became more difficult. In the past, monetary policy tended to be aimed directly at limiting the creation of credit by the banks through the use of the LGS/SRD framework and through direct requests to the banks to limit new lending. Within this framework the authorities attempted to control M3 by pressing the sales of Commonwealth government securities (CGS) to the non-bank private sector. Increased yields on CGS tended to draw deposits away from banks, as non-bank purchases of these securities increased. As interest rate controls prevented the banks from competing for deposits, they had to meet commitments from their existing LGS and were forced to reduce lending. This approach gradually ran into difficulties for a number of reasons including a decline in the relative importance of banks, lack of control over whether CGS were taken up by banks or non-banks and growing concern about the distortions that were being caused in financial markets. In particular, because monetary policy was acting directly on banks, it was creating further disadvantages for this part of the financial sector. Finally, there has been considerable conjecture as to whether regulatory measures have been effective in achieving the social goals of successive governments, particularly with regard to housing and small business. Interest rate controls forced banks to implement rationing devices for finance and since risk assessment becomes relatively more important in this situation, low interest rate finance was probably allocated to the most credit worthy rather than the more needy.

The process of deregulation

As perceptions of these problems increased, the government of the day, intent on finding ways of improving the efficiency and the operations of the financial system, established in 1979 a Committee (known as the Campbell Committee) to inquire into virtually all aspects of the Australian financial system. The Committee's terms of reference emphasised the role of free market forces. The committee report, published in 1981[7], recommended wide-ranging deregulation of the financial market and changes in such areas as sales of government securities. This report received widespread approval and some progress was made in implementation before the change of government occurred in 1983. The present Government established a group to review the financial system having regard to the recommendations of the Campbell Committee, the Government's economic and social objectives, as well as the need to improve the efficiency and maintain the stability of the financial system. The recommendations of the Review Group (contained in the Martin Report) were broadly similar to those of the Campbell Committee and the process of deregulation has continued[8].

The extent of deregulation to date has been extensive and details of changes are shown in Annex I. The major changes can be summarised as follows.

- Removal of most interest rate ceilings on bank loans and deposits and of restrictions relating to payment of interest on short-term deposits (effective from 1st August 1984). Ceilings remain only on owner-occupied housing loans of less than \$100 000;
- Selection of sixteen partly and fully foreign-owned subsidies for the granting of banking authorities (February 1985); renewal of the banking authority of the Bank of China (April 1985) and approval of three applications for banking authorities from domestic interests;
- Movement to a tender system for marketing Treasury notes and bonds, replacing the previous systems which set yields but not the volume of sales (December 1979 for Treasury notes and July 1982 for bonds);
- Floating of the Australian dollar (December 1983), issue of a large number of foreign exchange licences, abolition of almost all foreign exchange controls and removal of most of the restrictions on residents wishing to invest abroad.

As much of the deregulation is very recent or even incomplete, it is difficult to be precise about its impact. It is already evident that the trading banks have begun to win back asset shares lost to other financial intermediaries in the past (Table 1), while the savings banks' share appears to have stabilised since about 1980. Greater competition for deposits has become evident, the banks have moved away from unified support for one credit card (Bankcard) in response to competition from other financial intermediaries in this area, and more innovative and sophisticated services have sprung up. It is also expected that financial deregulation will have important demonstrative effects because of the key role of an efficient financial sector for the smooth operation of all aspects of commerce. It remains to be seen what these changes will imply for micro-efficiency within the financial system and for the operations of the financial system as a whole. In attempting to preview the implications of recent changes, it appears necessary to consider three main areas:

i) Efficiency gains within the financial sector itself;
ii) The continued pursuit of social goals through the financial system;
iii) The impact of changes on macro-efficiency in general and on the operations of monetary policy in particular.

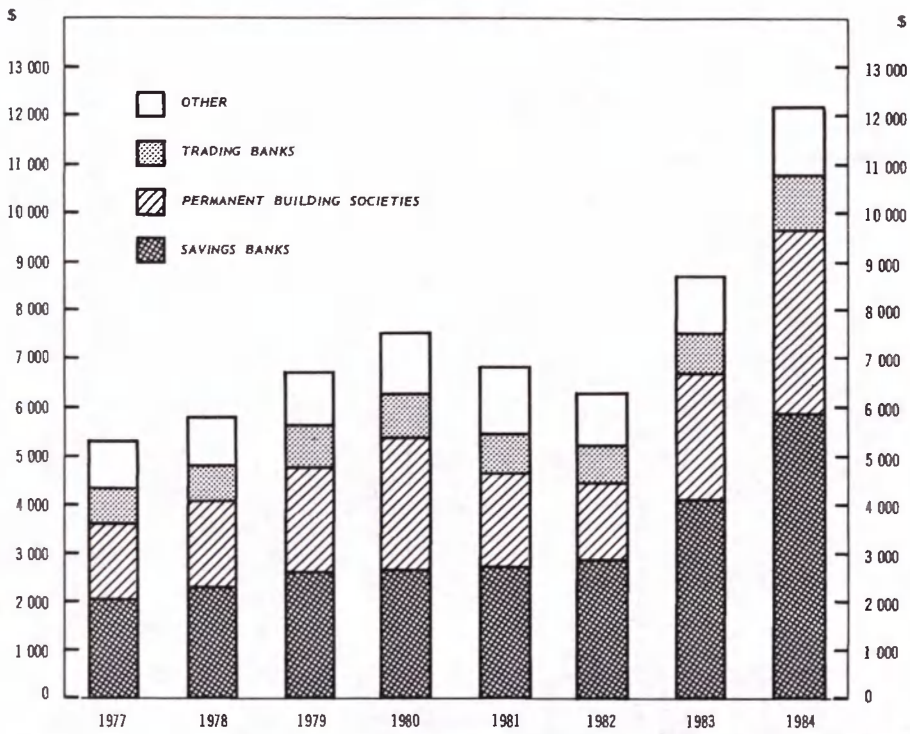
Efficiency gains

As deregulation proceeds, it is expected that an increasing amount of loan activity will return to the financial sector and that transfers will occur within the financial sector itself resulting in an increase in shares by the banking sector at the expense of merchant banks, finance companies and building societies. There is already some evidence of both of these changes. Increased intermediation is one of the factors influencing the unusual behaviour of the monetary aggregates in the 1984/85 fiscal year. This probably involves a reduction in activity in areas such as intercorporate loans, direct corporate borrowing abroad, etc., and a channelling of these loans through the financial system which has now become far more competitive and flexible. An increase in importance of banks within the financial system is considered desirable from an efficiency point of view. This efficiency gain would arise from the perception in the community of banks as virtually risk-free institutions, giving them the ability to borrow domestically at the lowest possible rates. Thus, an increase in the relative importance of banks would lower the average market-wide borrowing cost but, because of the reduction in risk, need not lower aggregate savings. Although there is a question whether deposits are explicitly guaranteed by the Reserve Bank, it is true that the degree of prudential supervision provides greater security than is available with other financial intermediaries. The privilege of greater security is not cost-free as the additional prudential supervision entails certain restrictions on the portfolio of banks and may limit their involvement in more risky projects. The community is clearly prepared to pay some price for this type of security but the problem is to decide at what point the marginal gain in efficiency associated with lower risk justifies the marginal cost of further prudential control.

Second, efficiency is expected to be gained through increased competition through the entry of new banks. The Campbell Committee was of the view that, on the basis of available evidence, there had been inadequate competition in the market for payment services in the past. The evidence, while not entirely conclusive, included the relatively high margins between borrowing and lending rates, the favourable profit position of the banking sector relative to other sectors, and a perceived tardiness in adopting innovations already introduced in more competitive environments in other countries. In addition, a lack of competition and a host of regulations have meant that many services have been inappropriately priced. This has probably contributed to a proliferation of small accounts for which transactions costs are high, and to the provision of extensive branch networks which may be inefficient. However, as mentioned earlier, the degree of competition is uneven across the whole range of activities in which banks participate. In the area of corporate finance, for example, competition comes from more than 50 money market corporations as well as from a number of other general financiers. Thus, while some trimming of margins is likely in this area, the scope may be relatively small. It would also appear likely that, if banks are able to borrow at lower rates, they will put pressure on existing institutions specialising in this section of the market and force some rationalisation to occur.

Much of the lack of competition has resulted more from regulation of operations than from barriers to entry. In the area of housing finance, for example, building societies from the mid-1960s achieved very rapid growth because of constraints on other participants in the market which left unsatisfied a large demand for housing finance. Their growth was assisted by the spread of mortgage insurance which enabled them to lend, albeit at a higher rate of interest, a much higher proportion of the assessed value of a property than was the custom of the more conservative banks. Much of their growth was at the expense of non-bank financial institutions who had been filling the gap left by the savings banks but at substantially higher rates. However, the share of building societies in new housing loans levelled out in the second half of the 1970s (Diagram 1) principally because of controls on their lending rates imposed at the State level. However, in recent years, market interest rates have generally remained below the ceiling on savings bank housing loans for owner occupation and, aided by the removal of certain controls, savings banks have greatly increased their market share. The permanent building societies have responded by offering more competitive deposit rates and the market now appears much more competitive. This situation is very dependent on market lending rates

Diagram 1. **Sources of housing finance**[1]



1. Refers to loans approved to individuals for construction or purchase of dwellings for owner occupation.
Source: Australian Bureau of Statistics.

Table 2. **Major trading banks: classification of advances**

	July 1963		July 1973		July 1980		July 1982		July 1984	
	$ million	% of total	$ million	% of total	$ million	% of total	$ million	% of total	$ million	% of total
Business										
1. Agriculture, grazing and dairying	495	22.1	1 051	14.4	2 103	11.7	2 722	12.0	3 250	12.1
2. Manufacturing	435	19.5	970	13.3	2 283	12.7	2 496	11.0	2 368	8.8
3. Transport, storage and communications	32	1.4	126	1.7	313	1.7	401	1.8	438	1.6
4. Finance	113	5.1	575	7.9	960	5.4	1 014	4.5	1 312	4.9
5. Commerce	452	20.2	950	13.0	2 010	11.2	2 177	9.6	2 583	9.6
6. Building and construction	66	3.0	293	4.0	514	2.9	571	2.5	747	2.8
7. Other business	185	8.3	1 365	18.7	2 470	13.8	2 930	12.9	3 319	12.4
8. Unclassified	19	0.8	105	1.4	327	1.8	621	2.7	768	2.9
Total business	1 797	80.4	5 434	74.4	10 979	61.3	13 207	58.3	14 786	55.2
of which: Companies	1 011	45.2	3 531	48.3	6 402	35.8	7 786	34.4	7 625	28.4
Persons	376	16.8	1 723	23.6	6 612	36.9	8 967	39.6	11 475	42.8
Other[1]	63	2.8	148	2.0	315	1.8	467	2.1	545	2.0
Total all borrowers	2 236	100.0	7 306	100.0	17 906	100.0	22 641	100.0	26 805	100.0

1. Includes public authorities, non-profit organisations and non-resident borrowers.
Source: Reserve Bank of Australia, *Occasional Paper 4B* and *Statistical Bulletin.*

remaining below the statutory maximum which still applies to the savings banks. The effects of deregulation have to some extent begun to affect the housing finance sector with relevant financial institutions now offering more flexible loan packages.

Efficiency gains are also expected to be achieved as a result of increased competition leading to the closing of gaps in the risk spectrum. It has often been argued that restrictions on the trading banks and lack of competition has resulted in an over-conservative attitude to risk which has in turn made it difficult for small firms and new projects to obtain finance at reasonable rates. Substantial gaps have sometimes occurred in the rates on advances by trading banks and those of the nearest competitors in this area and the existing banks have lacked the incentive and expertise to expand this type of lending. Loans by trading banks to business as a whole have been declining in importance relative to other activities of the banks (Table 2) although there is evidence that they have maintained their share in the borrowings of major corporations.

In choosing the applicants to receive new banking licences, considerable attention has been given to the type of expertise that the new banks might be able to introduce. A number of new entrants have identified small and medium-size enterprises as a segment of the market that has been inadequately serviced by banks in the past. Given that certain of the new entrants possess particular expertise in this area, it seems likely that improved services will result, providing better prospects for this type of enterprise. The interest rate ceiling on trading bank overdrafts of less than $100 000 was lifted in April this year and this could make the extension of overdraft facilities to small business more attractive. In extending lending activities in this higher risk area, banks will need to make commercial judgements about risk exposure so that their overall activities remain consistent with prudential requirements. Other specialised institutions, set up by the Government for this purpose, have been extensively involved in higher risk investments, at times by means of equity participation. These institutions, including the Australian Industry Development Corporation, management and investment corporations and the Commonwealth Development Bank, are either publicly owned or receive fiscal incentives. With competition from the banking sector increasing, the role of these specialised institutions is likely to come under increasing challenge and any "incentives" they receive to come under increasing scrutiny to assess whether gaps continue to exist which justify public support.

Although efficiency gains are bound to be achieved through the process of deregulation, the size of these gains could be moderate in certain areas. As already discussed, competition has been provided across a wide range of services by non-bank financial intermediaries, placing some limit on lending margins. Often, it has been necessary for the competition to develop in the face of certain obstacles which have led to distortions in the market with some loss of efficiency. The removal of these obstacles will allow competition to be more direct although in those cases where competition is already intense it is not clear how significant the gains would be. The increased competition will come about not only through the entry of new banks but, perhaps more importantly, via the dismantling of interest rate controls, etc. Despite the fact that prudential supervision should be reflected in the type of lending activities characterising banks and other financial institutions, deregulation should result in greatly diminished segmentation of financial markets. Many of the new banks have existing merchant banking facilities in place and can be expected to concentrate on wholesale banking where they already have an established clientele. However, about a third of these already have access to extensive branch networks and are likely to provide competition across a wide range of services. When account is taken of existing non-bank financial intermediaries in the area of personal finance and the insurance and pension funds, the mainstream financial markets should develop in a highly competitive way.

Social goals

The second area of policy which could be influenced by deregulation concerns the social goals set by the Government, particularly the provision of finance for housing, and small business. With regard to the latter, the Government still continues to provide assistance through specialised institutions such as the Commonwealth Development Bank and the Australian Industry Development Corporation, but the last major direct regulatory measure (the interest rate ceiling on loans under $100 000) was removed in April 1985. Housing finance has been dominated by the savings banks and building societies which together account for about three-quarters of loans approved to individuals for owner-occupied dwellings. Both of these groups of institutions have been heavily regulated in the past, either at a state or federal level, with the aim of reducing the cost of housing finance particularly for the less well-off. The use of such direct controls has been criticised by both the Campbell Committee and the Martin Group on the grounds that they have not been achieving the desired goals and that such instruments are inefficient for these purposes. Available evidence points to the fact that persons on less-than-average weekly earnings have been disadvantaged by regulatory measures in two respects:

- By the fact that housing loans from savings banks have been skewed towards higher income groups;
- By the fact that low income earners hold a much larger proportion of their savings in bank accounts earning low interest.

The Campbell Committee recommended that a large number of regulatory measures be removed and that fiscal measures be used instead to achieve certain social policy goals. Since that time, the importance of fiscal measures to aid home buyers has increased substantially with the budget allocation in FY 1984/85 year amounting to about $305 million.

In the deregulated environment, savings banks and building societies will continue to be the principal purveyors of housing finance. Despite the removal of many controls on savings banks, they are still subject to maximum lending rates (interest rate ceilings) and portfolio restrictions which leave a free tranche of only 6 per cent of assets. Similar restrictions also apply to building societies although this varies from state to state. With financial markets as open as those in Australia now are, an attempt to regulate one set of interest rates would appear to run the risk of adding instability to that section of the market which would defeat the purpose of the controls. The interest-rate ceiling for savings banks of 13.5 per cent is currently above the minimum lending rate of the banks by about 1.0 percentage point. If recent upward pressure on interest rates continues, this ceiling could once again become a constraint and rationing of loans could resume. In the longer term, stability in the provision of housing finance appears to require its removal. With the increasing awareness of depositors in recent years, banks and building societies need to be able to offer competitive deposit rates in order to maintain their deposit base. If lending rates are restricted, these institutions would be unwilling to suffer the compression of margins necessary to maintain deposits, the supply of funds would be reduced and rationing of loans would again become important. In this way, the social goals of the government with regard to housing could be endangered.

Operation of monetary policy

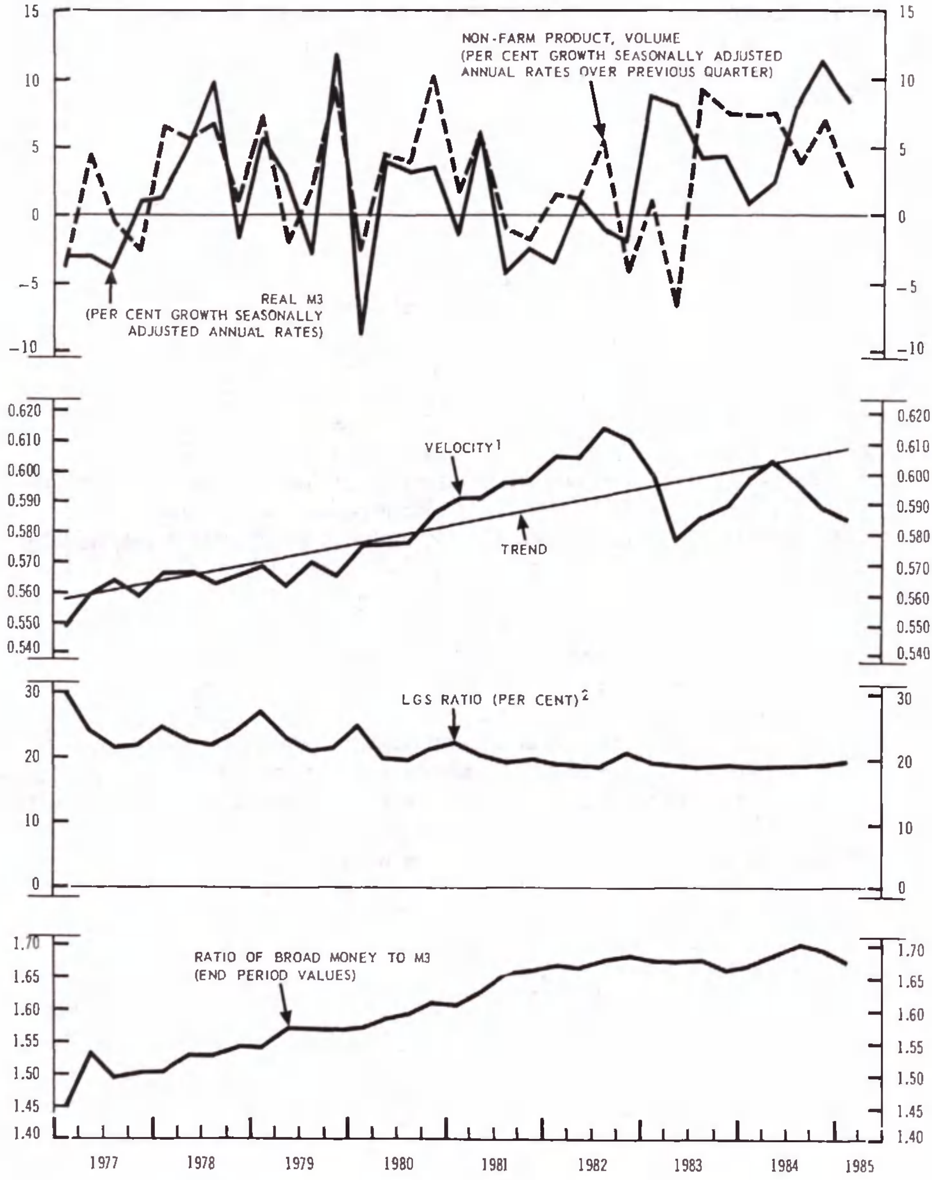
The third, and potentially most important, aspect of deregulation concerns its implications for macro-efficiency in general and for the operations of monetary policy in particular. Until the mid-1970s, the principal instruments of monetary policy tended to be changes in the SRD ratio (statutory deposits of banks with the Reserve Bank) and informal controls on the level of bank lending. Open market operations were relatively limited, partly reflecting the narrowness of the market which was, in turn, the result of extensive regulation. However, since the mid-1970s, open market operations have become increasingly important, so much so that this now represents the principal instrument of monetary policy. Although the SRD ratio still exists, it has not been changed since 1981 and is no longer regarded as an instrument of monetary policy. The prime assets requirement which recently replaced the LGS convention now includes 3 percentage points of the SRD ratio. Informal controls on bank lending were terminated in June 1982. However, as the orientation of monetary policy shifted more towards open market operations, financial regulation came increasingly to hinder rather than assist the effective operation of monetary policy.

The ultimate policy goal of monetary policy in Australia has always been non-inflationary growth. Since 1976, the major intermediate goal has been the rate of growth of M3 and this has been announced in advance as a "conditional projection" of the range for the growth of M3. What has changed, however, during the past ten years, is the perception of how monetary management works in the Australian environment and how the growth of M3 can be best controlled. As discussed earlier, monetary growth used to be controlled through influencing bank lending by a variety of means which affected the free liquidity of banks. The principal policy measures included the SRD/LGS framework, controls over bank deposit rates, quantitative lending guidance and open market operations. With the deregulation that has occurred and with the increasing sophistication of the financial markets, the principal policy instrument is open market operations. The Reserve Bank now attempts to control the liquidity of the overall financial system, thereby influencing interest rates, lending and monetary growth, in a way which does not discriminate against banks.

The approach to monetary policy has traditionally been based on money formation analysis. Essentially this involved looking at changes in the components of some monetary aggregate, typically M3, either to assess the implications of a particular policy mix or in order to forecast changes in M3. An example of such an analysis is summarised in Table 3. Under the exchange rate system that existed at the time (a moveable peg rate), the contribution of foreign exchange transactions was often large, unpredictable and difficult to control, thereby reducing the ability of the Reserve Bank to control the rate of growth of the money supply. Partly for this reason, the intermediate monetary target was not achieved in any year between fiscal years 1977/78 and 1982/83. Given a particular budget deficit, the major focus of monetary officials tended to be on controlling bank lending either by the sale of bonds to the non-bank sector to reduce the cash base of the banks or by use of the instruments discussed earlier (SRD ratios and direct controls on lending). With interest rates pegged, the costs of monetary policy fell disproportionately on the banks, while the non-bank financial intermediaries were often able to expand their lending by raising interest rates to attract higher deposits and to increase their share of particular markets. Thus, not only did a tightening of monetary policy impact predominantly on banks and bank lending but it could also be offset at least partly by increased lending activity, albeit at higher interest rates, by non-bank financial intermediaries. Monetary targeting was also made difficult by apparently unpredictable chages in M3 velocity, while the impact of specific monetary changes became difficult to determine as the ratio of M3 to broad money tended to decrease with the increasing importance of non-bank financial intermediaries (broad money is defined as M3 plus deposit liabilities to the non-financial private sector of non-bank financial institutions, including cash management trusts) [Diagram 2].

The changes which have been recently introduced, including floating of the exchange rate, have created an environment in which monetary policy can be more market oriented in its operations. Foreign transactions now cannot contribute to changes in the money supply except

Diagram 2. **Monetary indicators**



1. Velocity is defined as Non-farm GDP/M3 using seasonally adjusted data.
2. Major trading banks.

Sources: Australian Bureau of Statistics; Reserve Bank of Australia, *Bulletins*.

through interventions in the foreign exchange market by the Reserve Bank, thereby removing a major element of uncertainty in trying to control the money base (i.e. holdings of notes and coins by the private sector, plus deposits of banks with the Reserve Bank and Reserve Bank liabilities to the non-bank private sector). Lending both by banks and by non-bank intermediaries can now be influenced more clearly through the use of open-market operations and the impact of this on the liquidity of the financial system. Although the authorities are now in a better position to control cash conditions they do not attempt to control directly the growth in the money base as the nature and magnitude of the links between the money base and the major aggregates are not sufficiently clear, at least at this stage.

Financial markets are, however, undergoing a period of major adjustment, largely the result of deregulation. This process is likely to continue for several years as both existing and new banks compete on a stronger basis than before with other financial intermediaries. During this adjustment period, many of the established relationships have become blurred as a result of increased financial intermediation and disintermediation. In particular, the velocity of circulation appears to have contracted more sharply than had been anticipated. As a result, the Government has found it necessary to suspend the conditional projection for M3 growth for the 1984/85 financial year (see disussion of current financial conditions below). During this adjustment phase, it is the intention that monetary policy remain non-accommodating. In an environment where interpretation of individual monetary indicators is difficult, the authorities are monitoring a wide range of information. The market itself is paying increased attention to cash rates (i.e. the overnight rate in the official short-term money market) in assessing the stance of policy and this rate is being carefully monitored and influenced by the day-to-day operations of the Reserve Bank. These problems are of a transitory nature but they do appear to be creating some uncertainty in the market regarding the future course of both interest rates and the exchange rate. Part of this is the result of a learning process for participants in the markets as financial intermediaries become more sensitive to market changes. Part may be due to some uncertainty about the stance of policy following the suspension of the M3 projection, although interest rate movements since that time suggest that financial conditions have firmed and that this firming has been at least partly the result of tighter monetary policy.

Remaining problems

Despite extensive deregulation that has already occurred, some problem areas do remain. The first of these relates to continuing controls on lending rates for owner-occupied housing loans of under $100 000. The problems that could arise from declining competitiveness of savings banks and building societies if these ceilings continue have already been discussed. With recent rises in interest rates, these ceilings could once again become constraints which could inject some instability into certain areas of financial markets. There appears to be no sound economic or social reasons for maintaining these controls. Secondly, Australian financial markets are characterised by marked seasonal swings in liquidity. This is partly due to the seasonal pattern of private expenditure but a more important factor is the timing of provisional and corporate income tax payments which are concentrated in April and May. Following the floating of the exchange rate and the removal of interest rate controls, the authorities are now in a better position to handle this problem. Nevertheless, the problem persisted in 1984 and 1985 reflecting both a learning process for the market and some particular problems in 1985 relating to above-average tax payments falling due in the early part of the year, industrial disputation involving civil servants, depreciation of the exchange rate and a simultaneous tightening of monetary policy. Considering the resources that institutions need to devote to seasonal liquidity management and the uncertainty that tends to exist in financial markets at this time, some efficiency gains would appear possible through measures aimed at smoothing out seasonal liquidity swings, particularly by spreading the collection of income taxes more evenly over the year.

The final area of reform which is currently under active consideration concerns prudential supervision. The Reserve Bank presently monitors the activities of all banks whose operations come under the Banking Act. In developing and implementing prudential requirements, the Reserve Bank has developed a close relationship with individual banks. It has recently published an outline of the framework of prudential supervision, including details of its tests of capital adequacy, liquidity requirements, approaches to risk exposure and to associations with non-banks. It has also recently announced the termination of the LGS Convention and its replacement by the Prime Assets Ratio for the maintenance of trading bank liquidity. (The LGS/SRD arrangements had in fact become more of a prudential control in recent years, losing much of their function as an instrument of monetary policy.) The SRD ratio is, however, being maintained, although a proportion of the funds held in this form will be counted as prime assets. Given that these deposits no longer have a monetary policy function, their continued use (at less than market rates) would appear to reflect a type of tax impost on trading banks.

Questions of prudential control are important because they bear both on the attractiveness of banks to depositors and on the profitability of banks. Very tight supervision would virtually establish the banks as risk-free and hence enable them to borrow domestically at significantly lower rates than non-banks. At the same time, the banks would be severely limited in their risk exposure which would restrain their lending in areas such as small business and new ventures and would bear on profitability. Supervision that was too tight might limit the efficiency gains that are potentially available from deregulation with little additional benefit in terms of depositor protection.

III. MACROECONOMIC POLICIES

Monetary policy in a deregulated environment

Monetary policy and monetary developments must be seen against the background of the important changes in the financial system described above. On the one hand, the floating of the exchange rate in December 1983 made the task of monetary management easier by potentially cutting off money supply increases emanating from capital inflows from abroad. But on the other hand, the deregulation of the banking sector has made the interpretation of intermediate targets and the assessment of underlying financial conditions more difficult. This has also been complicated by a sharp fall in the Australian dollar in the first few months of 1985, accompanied by upward movements in both short and long-term interest rates.

During the fiscal year 1983/84, the conditional projection of M3 over the twelve months to the June quarter was originally set at 9 to 11 per cent but this was revised upwards to 10 to 12 per cent in December 1983 in the light of more rapid economic growth. In the event, this revised range was achieved and a conditional projection of 8 to 10 per cent was set for FY 1984/85. However, given the uncertainties surrounding the impact of deregulation of the financial sector and the freeing of the exchange rate on M3 growth, the projection was to be

Table 3. **Liquidity and monetary aggregates**

$ million[1]

	1982-83 Year	1983-84 Year	1983-84 I	1983-84 II	1984-85 I
Budget deficit	4 473	7 961	7 880	82	7 822
Foreign exchange transactions[2]	1 875	1 338	2 595	–1 259	–818
Other[3]	–147	487	–346	833	–848
Change in private sector LGS/SRD	6 201	9 786	10 129	–343	6 156
Less net sales of CGS to private sector[4]	5 682	8 705	8 977	–272	4 557
Other[5]	–54	9	44	–35	–308
Change in money base[6]	465	1 090	1 196	–105	1 291
Purchases of CGS by banks	1 515	1 668	2 236	–567	684
Change in bank advances	5 329	5 781	3 116	2 666	4 996
Other[7]	411	–1 076	–1 202	126	–268
Change in volume of money (M3)	7 720	7 463	5 346	2 117	6 703
Purchases of CGS by NBFIs[8]	296	685	868	–104	753
Change in NBFI advances	3 784	6 203	2 188	4 016	5 600
Other[9]	–111	–1 147	–356	–871	–1 073
Change in broad money[10]	11 689	13 204	8 046	5 158	11 983
Net sales of CGS to private sector comprising:					
Banks	1 515	1 668	2 236	–567	684
NBFIs	296	685	868	–104	753
Other[11]	3 871	6 352	5 873	399	3 120
Change in money base *of which:*					
Currency held by private sector	548	981	981	0	1 123
Deposits of the private sector with the RBA	–84	110	215	–105	169
Actual rate of growth of M3	12.5	10.8	16.0	5.7	18.2
Projected target growth	(9-11)	(10-12)			
Actual rate of growth of broad money	11.4	11.4	14.3	8.5	19.4

1. First five rows of the table are on a last day basis; private LGS/SRD and CGS (excluding IEDs) are measured on a face value basis. Remaining figures are on a montly average basis.
2. Foreign exchange transactions are defined as change in gold and foreign exchange reserves less valuation effects less net overseas raisings by the Commonwealth.
3. Includes miscellaneous accounts of the private sector with the Reserve Bank and miscellaneous factors nec.
4. "Private" is defined to exclude the Reserve Bank, Commonwealth Trust Funds and State Government.
5. Timing discrepancy reflecting the difference between the money base measured on a last-day basis and on a weekly average basis.
6. Money base is defined as the private sector's holdings of notes and coin plus deposits of the private sector with the Reserve Bank (including SRD accounts).
7. Other net assets of banks (excluding SRD accounts and other accounts with the Reserve Bank).
8. Defined as currency of the non-bank private sector plus bank deposits of the non-bank private sector.
9. Other net assets (excluding notes and coin) of non-bank financial intermediaries and cash management trusts.
10. The non-financial intermediary public's holdings of currency and depostits with financial institutions (including trading and savings banks, and registered financial corporations excluding "intra-group financiers" and "other financial corporations"). Cash management trusts are icluded from January 1983.
11. Includes timing discrepancy since the total is on a last-day basis.

Source: The Treasury.

kept under close review and a wide range of financial indicators were to be interpreted. During the twelve months to December 1984 M3 grew more than anticipated, at about 12 per cent. Over the same period, broad money grew even faster than M3 (Diagram 2), probably reflecting a shift away from direct financing but also some double counting as a result of transactions between non-bank financial intermediaries. Despite the acceleration in monetary aggregates, interest rates tended to rise. Although monetary indicators were conflicting, it was

Table 4. **Average LGS ratio of major trading banks**

	1977-78 to 1980-81 (Average)	1981-82 to 1983-84 (Average)
September quarter	20.9	18.9
December quarter	22.1	19.8
March quarter	24.6	19.0
June quarter	21.5	18.9
Annual average	22.3	19.2

Source: Treasury submission.

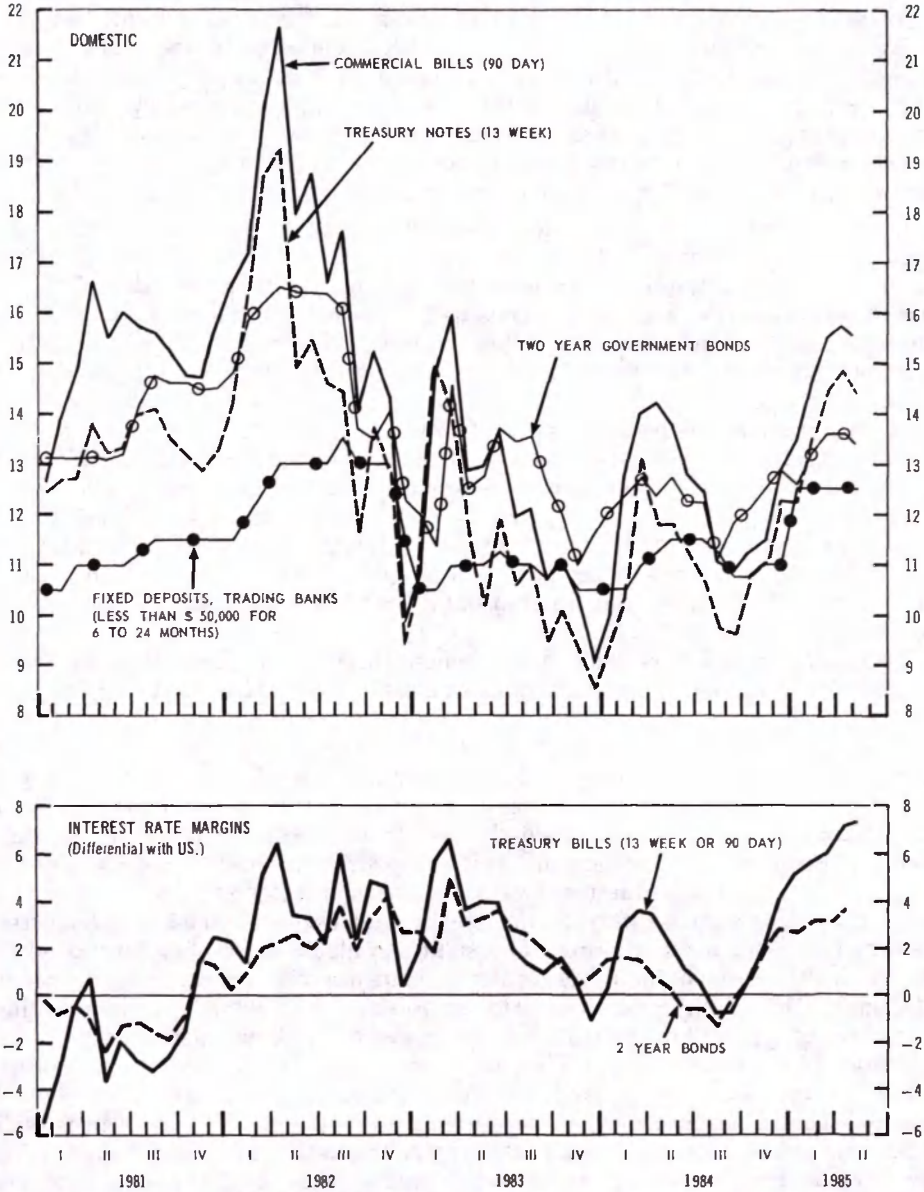
the authorities view that underlying financial conditions were tightening as the calendar year progressed and into 1985, particularly in the light of the continued deceleration in inflation and possibly inflationary expectations, and the appreciation of the exchange rate on a trade-weighted basis that occurred in the second half of 1984. On the basis that M3 no longer gave an adequate reflection of conditions in financial markets and that a curtailment of monetary growth to within the guidelines would have provoked an unwarranted and undesirable further rise in interest rates, the monetary projection was suspended in January 1985.

The growth pattern of M3 is likely to be affected also in the future by financial deregulation and by changes in operating procedures of monetary policy. A notable response to these developments has been more careful liability management by the banks, reflecting the much greater access they now have to wholesale funds. This has enabled the banks to trim the margin of free LGS reserves and to minimise the seasonal pattern (Table 4). What is now important is the liquidity of the financial sector as a whole rather than the liquidity of the banks themselves. Provided the financial sector as a whole holds sufficient maturing LGS, banks can bid for cash as taxes are paid, although this will not necessarily overcome the problem of significant seasonal rises in interest rates. The increased importance of liability management has two major policy implications. In the first place, it requires careful monitoring of the cash base by the Reserve Bank in order to influence the overall liquidity of the system and to smooth the flow of funds over the course of the year. Secondly, with the rationing element of bank lending no longer important, policy-induced changes in M3 growth now depend much more than previously on the interest rate sensitivity of lending. This may imply that greater changes in interest rates will be necessary in order to achieve a given change in monetary growth. It will take the authorities some time to fully explore the implications of these changes and during this transition period, significant fluctuations in interest rates and in the growth of monetary aggregates could be observed.

Interest rates have fluctuated considerably, particularly at the short end of the market. The usual seasonal tightening of liquidity in the first half of 1984 resulted in a sharp rise in short-term rates with the rate on 90-day bank bills increasing by about 5 percentage points in the first four months of the year (Diagram 3). This rise was not high in historical terms and indicated that financial markets were able to finance the seasonal tax payments without major difficulties even though the floating of the exchange rate had effectively cut off the option for the market as a whole of borrowing from abroad to meet taxation liabilities. However, as domestic rates rose, the interest rate differential made foreign borrowing more favourable which then contributed to a seasonal firming of the exchange rate, a feature that could become characteristic of the foreign exchange market. While the upward movement in rates was less marked than usual, it was sustained over a longer period. Short-term rates did fall significantly in the middle of the year. While money market call rates remained broadly stable

Diagram 3. **Interest rates and margins**

Per cent



Sources: Reserve Bank of Australia *Bulletins;* ABS; OECD.

at around 11 per cent, other short-term rates began to rise again about September, well in advance of the usual seasonal rise and at the same time as the money supply was growing more strongly than had been anticipated. Although it is possible that the behaviour of short-term rates in the second half of 1984 in part resulted from a belief in the market that rates would fall, which subsequently proved unfounded, it is clear that some firming of rates began in the last few months of the year and that this has been reinforced by the seasonal liquidity run-down and the decline in the Australian dollar. Call rates, which have assumed an important role in the market as a barometer of the stance of monetary policy, remained fairly stable until January but moved up sharply to around 15 per cent as monetary policy tightened. The rate on 90-day bank bills rose above 16 per cent in April while that on 2-year Treasury bonds rose by more than 2 percentage points in the six months to the end of March 1985.

In interpreting recent monetary developments, it is also important to note corresponding exchange rate movements. Following the floating of the currency in December 1983, the dollar first rose on a trade weighted basis but then fell slightly during the middle of the year. It began to move upwards again in the second half of the year, with interest rate differentials being sufficient to attract the capital inflow necessary to cover a growing current account deficit. The dollar weakened slightly at the turn of the year before falling sharply in February and March 1985. By the end of March, the trade-weighted exchange rate index had fallen by 17.1 per cent from its high point at the end of November with a slightly greater (18 per cent) drop in the Australian dollar *vis-à-vis* the U.S. dollar. Although a decline in the Australian dollar would appear justified on competitiveness grounds, the timing and magnitude of the change surprised the market. With the current account deficit expanding rapidly, a coincidence of economic, industrial and political events apparently gave rise to a sharp change in market sentiment which saw the dollar fall steeply over the course of about a week. As interest rates firmed, the fall was arrested but a further downturn was experienced in late March.

There are several factors which make recent financial developments difficult to interpret. First, following financial deregulation, reintermediation would generally be expected to lead to faster growth of more narrowly defined monetary aggregates than broad money. Under these circumstances, a faster growth of M3 than anticipated would not be abnormal. However, the more rapid growth of broad money suggests that this may not be the whole story. As mentioned, there has been some double counting within the deposits of non-bank financial intermediaries which may have raised the growth rate of broad money in the June to December period by ½ percentage point. It is also possible that part of this growth in broad money may reflect reintermediation towards the financial sector as a whole and away from other forms of financing e.g. equity, commercial bills, inter-company lending, direct corporate borrowing from abroad, etc. However, little data is available to establish this proposition. A second difficulty surrounds the seasonal pattern of liquidity since the beginning of 1984. With the freeing of the exchange rate, recourse to borrowing short-term funds overseas to adjust for periodic loss of liquidity in the system has effectively been eliminated (in the absence of intervention by the Reserve Bank). Thus, the financial system must now be more sensitive to short-term fluctuations in demand for funds. Liquidity fluctuations may have been compounded in the current year by changes in the seasonal pattern of government expenditure and receipts and also some industrial action by public sector unions which interrupted the collection of taxation revenue. Improved liability management by the banks and more active short-term liquidity management by the Reserve Bank should now permit a smoothing in the seasonal fluctuations, and short-term interest rates which rose sharply in the first half of 1985, may now give a better indication of the policy intentions of the Reserve Bank.

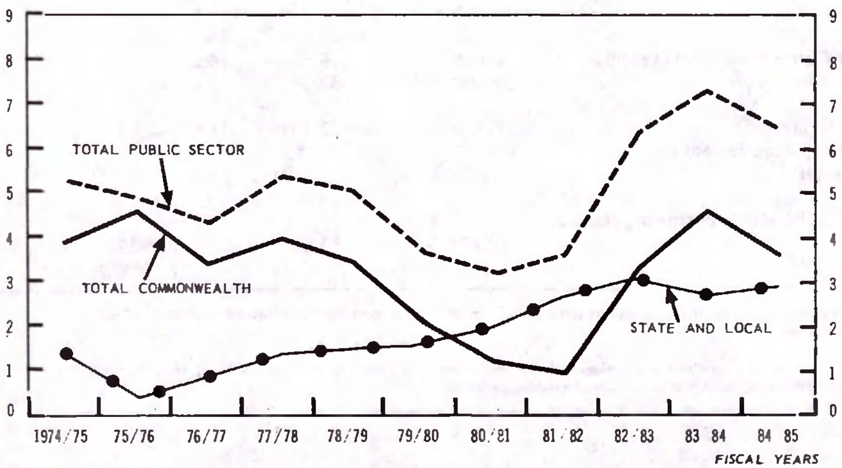
Despite difficulties in interpreting the various indicators, it would appear that in retrospect monetary policy was easier than desirable in the second half of 1984. The shift towards bank financing from other financial institutions (reintermediation) subsequent to financial market deregulation can explain a large part but not all of the strength of the monetary aggregates. And although some short-term interest rates rose towards the end of 1984, money market rates remained broadly unchanged through the second half of the year and into early 1985[9]. But since then monetary policy has firmed substantially. Money market rates have now risen from 11 per cent to around 15 per cent. This has signalled to the market the authorities' intention to maintain a non-accommodating policy and has probably helped ease the pressure on the exchange rate. The Government indicated in May that it will maintain a firmer stance of policy as long as it is required. With the Australian dollar now showing signs of stabilising, it will be necessary for monetary policy to remain firm in order to maintain confidence in the currency and to avoid fluctuations related more to speculative factors rather than fundamental weaknesses. High interest rates by themselves are not a long-term solution to the imbalances which are reflected in the large current account deficit, but they may be necessary in the short run until depreciation and more restrictive fiscal policy bring about the necessary fundamental changes.

Fiscal policy

During the period from FY 1974/75 to FY 1981/82 there was a fall in the public sector financing requirement, cutbacks by the Commonwealth Government being only partly offset by a steady rise at the state and local level (Diagram 4). In the subsequent period, expansionary measures raised the financing requirement of the Commonwealth Government (budget and off-budget) by 2.0 percentage points of GDP to 3.2 per cent in FY 1982/83. The state and local financing requirement also continued to grow over the same period, particularly for public enterprises. The total public sector borrowing requirement rose by 3.3 percentage points to 6.3 per cent of GDP from FY 1981/82 to FY 1982/83[10] (Diagram 4)). The FY 1983/84 budget was broadly expansionary but the Government considered

Diagram 4. **Public sector net borrowing requirements**

Per cent of GDP, fiscal years



Sources: Australian Bureau of Statistics, *Government financial estimates, Australia, 1984-85* (ABS Cat n° 5501.1) and Treasury estimates.

Table 5. **Budget transactions**[1]

$ million

	1982/83	1983/84			1984/85		
	Actual	Budget estimate	Actual	Percentage change	Budget estimate	Percentage change	Contribution to increase (%)
1. Commonwealth							
Receipts							
Income tax companies	5 107	4 827	4 940	–3.3	5 951	20.5	11.8
Individuals	22 967	24 773	24 710	7.6	30 388	23.0	66.0
Indirect taxes	12 760	14 581	14 848	16.4	16 121	8.6	14.8
Other receipts	3 628	4 161	4 112	11.9	4 743	15.3	7.3
Total receipts	44 462	48 342	48 610	9.3	57 203	17.7	100.0
Outlays							
Net expenditure on goods and services							
Defence	4 432	4 891	4 989	12.6	5 384	7.9	5.4
Other current	5 359	6 455	6 345	18.4	7 403	16.7	14.4
Capital	598	677	580	–3.0	840	44.8	3.5
Transfer payments and net transactions							
To States and local government	16 419	18 710	18 754	14.3	20 415	8.9	22.6
Personal benefit payments	16 233	19 366	19 033	17.2	21 669	13.8	35.8
Other	5 894	6 604	6 869	16.5	8 237	19.9	18.6
Total outlays	48 935	56 703	56 570	15.6	63 948	13.0	100.0
Budget deficit	–4 473	–8 361	–7 961		–6 745		
(% GDP)	(2.7)		(4.2)		(3.3)		
Off-budget deficit[2]	–892	–676	–739		–599		
Total borrowing requirement	–5 365	–9 037	–8 700		–7 344		
(% GDP)	(3.2)		(4.6)		(3.6)		
2. State and local (total)[3]							
Receipts							
From own sources:							
Taxation	10 846		11 986	10.5	13 207	10.2	30.0
Other	6 135		7 039	14.7	8 232	16.9	29.3
Net Commonwealth payments	16 418		18 754	14.2	20 414	8.9	40.7
Total receipts	33 400		37 779	13.1	41 853	10.8	100.0
Total outlays	38 471		42 749	11.1	47 850	11.9	
Borrowing requirement (net)	–5 071		–4 969		–5 997		
(% GDP)	(3.1)		(2.7)		(2.9)		
3. Total public sector borrowing requirement	–10 436		13 669		13 341		
(% GDP)	(6.3)		(7.3)		(6.5)		

1. The Commonwealth Budget distinguishes between a budget and off-budget sector, the latter broadly including the public enterprise sector (public authorities).
2. Public authorities.
3. Includes known sale and leaseback transactions with the private sector and expenditures of the Portland Trust (in 1984-85).

Source: Budget Statement, No. 6 and submission of national authorities.

it necessary to take into account the sharp rise in the deficit in the preceding fiscal year (Table 5). The Government consequently adopted a number of measures aimed at holding back the deficit but also attempted to stimulate the economy through new expenditure programmes[11]. The major increases in expenditure were related to the introduction of Medicare[12], a higher number of social insurance beneficiaries and increased benefits per beneficiary. Slower growth of tax revenues in relation to GDP was mainly due to the full-year effects of tax concessions in the preceding fiscal year and the lagged effects of depressed profits on taxes. Despite some reduction in the borrowing requirement at the state and local level, the public sector borrowing requirement rose by an additional $3.2 billion (1 per cent of GDP) to $13.7 billion or 7.3 per cent of GDP.

The preparation of the FY 1984/85 Commonwealth Budget was assisted by a cumulation of positive revenue effects. Approximately two-thirds of the expected increase in total revenues comes from a 23 per cent projected rise in personal income taxes reflecting the full-year effects of Medicare (introduced in the previous fiscal year), the Prescribed Payments System[13] and no indexation of tax bands. Other major factors include the sharp rise in farm incomes after the end of the drought, higher property incomes as profits rose and higher employment and wage increases[14]. Personal income tax revenues would have been even higher (28 per cent) but for considerable tax reliefs which were seen as both an expansionary measure and as part of the Government's commitments under the Accord. The sharp increase in profits – associated with sound productivity growth in the face of stable labour costs – which had occurred over the preceding fiscal year led to a projected 20.5 per cent growth in corporate profits tax[15]. The rapid rise in imports boosted import duties as well. Other indirect taxes grew more slowly even though there were some excise tax increases[16]. In all, total revenues were estimated at the time of the Budget to increase by 17.7 per cent (or $8 593 billion). In the absence of policy changes, the increase would have been around 20 per cent.

Commonwealth Budget expenditures are projected to rise by 13 per cent, a somewhat lower rate than in the preceding years. A substantial part of this increase relates to personal transfer benefits, payments to the state and local governments, interest on the public debt and government wages and salaries. A large part of the personal transfer benefit increase reflects the introduction of Medicare. But in addition, there were increases in real rates of benefits for pensioners, the unemployed, those on supplementary assistance and child allowances. Other current expenditure has also risen again partly reflecting increased administrative support for the Medicare system as well as an increase in employment in a number of other sectors.

With the rapid growth in revenues, there is an expected fall in the Commonwealth Budget deficit of $1.2 billion (¾ of a per cent of GDP) to $6¾ billion and on the basis of the mid-year Budget review this is likely to be met. A slight fall in off-budget expenditures should further augment this decline. At the state and local government level, the increase in outlays is expected to remain roughly unchanged. However, slower growth in net Commonwealth payments will lead to a more sluggish rise in revenue and the deficit is estimated to widen by roughly $1 billion. Thus the total public sector borrowing requirement is expected to fall to around $13⅓ billion or 6.5 per cent of GDP. On a national accounts basis – which excludes the public enterprise sector – the decline in the deficit (net lending of general government) could be of roughly the same magnitude. The separation of the cyclical and structural components of the movement in the deficit is open to wide margins of error. Nonetheless, the cyclical decline in the deficit would have been more than 1 percentage point. Consequently, the net budgetary position in FY 1984/85 is mildly expansionary and would have been contractionary in the absence of the announced policy measures.

A major review of the current tax system is now under way. Pressures for reform have increased in recent years. The personal tax system allows a large number of exemptions for certain types of income which have reduced the tax base[17]. To the extent that those with higher income have been best able to profit from these, the system has become less progressive. More importantly, fiscal drag has raised marginal tax rates so much that maximum marginal rates of 60 per cent already apply to those receiving above 1.6 times average earnings[18]. These problems have often been linked in public debate to proposals for the introduction of a broadly based consumption tax. While it is argued that this would make the tax system less progressive, it is also claimed that this would permit some of the income excluded from the personal tax base to be taxed as it is spent. This argument is reinforced by the fact that the share of broadly based indirect taxes in total taxes is relatively small by international comparison, although this is compensated by a relatively large amount of narrowly based taxes on alcohol, tobacco, petroleum products and motor vehicles and spare parts at high rates. It is widely recognised that the resulting tax structure is inequitable both across groups earning the same income and across different income groups, and introduces major distortions into the economy.

Within this context, the Government called for a taxation summit to achieve a broad consensus for reform of the tax system and laid down a number of guidelines[19]. More recently in a White Paper[20], the Government has proposed three possible approaches to tax reform with illustrative estimates regarding their form and likely revenue effect. In the first approach, only the income tax base would be broadened and the added revenues used to reduce marginal tax rates. The most important elements (in order of their likely revenue effects) are the taxation of fringe benefits (both cash and in kind)[21], a national identification scheme to improve reporting of other revenue, a capital gains tax[22], limitation of interest deductibility or losses on certain assets to the revenue they produce (negative gearing and primary producer losses) and a tax on income from gold mining[23]. These measures are estimated to increase Commonwealth revenues by roughly $3 billion per year after four to five years (or around 5 per cent of estimated Commonwealth revenues in FY 1984/85). Consistent with the Government's overriding objective, this revenue would be largely devoted to lowering the marginal tax rates facing middle-income earners. But the reductions in marginal rates would be quite modest, particularly at lower levels. To obtain supplementary revenue which would permit further reductions in marginal tax rates, a second approach proposes, in addition, the introduction of a broadly-based consumption tax (retail sales tax on both goods and services) at a rate of say 5 per cent with the existing wholesale tax rate reduced to 10 per cent on a narrower range of goods. This would raise an additional $1.5 billion in revenue after allowing for compensation for lower income groups ($0.5 billion) for an estimated consequent 1.5 per cent rise in consumer prices. However, as the additional revenue earned under this approach is limited, the Government views more favourably the elimination of the current wholesale tax system and its replacement by a retail sales tax at a relatively high rate of, say, 12½ per cent. This third alternative would have an estimated net revenue effect (after compensating needy income groups[24] for an estimated rise in the CPI of 6.5 per cent) of $6.8 billion (12 per cent of estimated Commonwealth 1984/85 revenues) which, when combined with the revenue from the widening in the tax base, could permit an increase in the basic income tax exemption by one-third and a reduction in the marginal rates by 5 to 11 percentage points depending on the income band[25].

Although the exact form of the final proposal will be known only after consultation and discussion, it would appear that the third alternative has several attractive features. First, the reduction of the marginal income tax rates and the closing of certain tax loopholes will make the tax system more horizontally equitable, reduce the incentive for tax evasion and avoidance and reduce the disincentive effects on labour supply, particularly where income-related transfers to individual households fall sharply as non-transfer incomes rise (poverty trap). Second, the introduction of a retail sales tax, combined with the abolition of the current wholesale sales tax would reduce the resource allocation distortions created by differential indirect tax rates. Finally, the closing of certain tax loopholes and the fact that lower income groups may be more than compensated for the impact of tax-related price increases should maintain and possibly enhance the progressivity of the tax-transfer system[26]. But the Government is seeking a commitment from the unions that direct tax relief would be taken as compensation for the indirect tax-related price increases. It is not clear that the Government would proceed with the reform entailing the introduction of a broadly based retail sales tax at a high rate if no agreement on this can be reached.

Although the FY 1985/86 Commonwealth Budget will not be introduced until August, the thrust of fiscal policy is already becoming evident. During the 1984 election campaign the Government gave an undertaking that, if returned, it would contain the budget aggregates during its three-year term as follows:

- outlays would not grow as a proportion of GDP;
- taxation receipts would not grow as a proportion of GDP; and
- the Commonwealth Government deficit would not increase as a proportion of GDP.

This commitment, the so-called Trilogy, has since been reaffirmed and forms the basis of the 1985-86 budgetary strategy. Further, the Government announced that the Commonwealth deficit for FY 1985/86 would be reduced in money terms from the FY 1984/85 level. The Government announced expenditure cuts in May amounting to $1 259 million from the forward estimates of the Commonwealth budget outlays for the 1985/86 fiscal year. The major part of these cuts apply to recurrent items rather than capital expenditure. The expectation is that the Government will aim for a deficit of below $6 000 million (an estimated 2.6 per cent of GDP), compared with a budgeted deficit for FY 1984/85 of $6 750 million (3.3 per cent of GDP). At this stage, it is too early to be precise about the likely outcome for the rest of the public sector. Commonwealth general revenue grants to the State governments are to be held constant in real terms in FY 1985/86 with an agreed real increase of 2 per cent in the succeeding two years. The global limits on State semi-government authority borrowings[27] will be 3.6 per cent lower in money terms in FY 1985/86 than comparable borrowings in FY 1984/85. Borrowings at the state and local level increased rapidly in the early 1980s, partly to provide infrastructure, particularly power stations, in support of developments in the resources sector. With this cycle nearing an end, some significant easing in the net borrowing requirement could be seen over the coming years.

The discipline imposed by the Trilogy is severe if a substantial reduction in the Commonwealth budget deficit to, say, below $6 000 million is to be achieved. With taxation revenue growth constrained, expenditure will need to grow about 2 percentage points slower than GDP. As private sector demand appears to be growing strongly in early 1985, this type of constraint is clearly necessary. The net savings of the private sector in FY 1985/86 is likely to be significantly lower than in FY 1984/85. A reduction in the public sector borrowing requirement to below 6 per cent of GDP (currently 6.5 per cent), would ease pressures on financial markets, prevent crowding out of the private sector and a further deterioration in the current balance and help restore confidence in the currency. By reducing the rate of growth of the stock of public debt, it would also begin to have an impact on the debt servicing requirement which has been one of the most rapidly growing components of current outlays.

IV. WAGES, PRICES AND INCOMES POLICY

Wages and prices

The recent period of wage restraint had its origins in the very rapid increase in labour costs during 1982. The centralised wage determination system broke down in 1981 when the Arbitration Commission abandoned national increases in award wages because it felt that there was no longer an adequate commitment by the participants in the system for it to continue to operate. Wage determination reverted to a case-by-case basis and, in the face of extensive industrial disruption, several key unions negotiated agreements for substantial wage increases and reductions in standard working hours which were later ratified by the Commission. With the usual flow-on procedures characteristic of the Australian wage-fixing system, these increases were reflected in rises for other awards during 1982. As a result, average weekly award wage rates (centered on the mid-point of the period) grew at an annual rate of about 17 and 12 per cent in the first and second halves of 1982 respectively (Table 6)[28]. Average earnings (including overtime) for full-time adult employees grew at a similar rate over the first half of 1982 and at a faster rate (around 14 per cent) in the second half. Corporate profitability fell as the growth of real unit labour costs accelerated and this fall was accentuated as the economy had entered a recession.

In this environment, the previous Government successfully argued before the Arbitration Commission for the introduction of a wages pause at the end of 1982. All State tribunals also adopted a wages pause. With the change of Government in March 1983, this was replaced in the second half of the year by the present wage fixation principles under which wages are effectively indexed semi-annually according to movements in the consumer price index in the preceding six month-period[29]. Under the wage-fixing principles, the rate of increase of award wage rates has moderated considerably. This has been aided by the fact that movements in the consumer price index, particularly in the first half of 1984, were affected by a switch from private to partly publicly-financed health care. As a result, this index actually fell in the first two quarters of the year and the indexation hearing scheduled for October 1984 was not held. Thus, these rates were not adjusted for twelve months after April 1984 and there was virtually no change in average award rates over this period.

Recent movements in average earnings are more difficult to interpret, but they do suggest that some wagedrift has been occurring. On a survey basis, average weekly earnings per employee increased much more rapidly than award rates during 1983 and the first half of 1984. Some of the difference could be accounted for by compositional changes as the most rapid gains in employment appear to have been in those areas where the level of earnings is above average, but a substantial gap remains to be explained. Some concern has been expressed about the reliability of this series and it is likely that average non-farm earnings on a national accounts basis provides a better indication of recent trends. On the basis of this series, average earnings grew more rapidly than award wage rates in the two years to the end of 1984 although the difference amounted to only about ½ percentage point a year on average. However, in the second half of 1984, earnings grew at an annual rate of 8.2 per cent compared with 4.3 per cent for wage rates. The most recently available data suggest that no further wagedrift occurred in the first quarter of 1985. There is little or no evidence that over-award increases are being granted and it is more likely that the drift is the result of agreements within firms, such as the reclassification of employees, which have the effect of increasing average earnings. In the absence of other evidence of wagedrift, it is too early to point to this as a failure of the Accord. It is, however, a disturbing development and one which will need to be carefully monitored.

Table 6. **Recent trends in prices and costs**

Percentage change from previous period, annual rates

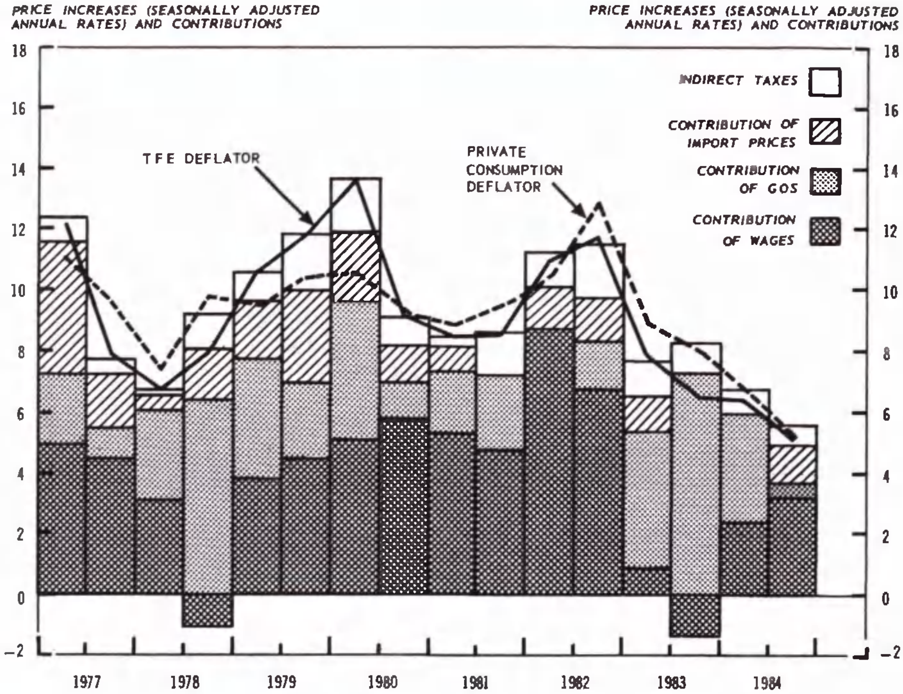
	1980		1981		1982		1983		1984		1985
	I	II	I	II	I	II	I	II	I	II	QI
National accounts deflators[1]											
Private consumption	10.6	9.3	8.8	9.5	10.4	12.8	8.9	8.0	6.8	5.2	6.2
Final domestic demand	11.4	10.3	9.2	10.3	12.4	12.6	9.8	6.7	6.8	5.4	5.9
GDP	13.4	9.4	9.1	10.1	11.5	12.0	7.6	7.3	7.9	4.9	11.3
Exports of goods and services	19.2	4.0	6.0	–1.2	2.6	7.5	10.8	7.5	–2.6	8.2	8.1
Imports of goods and services	15.4	7.4	5.2	0.5	8.8	8.9	7.7	0.8	–0.6	9.5	12.2
Non-farm GDP	14.1	8.8	10.2	11.5	13.3	11.9	7.4	7.0	8.2	4.5	12.0
Consumer price index											
Food	13.5	9.7	8.5	10.5	5.0	10.3	10.9	8.1	4.2	5.6	4.1
Total	10.6	8.9	9.3	10.9	10.4	12.9	9.8	8.0	1.8	4.3	5.7
Total excluding hospital and medical services	10.1	9.2	9.5	10.0	9.0	12.2	9.3	8.1	6.1	5.5	5.7
Manufacturing											
Articles produced by manufacturers	15.0	10.6	8.2	6.8	9.3	10.4	8.1	6.1	5.1	5.7	5.2
Wage costs[1]											
Award wage rates	12.6	11.9	11.5	10.1	16.7	12.0	3.4	4.2	9.1	4.3	0.1
Average non-farm earnings[2]	10.9	13.9	13.2	11.2	20.0	15.7	2.2	3.9	8.7	8.2	0.0
Average weekly earnings, all employees[3]	n.a.	n.a.	n.a.	n.a.	18.6	10.5	6.0	6.8	14.4	4.6	5.5
Non-farm unit labour costs	10.8	11.0	9.8	12.1	20.2	10.7	1.1	0.6	5.8	5.6	2.8
Gross operating surpluses[1]											
Corporate trading enterprises	25.1	8.4	21.5	0.7	–10.6	7.9	26.7	31.9	38.0	–1.6	22.4
Non-farm unincorporated enterprises, dwellings, etc.[4]	17.3	11.0	16.2	16.4	15.8	14.1	9.6	17.5	12.4	12.8	19.8
Farm unincorporated enterprises	–2.2	–10.0	–31.8	20.1	–25.5	–72.6	–23.5	1023.2	–8.8	–24.7	35.0
Memorandum item:											
Productivity (per person employed in the non-farm sector)	0.1	2.6	3.1	–0.8	–0.2	4.5	1.1	3.3	2.7	2.5	–2.7

1. Derived from seasonally adjusted data.
2. On a national accounts basis.
3. On a survey basis, not seasonally adjusted.
4. Gross operating surpluses of unincorporated enterprises, public trading enterprises and dwellings owned by persons less income of farm unincorporated enterprises.

Source: Australian Bureau of Statistics.

Diagram 5. **Contribution to the total final expenditure deflator**

Percentage and ratio



Sources: ABS. TFE = GDP + Imports. This diagram should be interpreted with caution. The TFE deflator contains export prices and hence an indetermined amount of the additional cost falls on importers of Australian exports. Hence, there are generally differences between the rates of growth of domestic deflators and the TFE deflator. The contribution of each element was calculated as the share in the previous period of each of the four components multiplied by their respective growth rates per unit of output. Columns do not always add exactly because of rounding.

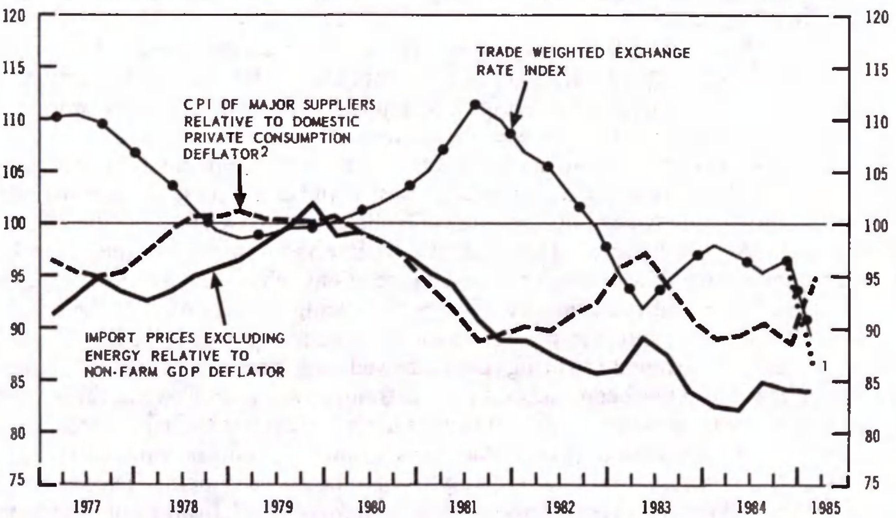
The rate of inflation, which started to improve during 1983, fell further during 1984 and by the end of the year had stabilised at around 5½ per cent. The principal driving force behind this decline has clearly been significant wage moderation but this was aided by a sharp reduction in the contribution of import prices in the second half of 1983 and the first half of 1984. The rate of inflation measured by the consumer price index fell from an annual rate of about 8 per cent in the second half of 1983 to around 2 per cent in 1984 first half before reaccelerating to 4.3 per cent in the second half of the year (Table 6 and Diagram 5). When an adjustment is made for changes in the financing of health care, the underlying rate of inflation was still about 6 per cent in the first half of 1984 and there was a further slight fall in the remainder of the year. With an acceleration in wage costs and higher import prices in the second half of 1984, some additional cost pressures have emerged, preventing any further significant fall in the rate of inflation.

Accompanying the decline in inflationary pressures has been a strong recovery in profitability in the non-farm sector. Gross operating surpluses of corporate trading enterprises rose by almost 30 per cent during 1983 and at an annual rate of close to 40 per cent in the first half of 1984 before falling slightly in the second half of the year. For the fiscal year 1983/84, the share of gross operating surplus in value added for the private non-farm corporate sector was roughly equal to the average achieved in the six years prior to the first oil price shock in 1973. Although some slight decline in the corporate profit share occurred in the second half of 1984, some further improvement is likely in the first half of 1985, given the fact that no increase in award wages occurred in the twelve months prior to April 1985. In the farm sector, the sharp rise in profits in the second half of 1983 resulted from the breaking of a severe drought. Since then, farm incomes have fallen somewhat as weather conditions have returned to normal and world prices of many major commodities, particularly grains, have remained depressed.

An important implication of the sharp rise in labour costs in 1982 was a marked decline in competitiveness. To some extent this was offset by a gradual decline in the trade-weighted exchange rate and by a 10 per cent devaluation in March 1983, but Australia's competitive position was then still worse than it had been in 1980 (Diagram 6). Despite this deterioration in competitiveness, import penetration actually declined throughout 1982 and into 1983 as the recession caused a sharp fall in import demand (see analysis of balance of payments in Part V). The rise in wages and prices moderated in 1983 and 1984 but the strengthening of the exchange rate during this period resulted in a further deterioration in the competitive position of domestic producers. This began to become apparent during 1984 since, as domestic demand

Diagram 6. **Competitiveness indicators**

Indexes fiscal years 1979/80 = 100



1. Exchange rate in March relative to the rate in the fourth quarter.
2. United States, Japan, Germany and the United Kingdom adjusted for exchange rates and special factors weighted according to their relative size in imports.

Sources: NIF. 10 Model database; ABS; OECD.

strengthened, import penetration increased sharply and the deficit on current account grew to unsustainable levels. This was no doubt one of the most important factors contributing to a subsequent sharp fall in the exchange rate. Between the end of January and end of April 1985, the Australian dollar fell by about 20 per cent both on a trade-weighted basis and against the U.S. dollar, with most of this decline occurring at the end of February (Diagram 6). This sudden fall in the exchange rate will contribute, via higher import prices, to a substantial rise in inflationary pressures in 1985 which, under the existing policy framework, must be addressed directly by incomes policy.

Incomes policy

As pointed out in Part I of the present Survey, incomes policy forms one component of the Accord. Under the Accord, fiscal policy was to remain broadly expansionary in order to promote growth of demand, output and employment while inflationary pressures were to be controlled by a wages and prices agreement supported by a non-accommodating monetary policy. The wage-fixing principles were laid down by the Conciliation and Arbitration Commission in September 1983 after broad agreement had been reached at the National Economic Summit in June of that year[30]. The principles provide for six-monthly indexation hearings until the end of 1985 when they will be reviewed. The principles place tight restrictions on additional wage increases and claims outside the principles have been forbidden[31]. It nevertheless remains possible for individual firms to give larger increases but this has certainly been discouraged under the principles. Under the wage-fixing principles, the Commission may also consider upon application by the Unions whether an increase in wages and salaries or changes in conditions of employment should be awarded on account of productivity growth. The timing of this productivity case has not been determined but it has generally been anticipated as sometime after mid-1985. Increased benefits are unlikely to begin to flow until well into 1986. Details of the principles were provided in the 1984 Economic Survey of Australia, Annex I.

It is evident that to date this policy approach and the preceding wage pause have been remarkably successful, with the annual inflation rate falling by about 6 percentage points from its recent peak and employment rising by around 340 000 within the first two years. One reason for the apparent success of the Accord has been the fact that it paid due regard to the institutional framework and labour market norms in the Australian environment, including the role of the Conciliation and Arbitration Commission and of the trade union movement and its major peak council, the Australian Council of Trade Unions (A.C.T.U.). While the current framework of the Accord implies a lack of flexibility in wage fixing at the micro level, it has provided a major source of stability in industrial relations which was badly needed.

So far there has been little evidence of wage rises being granted outside the wage-fixing principles of the Accord, but the possibility of this occurring will increase. Historically, economic recoveries have tended to bring forth renewed wage pressure with clear implications for inflation. The Accord has been successful in restraining wage increases in the early stages of the recovery. Over the next two years, the aim must be to restrain these cost pressures while enabling strong economic growth to continue. With company profits now much stronger than at the start of the recovery, the task is likely to become more difficult. The current wage setting principles will remain in their present form for most of 1985. In addition, a productivity case is expected to commence before the Conciliation and Arbitration Commission after mid-1985 and the unions are likely to claim increased benefits in the form of extended pension entitlements rather than a straight wage rise. Although the exact size of the increase will be determined by the Arbitration Commission only after hearing arguments from all interested parties, an effective labour-cost increase of around 3 per cent appears likely to be sought by the unions. Because of the complexities of introducing or improving such schemes, it seems likely that the impact of the productivity case on labour costs could be spread over a relatively long period, perhaps as much as two years or more, and thus, of itself, could have a minimal impact on inflationary pressures. With regard to inflation adjustments to wages, the next increase will be based on the increase in the consumer price index in the first two quarters of 1985. Although depreciation of the exchange rate will have some impact on the index in this period, the effect will be relatively small, perhaps no more than half a percentage point. However, for the subsequent indexed rise in award wage rates, the depreciation induced rise in consumer prices is likely to be significant. If wages were to be increased by the full rise in the consumer price index, domestic cost pressures would rise considerably and the inflationary spiral could resume. Since a real depreciation must be maintained to have a positive impact on domestic output, it is important that some means be found to avoid the increase in import prices being passed on in wages.

Several options are open to the social partners which undoubtedly will be canvassed later this year. Firstly, the wage increase could be discounted by the rise in consumer prices resulting from the effect of exchange rate movements on import prices. However, the union movement has already expressed its objection to such an approach and the Government has not seen fit to press the issue at this stage. Secondly, the hearing of the productivity case could be delayed, thereby allowing the price effects of depreciation to be offset by the full gains of productivity, i.e. without a wage increase. Given that the size of the depreciation to date could well add 3 percentage points to the rate of inflation in fiscal year 1985/86 and that long-term productivity growth could not be expected to exceed about 1¾ per cent a year, this would necessitate a delay in any productivity case of at least eighteen months. Even then, inflation would rise or profits fall during 1985-86 as the offsetting productivity gains would be spread over a longer period than the rise in import prices. Thirdly, the effect of depreciation could be taken into account at the time of the productivity case through an adjustment for the terms-of-trade loss. However, a terms-of-trade adjustment based on differences in the rate of growth of import and export prices, is unlikely to reflect fully the impact of depreciation. Because the majority of Australian exports are either denominated in foreign currencies or sold in markets where Australian producers take world prices, it is likely that average export prices will also increase following depreciation and moderate the terms-of-trade loss. The more important consequence would be a loss of purchasing power for those who consume imported goods (the majority of the community) partly offset by significant income gains for firms exporting farm products and mineral resources. While the ability of these firms to pay higher wages could be enhanced, they would account for much less than 10 per cent of total employment. Since the vast majority of firms would not experience this improvement in profitability, a wage increase based on terms-of-trade adjusted productivity growth would still add substantially to cost pressures.

The support of the trade union movement for one or a combination of these approaches would be desirable. It would appear that some partial adjustment of the consumer price index combined with a delay of, say, one year in the productivity case, would greatly diminish the inflationary pressures while having only a small impact on real incomes. The benefits to the community would flow from improved medium-term growth prospects, implying higher employment, reduced interest rates and an improved environment for taxation reform. As the only apparent alternative to the Accord in restraining inflation and avoiding further falls in the value of the dollar would be tighter monetary and fiscal policy, there would appear to be a strong incentive to the unions to find a way of taking adequate account of devaluation within the context of the Accord and the wage-fixing principles.

In the longer term, the Accord does pose several problems. The first of these is well illustrated by the inflationary pressures that have now arisen as a result of the decline in the dollar. A somewhat analagous situation could arise if taxation reform currently under consideration leads to an increase in indirect taxes and hence a once-off sharp rise in the consumer price index. The situation, in that event, would, however, be rather different in that wage earners would be more than compensated by direct tax cuts. Nonetheless, repeated *ad hoc* adjustments to the index which was supposed to form the basis for indexation increases run the risk that the unions will lose confidence in the system and will resort to bargaining outside the existing wage-fixing principles. Secondly, while the Accord may have been a major factor in bringing inflation under control, it has done so via a rigidly controlled system of centralised wage determination which implies little or no flexibility in wage relativities. As discussed in the last OECD review of the Australian economy, wage fixing in Australia has, for the most part, been based on centralised wage fixing for much of the past sixty years, either under clearly defined principles as currently exist or through centralised wage bargaining but on a case-by-case basis, as was the case for a brief period from 1981. Under either system, the amount of flexibility in wage relativities has been limited. A more apparent outcome has been that, under the principle of comparative wage justice, increases won by more powerful unions have soon been passed on through other awards with little change in relativities. Strong industrial action on a national basis was often used in support of wage claims, with the result that intermittent periods of wage increases occurred which were clearly beyond the capaity of firms to accommodate. The medium-term advantage won by the Accord is that aggregate wage movements have been contained. However, it is important that in the longer term, wage fixing procedures be developed which allow for greater flexibility in the determination of wage relativities without impairing its capacity to effect necessary adjustment in aggregate wages[32].

V. RECENT GROWTH AND SHORT-TERM PROSPECTS

Demand and output

The very fast rate of GDP growth in the second half of 1983 gave way in the course of 1984 to a slower pace as a number of temporary and policy related factors lost their force. In the early part of the recovery, GDP growth had been buoyed up by rapid growth of public expenditure, a swing in non-farm stockbuilding and the impact of the end of the drought on farm output, farm inventories and exports. In addition, higher world export demand, accompanied by the coming-on-stream of several resource related projects undertaken during the preceding investment boom, was reflected in a rapid rise in non-rural exports. The deceleration in GDP growth through 1984 as these factors faded was partially offset by a strengthening in final domestic demand. Demand management policies broadly maintained the growth of public consumption and provided some support for employment and incomes, while housing subsidies were one of the factors underlying a rapid acceleration in housing investment. The interpretation of movements in GDP growth has been rendered difficult at times by the size of the statistical discrepancy between income and expenditure measures of GDP.

Table 7. **Demand and output**

Percentage change, in volume[1]

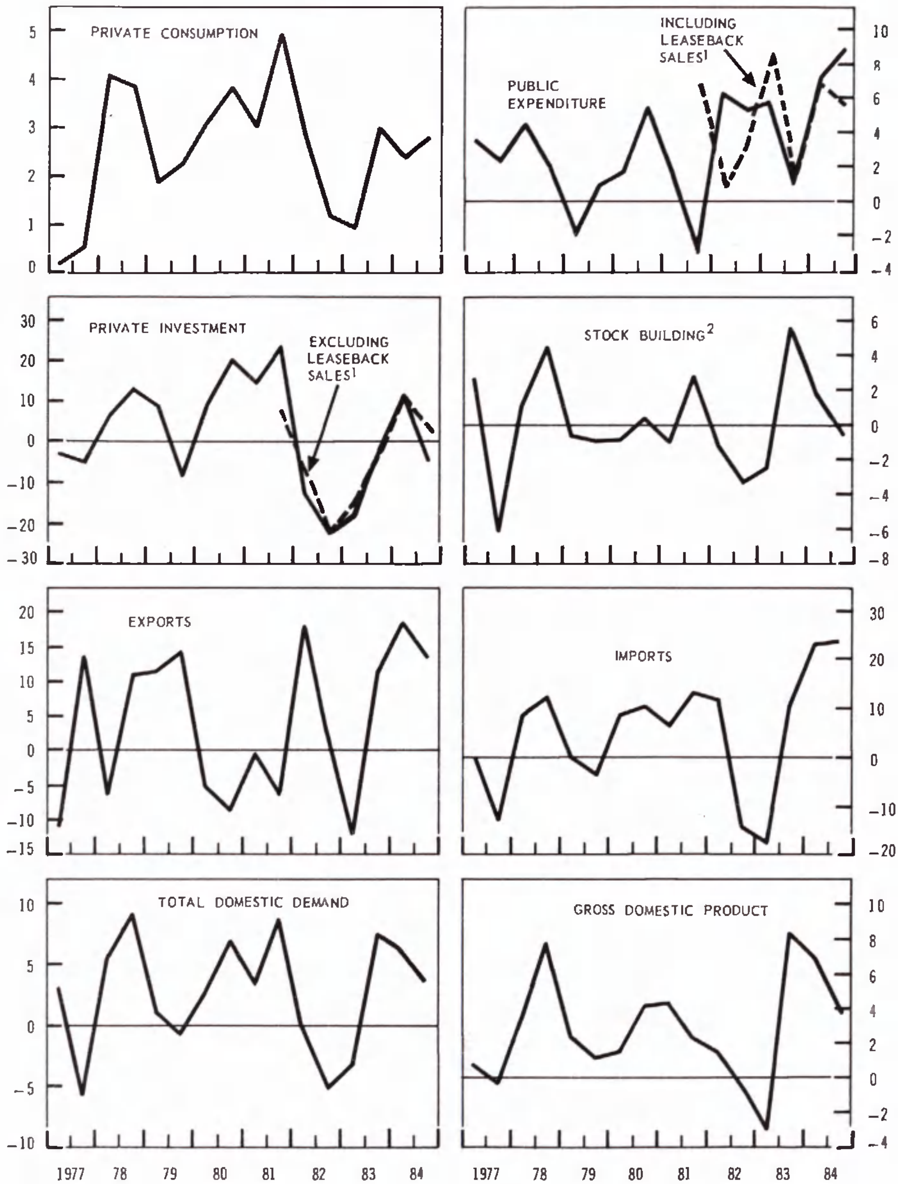
	From previous year[2]				From previous period, seasonally adjusted annual rate					
	1982	1983	1984	1983/84	1982	1983		1984		1985
	Calendar years			June year	II	I	II	I	II	Q1
Consumption										
Private	2.9	1.5	2.6	2.3	1.2	1.0	2.9	2.4	2.8	8.3
Public	0.2	6.4	6.3	4.7	4.8	10.2	0.4	8.2	8.6	-0.6
Gross fixed investment	-2.9	-9.3	6.3	-0.4	-14.2	-11.5	0.7	9.8	4.8	30.5
Of which:										
Public	11.0	0.2	5.4	1.2	6.2	-3.1	1.3	5.6	9.2	148.7
Private:										
Total	-8.3	-13.9	6.7	-1.2	-22.4	-15.6	0.4	12.2	2.5	-11.9
Dwellings	-14.5	-16.9	23.3	10.2	-28.8	-27.5	28.0	25.0	16.0	1.3
Other construction	-3.7	-24.5	-3.7	-24.7	-14.9	-23.3	-36.5	4.5	25.9	-14.8
Equipment	-5.6	-12.0	0.9	-1.9	-22.4	-11.4	-1.0	6.8	-8.4	-16.4
Real estate transfer costs	-19.1	16.4	24.2	34.4	-17.1	23.6	43.0	29.0	1.6	-17.1
Final domestic demand	1.1	-0.3	4.0	2.1	-2.2	-0.6	2.0	4.9	4.2	11.4
Change in stockbuilding[3]	-0.8	-0.7	2.0	2.6	3.3	-2.5	5.7	1.7	-0.6	-2.8
Of which:										
Private non-farm[3]	-0.6	-1.5	2.5	1.1	-1.4	-3.3	2.0	3.8	0.3	-2.2
Farm and miscellaneous[3]	-0.2	0.9	-0.4	1.5	-1.9	0.9	3.8	-2.2	-0.9	-0.6
Total domestic demand	0.3	-1.0	6.1	4.7	-5.3	-3.0	7.9	6.6	3.5	8.2
Exports of goods and services	7.2	-3.3	15.2	6.6	1.5	-12.1	11.4	18.2	13.2	7.0
Imports of goods and services	4.8	-10.4	20.5	6.0	-14.5	-17.7	11.4	23.4	24.0	-13.5
Change in foreign balance[3]	0.2	1.5	-1.2	0	3.4	1.4	-0.1	-1.1	-2.2	4.3
GDP (expenditure-based estimate)	0.5	0.5	5.0	4.8	-2.2	-1.6	7.9	5.5	1.4	13.1
Statistical discrepancy[3]	0.5	0	1.5	0.4	1.6	-1.2	0.8	1.3	2.5	-10.4
GDP (income-based)	1.0	0.5	6.5	5.3	-0.7	-2.7	8.7	6.8	3.9	2.2
Of which:										
Farm	2.2	2.3	13.0	37.0	-34.3	-10.1	99.2	-0.8	-11.9	6.2
Non-farm	0.9	0.4	6.1	3.5	2.0	-2.4	4.7	7.4	5.0	1.9

1. Volume data measured at 1979/80 prices.
2. Published annual national accounts estimates are compiled for years ended 30th June. The calendar year estimates have been obtained by summing original quarterly data.
3. Contribution to GDP growth (percentage points on income measure).

Source: Quarterly Estimates of National Income and Expenditure, ABS.

Diagram 7. **Demand and output**

Half-years per cent growth seasonally adjusted annual rates



1. Adjusted by the Secretariat for the sale of major capital assets by the public sector to the private sector and subsequent leaseback.
2. Contribution to percentage change in GDP at annual rates.

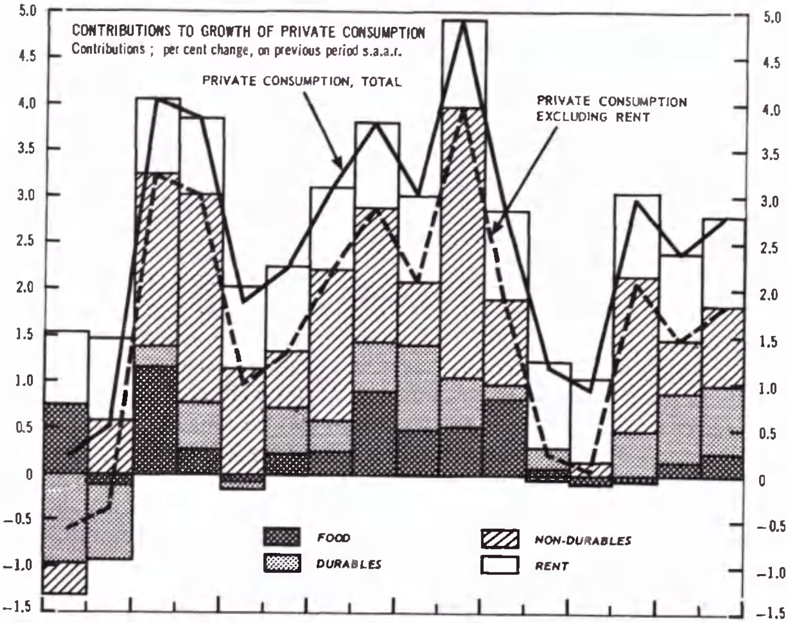
Source: Australian Bureau of Statistics.

Private consumption growth continued to decelerate into the first half of 1983 before rebounding in the second half of 1983 (Diagram 8, first panel) accompanied by a sharp fall in savings which appeared concentrated in the non-farm sector. Private consumption growth has not been as rapid as in the initial stages of the previous cycle. After adjustment for Medicare, expenditure grew by roughly 3 per cent in each of the three half-years to end-1984[33]. This more modest behaviour may reflect a different contribution of income components to disposable income, the lagged effects of uncertainty surrounding the high levels of inflation from 1981 to 1983 and the rapid rise in unemployment during that period. In the current cycle, a fall in employment in 1982 and early 1983, the wage freeze in the first nine months of 1983 and the effects of the Accord thereafter first led to a decline in real wage income and subsequently limited its increase (Diagram 8, second panel). The fall in real income from wages was offset by lower income taxes and higher transfers as unemployment rose in the first half of 1983. However, net taxes and transfers depressed income in the next three half years. In 1983, a strong boost to household income came from a surge in revenues of unincorporated enterprises, particularly in the second half when farm incomes rose sharply. This may have depressed consumption growth relative to what would have been expected given the growth in household income as the propensity to consume out of this source of income may be initially lower than for wage or transfer incomes and feed through into consumption more slowly. This may partly explain some of the continued high rate of saving as the saving ratio adjusted for fluctuations in agricultural income has dropped by more than the unadjusted rate (Diagram 8, final panel)[34]. But it also seems likely that households may not have entirely adjusted their pessimistic expectations regarding unemployment and inflation. The larger contribution of labour incomes in 1984 may set the stage for a further strengthening in consumption as the recovery proceeds, particularly if uncertainty of households regarding unemployment and inflation recedes. *Public expenditure* has been a strong component of final demand during 1984 partly reflecting the introduction of Medicare. Expenditure broadly stagnated in the second half of 1983 but grew by an average of 8.5 per cent in the subsequent two half-years in part as a result of a number of exceptional expenditure items (arrival of military equipment and purchase of aircraft)[35].

The most dynamic element of investment has been *housing construction* which contributed roughly ¾ of a per cent to GDP growth in the three half-years to the second half of 1984. The rapid growth was attributable to readily available finance, lower interest rates and government incentive schemes which may have brought forward the timing of home purchases[36]. On the basis of current indicators, the housing cycle now appears to be reaching its peak at about roughly the same level as at the top of the previous cycle – housing starts now appear to be on a plateau. In contrast, *private business fixed investment* has been more sluggish (Diagram 7). With the end of the preceding mining boom some decline in investment was to be expected. The fall in primary commodity prices and demand during the world recession and deteriorating competitiveness combined with the severe profit squeeze during the 1981-82 wage explosion, higher interest rates, the decline in domestic demand, and growing excess capacity led to a sharper fall in investment than had been experienced during preceding cycles[37]. Investment spending by business continued to fall erratically into the second half of 1983, particularly for construction. Sectoral data, which is only available on a survey (rather than a national accounts) basis indicates that, although declines were experienced in mining and to a lesser extent manufacturing into the first half of 1984, some recovery occurred in the property and finance sector. This appears to have led to a modest overall rise in both construction and in machinery and equipment. However, investment in equipment fell back again in the second half of the year and the level of total investment remains 25 per cent below the previous peak and at roughly the same level as the trough in the first half of 1983[38].

Diagram 8. **Private consumption, income[1] and savings[2]**

Panel A



Panel B

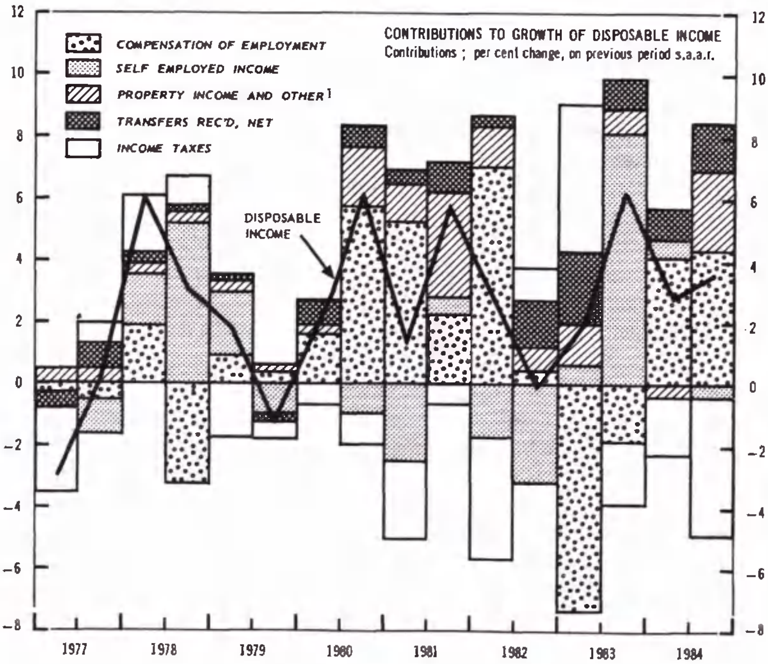
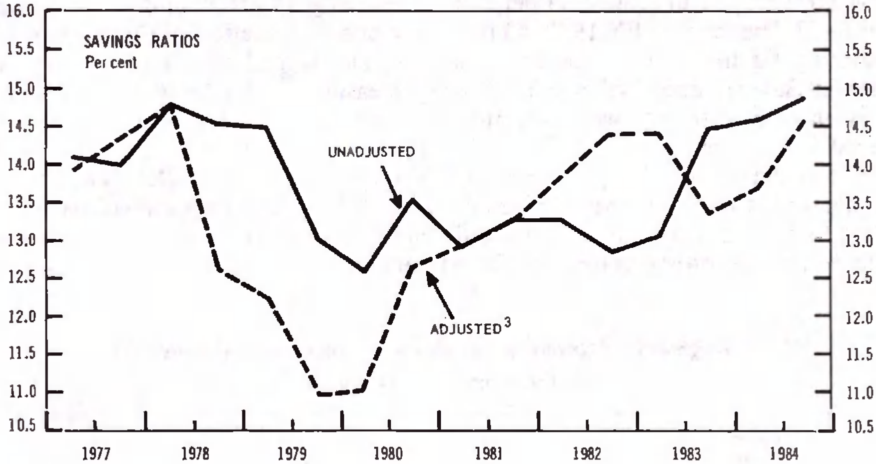


Diagram 8 (Continued). **Private consumption, income[1] and savings[2]**

Panel C



1. Net of consumer debt interest.
2. Data for consumption does not take into account the effect of transferring part of medical spending from the private to the public sector.
3. In the adjusted series, savings and household income were calculated using a 4 year moving average of self employed agricultural income.

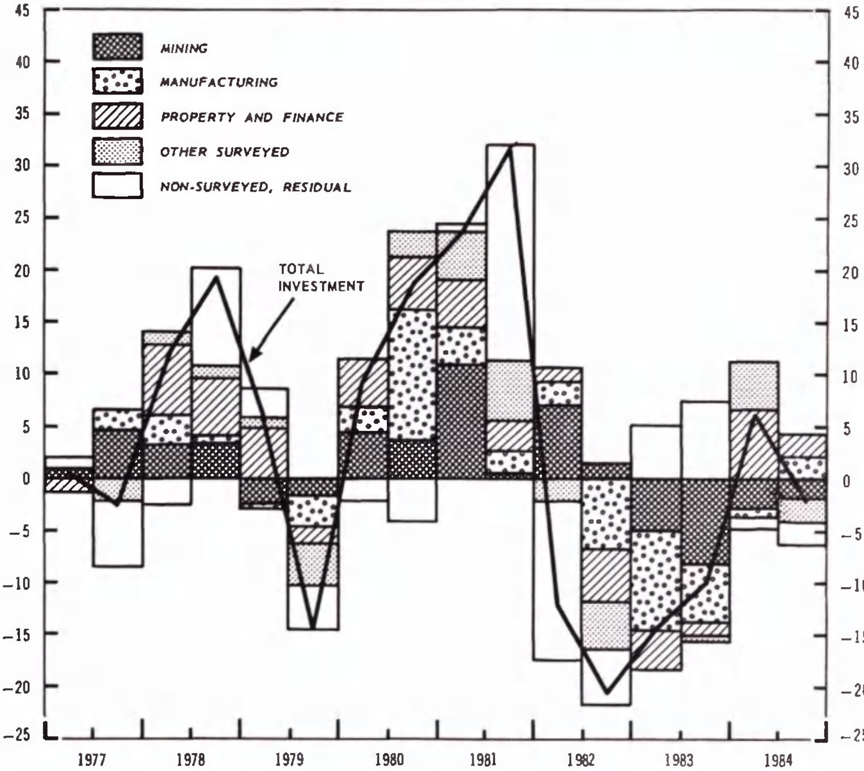
Source: Australian Bureau of Statistics.

As mentioned, *inventory investment* was one of the most dynamic elements early in the recovery. In the second half of 1983, stockbuilding contributed about two-thirds of total GDP growth of 4.2 per cent. However, the impact weakened during 1984 and in the second half of the year detracted from growth. Movements in agricultural stocks reflect in large part fluctuations in crop levels relative to exports. During the period of drought, stocks were drawn down; the bumper harvest in FY 1983/84 following the end of the drought led to a very sharp rise in stocks, particularly in the second half of 1983 and this was reflected in a sharp rise in agricultural exports in the subsequent period. The importance of the turnaround in the non-farm sector reflected the extent of the destocking which had preceded it; stocks declined almost continuously from the second quarter of 1982 to the fourth quarter of 1983 and the non-farm stocks to sales ratio fell by 13 per cent from 1982 Q3 to 1984 Q3. Some of this decline was cyclical and, as the size of the subsequent turnaround in sales in 1983 was probably unexpected, there was possibly also some unintended destocking in the second half of 1983. But about three quarters of this fall appears to reflect the composition of demand away from industry and retail and wholesale trade towards services which tend to hold lower stocks. Although more difficult to verify, there may also have been a move towards a more parsimonious use of stocks following the profit squeeze in 1982 and continuing high real interest rates as there have also been falls in stocks to sales ratios in both manufacturing and retail and wholesale trade individually. Although current ratios of non-farm stocks to sales are well below their historical levels, a return to previous levels now appears unlikely.

In the current cycle, the low level of investment in the private sector has been juxtapositioned against substantial changes in aggregate savings, investment and net lending and their distribution across sectors[39]. After declining gradually from around 26 per cent of GDP in FY 1973/74 to around 21 per cent in the early 1980s, total domestic savings fell further to 17.7 per cent in FY 1982/83 under the cumulative effect of the fall in profits and deteriorating public sector accounts (table 8). The lagged effects of the recession on government savings and further expansionary measures in FY 1983/84 prevented a full recovery in aggregate savings as private sector savings rose. Lower government savings combined with a large investment programme by the state and local public authorities in that year, led to a sharp rise in the public sector deficit to 6.7 per cent of GDP. Since total private sector investment fell by 5.4 percentage points in 1982/83 with only a small recovery in the following fiscal year, there was little pressure on financial markets and the deficit on current account declined as lower private sector investment reduced the demand for domestic savings.

Diagram 9. **Contributions to growth of private business investment**

Per cent change (s.a.a.r), contributions

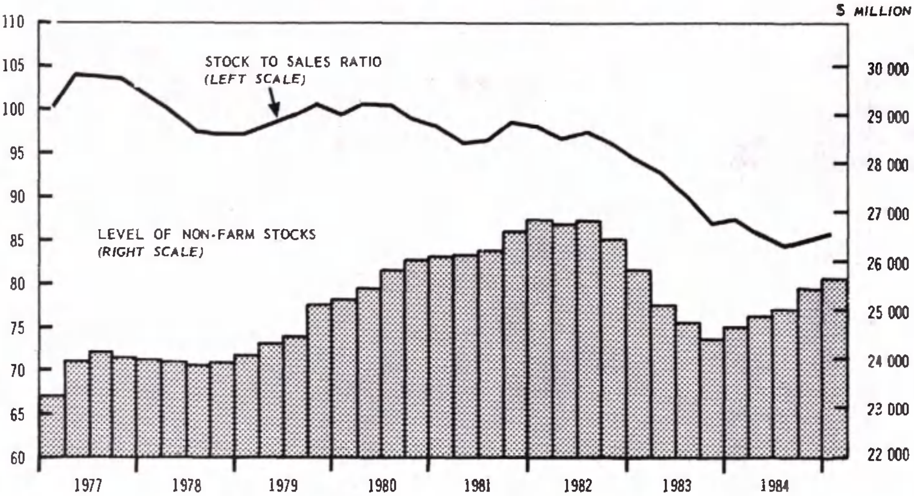


Note: Gross investment by business in non-dwelling construction and equipment (volume). Diagram combines survey and national accounts data. Data for individual sectors are from survey data which primarily covers large firms. The non-surveyed is the residual between total investment on a national accounts basis and the total surveyed. Does not take into account sales by the public sector to the private sector and their subsequent leaseback.

Source: Australian Bureau of Statistics.

Diagram 10. **Stock to sales ratio and non-farm stocks**[1]

Ratio fiscal year 1979/80 = 100 and levels (1979-80 prices)



1. Ratio of non-farm inventories to expenditure on home-produced non-inventory goods plus imports.
Source: NIF. 10 Model database.

Indeed, the increase in the public sector borrowing requirement provided necessary support to aggregate demand as the recession deepened. But with the recovery in 1984, the demand for savings has increased and has been reflected in a steady widening in the current external deficit, which is likely to continue if the public sector borrowing requirement is not reined back as private sector demand rises[40].

Export volumes of goods and services have continued to rise rapidly and by the second half of 1984 were 15.7 per cent above a year earlier (Table 9). Export growth has been led by the agricultural sector which rose by around 25 per cent in the same period because of the bumper 1983/84 crop. The most dramatic increase was for cereals but there were increases in most other categories as well. Non-rural commodities – which comprise about 50 per cent of total exports – have also been rising steadily as a number of projects begun in the early 1980s came on stream. Initially this had affected manufactured metals, but more recently energy exports (coal, LP gas and oil) have grown rapidly. Imports grew more rapidly than exports over this period and in the second half of 1984 were 23.7 per cent higher than a year earlier. The surge in imports has been fairly broadly based although the increase has been somewhat greater – relative to investment demand – for machinery and transport equipment. This may have reflected increased computerisation and the introduction of other new technology as imports of data processing and office equipment rose sharply over the period. As a consequence, import penetration, which had reached very low levels during the previous recession, rebounded sharply and are now at their previous peaks at a relatively early point in the cycle (Diagram 11). Part of this reflects the importance of the stock cycle and the initial pick up in economic activity, the continuing trend towards the broader integration of the Australian economy into the world trading system and possibly increased demand for products which are not yet produced competitively in Australia. But beyond this the increased penetration probably reflects worsening price competitiveness over the recent past. In the

Table 8. **Saving, investment and net lending by sector**[1]
1973/74 to 1983/84
Per cent o GDP[2]

	Fiscal year										
	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84
Saving											
Government	7.0	6.0	5.0	4.3	3.5	2.6	3.8	4.0	4.4	2.5	1.4
Corporate	6.0	4.0	5.3	5.6	6.2	6.5	6.8	6.4	4.0	4.1	7.6
Households	13.4	14.2	12.4	11.8	11.7	11.9	10.9	11.2	11.5	11.2	11.7
Total domestic	26.4	24.2	22.7	21.7	21.5	21.0	21.5	21.5	19.9	17.7	20.7
Investment[3]											
Government	8.3	10.5	9.6	8.8	8.9	7.9	7.5	7.4	7.4	8.4	8.0
Corporate	8.6	7.6	6.5	7.6	6.4	8.8	7.8	8.7	10.2	7.2	8.0
Households	7.9	6.1	7.1	7.7	6.8	7.1	7.0	7.7	7.7	5.3	5.3
Total domestic	24.8	24.2	23.2	24.1	22.1	23.7	22.3	23.8	25.3	20.9	21.4
Net lending											
Government	–1.3	–4.5	–4.6	–4.5	–5.4	–5.3	–3.8	–3.4	–3.0	–5.9	–6.7
Corporate	–2.6	–3.7	–1.2	–2.0	–0.2	–2.3	–1.0	–2.3	–6.2	–3.2	–0.4
Households	5.4	8.2	5.3	4.1	4.9	4.8	3.9	3.5	3.8	5.9	6.4
Total domestic	1.6	–0.0	–0.6	–2.4	–0.6	–2.7	–1.8	–2.2	–5.4	–3.2	–0.7
Statistical discrepancy	–2.6	–1.6	–0.6	0.1	–2.1	–0.2	–0.2	–1.4	–0.4	–1.1	–3.0
Current balance	–1.1	–1.6	–1.2	–2.3	–2.7	–2.9	–1.0	–3.6	–5.8	–4.3	–3.7

1. The private financial sector has been added to the corporate trading enterprises and the Reserve Bank has been added into the government sector.
2. Totals may not add due to rounding.
3. Includes capital transfers received, inventory and fixed capital investment.

Source: Reserve Bank of Australia, *Bulletin Supplement: Financial Flows*, May 1985, and ABS, March 1985, *National Accounts*.

Table 9. **Foreign trade**

	1981	1982	1983	1984	1983 I	1983 II	1984 I	1984 II
	Value $A billion	Percentage change over previous period (annual rate)						
Exports								
Volumes								
Rural	7.5	12.5	–18.8	24.0	–37.3	7.2	38.9	13.9
Fuels	2.6	0.4	22.9	26.1	24.4	23.4	20.5	39.7
Metals (ores and manufactures)	4.8	6.1	3.7	2.6	2.7	6.9	4.9	–5.8
Other manufactured goods	2.3	4.6	10.5	14.1	16.7	23.2	4.9	25.2
Total non-rural goods	9.6	4.2	10.3	12.1	11.5	15.2	9.3	14.6
Services	3.0	3.6	–4.6	6.5	–9.4	7.1	6.6	5.8
Goods and services	20.1	7.2	–3.3	15.2	–12.1	11.4	18.2	13.2
Price deflator								
Rural	..	–5.2	10.1	4.5	15.6	15.1	–0.7	5.6
Fuels	..	16.2	4.3	–2.3	3.7	–10.6	–3.4	10.1
Metals (ores and manufactures)	..	4.8	6.3	2.5	–0.2	14.5	–6.8	12.1
Other manufactured goods	..	6.0	9.5	1.6	9.2	6.8	–2.8	6.7
Total non-rural goods	..	8.1	7.1	1.3	4.0	4.5	–4.5	11.4
Services	..	7.7	9.0	3.9	6.3	5.8	3.3	4.7
Goods and services	..	2.9	9.1	2.5	10.8	7.6	–2.6	8.3
Imports								
Volumes								
Food and raw materials	1.7	0.5	0.1	15.1	9.0	10.4	20.8	9.0
Fuels	1.9	10.6	–31.8	7.0	–43.8	–36.4	52.2	–9.0
Manufactured goods	14.9	5.1	–9.9	23.7	–17.3	18.5	22.6	30.8
Services	5.4	3.3	–6.8	17.5	–14.6	10.5	19.7	20.0
Goods and services	23.9	4.8	–10.4	20.5	–17.7	11.4	23.4	24.0
Price deflator								
Food and raw materials	..	3.9	6.4	8.1	3.4	9.4	3.4	8.6
Fuels	..	8.9	0.1	–2.5	–7.8	–3.8	–8.6	13.4
Manufactured goods	..	6.2	8.0	3.4	13.0	2.2	0.5	12.0
Services	..	6.6	7.5	0.6	9.8	0.9	–2.2	6.1
Goods and services	..	6.7	6.2	2.2	7.7	0.9	–0.6	9.4

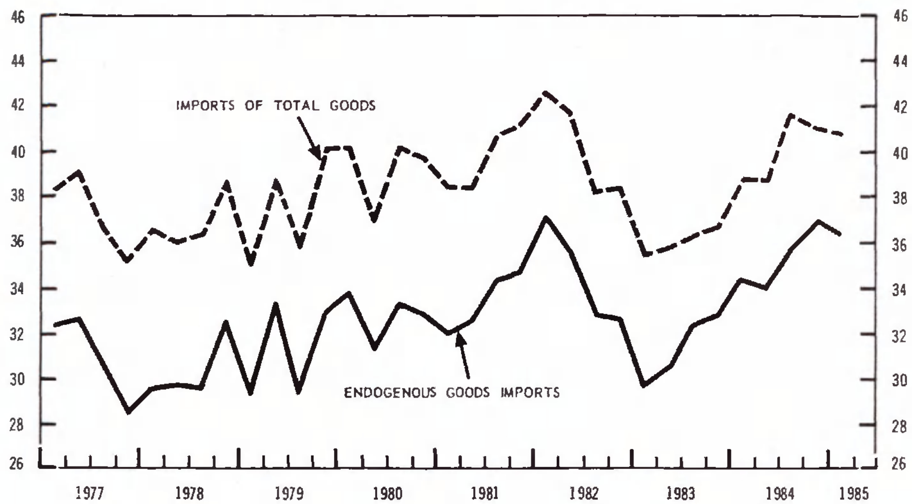
Source: Australian Bureau of Statistics.

period 1979-81, an appreciating Australian dollar overlay an already worsening price and unit labour cost performance. While the Australian dollar depreciated in the subsequent period, the fall was insufficient to return competitiveness to its previous levels. During the recession, the sharp fall in demand – particularly in those demand components which have a high import content (investment and stockbuilding) – probably masked the deterioration in competitive performance[41].

Export prices have, however, remained depressed and have partially offset the higher volume in certain categories of products. In the rural sector, good harvests in a number of exporting countries as well as improved agricultural surpluses in many developing countries has reduced overall demand and prices have remained broadly unchanged from 1983. For non-rural goods there is considerable excess capacity on world markets with some capacity in other countries being maintained at uneconomical levels for balance-of-payments and

Diagram 11. **Import penetration ratios**

Per cent of import related demand



Source: NIF. 10 Model database: import related demand (denominator) excludes those components having little import content (rent, services, food, construction and parts of other demand components). Endogenous imports (numerator) exclude petroleum, civilian aircraft and government goods.

employment reasons. Overall, the value of exports of goods and services continued to rise throughout 1984. Over the two half years of 1984, import prices rose by 4.4 per cent, somewhat more than export prices. This, combined with the acceleration in the growth of import volumes led to a deterioration in the trade balance through the year. But there was a deterioration in invisibles transactions as well and the rapid rise in merchandise imports led to a sharp rise in freight and insurance payments. More important, there was a marked increase in retained earnings and profit remittances abroad and higher interest payments on an increased stock of external debt. The cumulation of these factors led to a widening in the current balance to around $12 billion (s.a.a.r.) in the last quarter of the year. Capital movements to compensate the widening current account deficit differed from 1983 when there were large short-term capital inflows at year-end (Table 10). There was a large fall in direct investment from abroad and this was compounded by a $2.5 billion increase in Australian foreign investment, possibly reflecting the easing of exchange controls during the course of the year. This was partly compensated for by public sector borrowing and in the first half of 1984 by a fall in reserves. The remainder was broadly made up by increased borrowing abroad, about 40 per cent of which represented an increased indebtedness by public non-financial enterprises.

The increase in debt-interest payments, within the context of the widening current account deficit, reflects both the increased size as well the structure of outstanding liabilities. Since the late 1970s there has been a more rapid increase in debt than equity. Even though there has been a substantial amount of direct foreign investment and in equities during certain years[42], direct investment has fallen as a proportion of total external liabilities. In the enterprise sector, the level of direct investment as a per cent of GDP fell from 17 per cent in

Table 10. **Balance of payments – current and capital accounts**

$ million

	1982	1983	1984	1983 I	1983 II	1984 I	1984 II	1985 Q1
Seasonally adjusted								
Trade balance	2 562	50	–1 111	–181	231	–175	–936	–194
Net services	–2 665	–2 539	–3 292	–1 235	–1 304	–1 477	–1 815	–895
Net investment income	–2 267	–3 434	–4 401	–1 225	–2 209	–1 963	–2 438	–1 419
Net transfers	–453	–496	–553	–234	–262	–272	–281	–67
Current account	–7 947	–6 417	–9 357	–2 876	–3 541	–3 888	–5 469	–2 575
Not seasonally adjusted								
Trade balance	–2 521	12	–1 236	–158	170	2	–1 238	–366
Net services	–2 674	–2 539	–3 299	–1 233	–1 306	–1 472	–1 827	–818
Net investment income	–2 273	–3 422	:4 400	–1 272	–2 150	–1 996	–2 404	–1 368
Net transfers	–452	494	–531	–285	–209	–330	–201	–86
Current account	–7 921	–6 443	–9 466	–2 948	–3 495	–3 796	–5 670	–2 638
Public sector capital flows	1 065	485	1 162	–140	625	–19	1 181	155
Direct investment	1 993	3 165	999	681	2 484	–271	1 270	576
Private sector portfolio investment:								
Equities	755	953	–12	575	378	159	–171	143
Borrowings	8 431	4 967	7 501	2 857	2 110	3 814	3 687	2 226
Australian investment abroad	–1 219	–1 046	–2 555	–713	–333	–1 405	–1 150	–988
Other	503	235	835	–130	365	–145	980	–255
Capital inflow (observed)	11 527	8 759	7 930	3 130	5 629	2 133	5 797	1 857
Errors and omissions	1 278	1 028	98	29	999	381	–283	–61
Capital inflow (apparent)	12 805	9 786	8 028	3 159	6 627	2 514	5 514	1 795

Source: Australian Bureau of Statistics, Reserve Bank of Australia.

June 1970 to 11 per cent in June 1984. Over the same period the level of borrowings rose from 2½ per cent of GDP to 15 per cent of GDP. Although Commonwealth government debt increased towards the end of the 1970s, the level of outstanding debt as a proportion of GDP runs at roughly the same level as at the beginning of the 1970s and the rise since the beginning of the current decade has been largely offset by an increase in official reserve assets. Nonetheless total outstanding external debt – both private and public – as risen from 9½ per cent of GDP at its low point in 1975 to 23½ per cent in 1984 with a rise of around 10 percentage points occurring in the past three years. Debt interest payments have risen threefold, from 4½ per cent of export receipts in FY 1979/80 to 12¼ per cent in FY 1983/84 not only because of the greater need for foreign capital but also because of the rising share of debt in capital inflows.

Employment, labour force and unemployment

Total employment during the preceding recession dropped sharply by 3 per cent from the cyclical peak in the first quarter of 1982 to the trough in the second quarter of 1983. This was accompanied by a fall in average hours worked and in the number of overtime hours. As the severity of the labour shakeout was probably related to the profit squeeze in 1981 and 1982,

Table 11. **Labour force indicators**

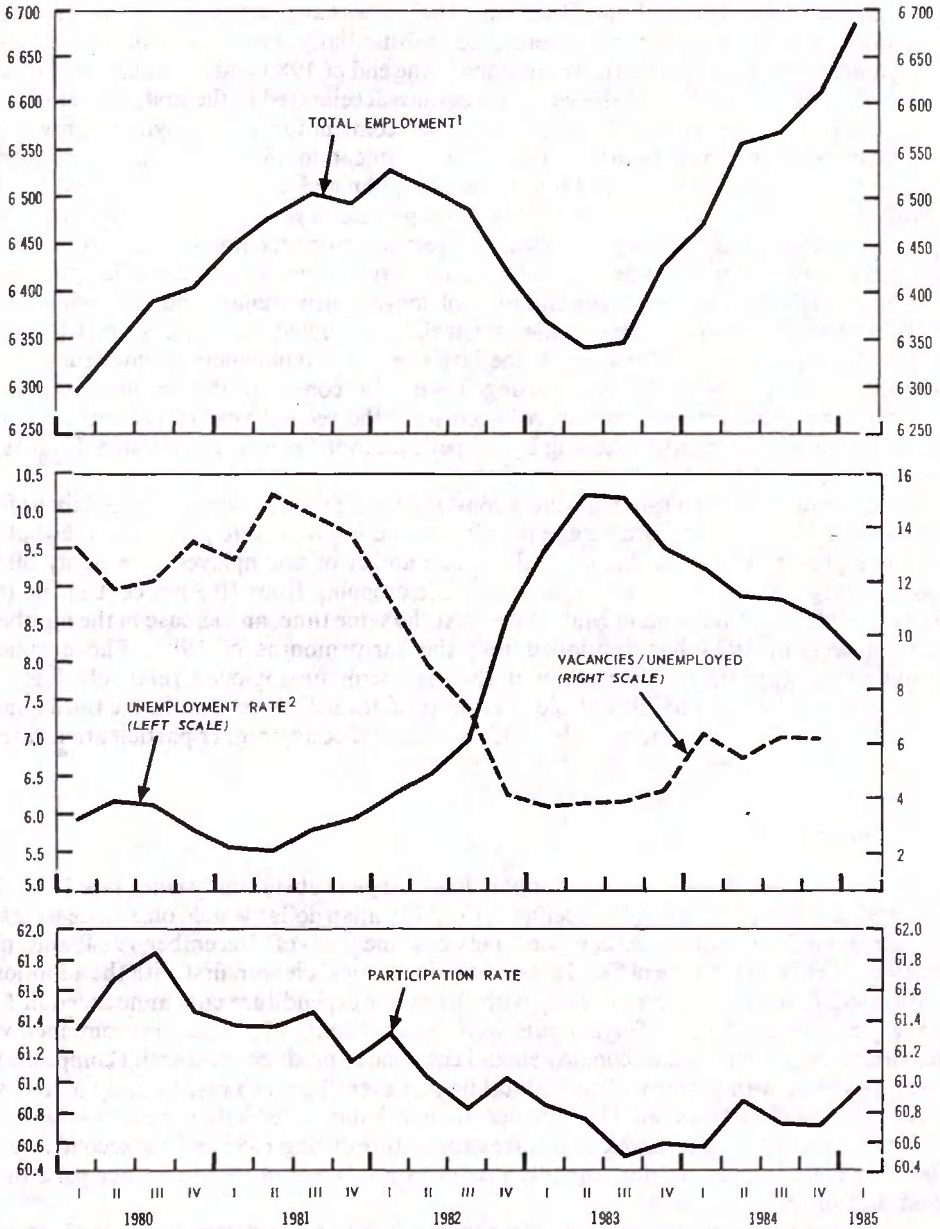
	1982				1983				1984				1985
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Civilian labour force[1]	3.1	–0.2	1.3	3.3	–0.3	1.5	2.1	0.8	2.6	4.0	. .	0.3	3.2
Of which:													
Males	3.2	. .	1.8	2.6	–1.3	1.7	1.1	0.5	1.9	2.5	–0.1	–1.1	1.4
Females	2.9	–0.6	0.3	4.4	1.3	1.1	3.7	1.4	3.7	6.9	0.1	2.6	6.0
Total civilian employment[1]	1.9	–1.8	–1.1	–3.7	–4.0	–1.4	1.7	3.9	3.9	4.8	1.6	1.4	3.4
Of which:													
Males	2.4	–1.8	–1.6	–4.5	–6.0	–2.0	1.3	3.5	3.6	3.1	0.9	0.4	1.7
Females	1.1	–1.8	–0.2	2.4	–0.5	0.3	2.6	4.5	4.4	7.7	2.6	3.1	6.8
Unemployment rate[2]	6.2	6.6	7.2	8.8	9.6	10.3	10.3	9.7	9.4	9.2	8.8	8.6	8.5
Of which:													
Males	5.2	5.6	6.5	8.2	9.3	10.1	10.1	9.4	9.0	8.9	8.6	8.3	8.2
Females	7.9	8.2	8.3	9.8	19.2	10.5	10.7	10.0	9.9	9.7	9.2	9.1	9.0
Juniors looking for full-time work	17.8	19.0	19.6	22.5	25.7	26.8	27.6	25.9	25.8	25.0	24.6	23.6	23.5
Aged 20 and over looking for full-time work	4.7	5.1	5.7	7.5	8.4	9.0	8.9	8.4	8.0	7.9	7.5	7.3	7.2
Participation rate[2]	61.1	60.7	60.6	60.8	60.5	60.4	60.5	60.4	60.5	60.9	60.6	60.4	60.6
Of which:													
Males	77.7	77.3	77.3	77.5	76.9	76.9	76.7	76.5	76.5	76.6	76.3	75.8	75.8
Females	44.9	44.6	44.4	44.7	44.6	44.5	44.7	44.7	44.9	45.5	45.3	45.5	46.0
Average hours worked[3]	32.6	34.1	35.2	35.8	31.5	34.2	35.3	36.0	31.6	35.5	35.6	35.9	33.4
Overtime hours per week, non-farm[3]	1.48	1.45	1.26	1.30	1.14	1.19	1.20	1.09	1.05	1.11	1.06	1.22	1.22
Non-farm vacancies (thousands)[3]	33.7	25.3	21.5	16.4	16.9	17.5	16.7	30.1	44.3	34.8	37.6	39.8	55.0

1. Percentage change over previous quarter at seasonally adjusted annual rates.
2. Seasonally adjusted.
3. Not seasonally adjusted.

Source: Australian Bureau of Statistics.

Diagram 12. **Employment, unemployment, vacancies and participation rates**

Thousands and per cent



1. Values taken at mid-period.
2. Values taken at mid-period. Per cent of civilian labour force.

Source: Australian Bureau of Statistics.

the effects of the wage pause in the first nine months of 1983 on profitability would have assisted renewed employment growth as the recovery gathered pace. In the event, employment began to grow from the third quarter of 1983 and by the first quarter of 1985 had risen by 5.2 per cent (Table 11 and Diagram 12). This was accompanied by some increase in hours worked per week but they remained substantially below previous peak levels. Employment growth was particularly vigorous at the end of 1983 and in the first half of 1984 but slowed in the second half of the year. It has since accelerated in the first quarter of 1985. During the initial stage of the upswing the largest contributor to employment growth was community services (roughly 40 per cent). Employment in this sector had continued to increase even during the recession. Public administration and defence also recorded a strong increase. While this was probably related to the rapid rise in government expenditure, under 20 per cent of total employment growth was in direct government employment. There was also a significant rise in finance, property and business services, partly reflecting deregulation of the financial system but also a continuation of longer-term trends, and somewhat slower growth in wholesale and retail trade. However, it should be noted that there is a relatively high proportion of part-time employment in the latter sector. Employment in construction also recovered substantially with the housing boom. In contrast, the earlier declines in manufacturing employment were not reversed until the second year of the recovery, with manufacturing employment increasing by 2.2 per cent over the year to February 1985 as the recovery broadened.

With the participation rate remaining constant during the upswing, the total labour force has moved in line with the working age population and has tended to grow by somewhat less than employment. There has been a fall in the number of unemployed of roughly 60 000 persons during 1984 with the unemployment rate dropping from 10.3 per cent in the third quarter of 1983 to 8.4 per cent in May 1985[43]. At the same time, an increase in the number of vacancies seen in 1984 has continued into the early months of 1985. The decline in unemployment appears to have affected the long-term unemployed relatively less. The unemployment rate of 15 to 19 year-olds has dropped from 27.6 per cent in the third quarter of 1983 to around 23 per cent in early 1985, possibly reflecting higher participation rates in education.

Short-term prospects

The outlook for the Australian economy has changed substantially since late 1984. The most important factor has been the decline in the Australian dollar which, on a trade weighted basis, amounted to almost 20 per cent between the end of December 1984 and mid-June 1985. The future stance of fiscal policy has also become clearer, first with the adoption of the so-called Trilogy and more recently with the major expenditure cuts announced in May and the clear indication that further cuts were being sought. These factors, combined with some underlying trends in the economy should combine to produce substantial compositional changes in the growth pattern while maintaining an overall growth rate broadly in line with that for the 1984-85 fiscal year. These compositional changes are likely to be of two types, the first involving a switch from public to private expenditure during 1985 and the second a switch in demand from imports to domestically-produced goods which should gather pace in the second half of 1985.

The depreciation of the dollar is likely to give rise to some deterioration in the rate of inflation and, after a lag, a more rapid increase in wages. Consumer price inflation fell to around 5½ per cent annual rate in the second half of the year and remained at this level in the first quarter of 1985. Higher import prices resulting from depreciation should begin to flow

Table 12. The outlook to 1986[1]

	Per cent share of GDP 1982	Constant 1979/80 prices, seasonally adjusted, percentage changes at annual rates							
		Calendar years		Fiscal years		1985		1986	
		1985	1986	1984/85	1985/86	I	II	I	II
Private consumption	62.0	3.6	3.3	3.0	3.5	4.1	3.4	3.2	3.2
Government consumption	15.8	3.3	1.8	6.7	1.8	1.5	1.9	1.8	1.8
Gross fixed investment	24.3	6.2	2.3	7.1	4.0	8.6	2.7	2.4	1.8
Of which:									
Public investment	7.8	5.0	2.0	7.1	2.6	4.5	2.0	2.0	1.9
Private dwellings	3.7	3.2	–1.0	13.7	–1.5	0.0	–2.0	–2.0	2.0
Private construction	2.9	18.8	2.0	20.3	7.3	25.0	2.0	2.5	1.0
Private plant and equipment	9.0	6.0	4.5	0.6	7.6	14.0	6.0	5.0	2.0
Final domestic demand	102.1	4.1	2.8	4.5	3.3	4.6	3.0	2.8	2.7
Stockbuilding[2]	0.0	–0.5	0.0	–0.1	–0.2	–0.8	0.2	–0.2	0.0
Total domestic demand	102.0	3.6	2.7	4.3	3.2	3.8	3.1	2.6	2.7
Foreign balance[2]	–2.8	0.6	1.4	–0.9	1.4	1.6	1.3	1.3	1.4
Exports of goods and services	17.4	5.7	3.3	11.8	3.2	3.5	3.0	3.2	3.9
Imports of goods and services	20.2	2.0	–3.6	15.9	–3.9	–4.4	–3.7	–3.7	–3.4
GDP at market prices[3]	100.0	3.9	4.1	4.5	4.4	3.7	4.5	3.9	4.1
Memorandum items:									
Consumer prices[4]		6.2	6.8	5.8	6.8	6.1	7.2	6.7	6.6
Unemployment rate		8.2	7.9	8.5	8.0	8.3	8.1	7.9	7.8
Current balance (A$ bill.)		–10.4	–9.9	–10.7	–10.5				
As per cent of GDP		–4.7	–4.1	–5.1	–4.5				

1. Based on seasonally adjusted data.
2. Contribution to growth.
3. Includes statistical discrepancy not shown elsewhere.
4. Private consumption deflator.

Source: Secretariat forecasts.

through in the second quarter and are likely to have most of their impact before the end of 1985. The forecasts have been prepared on the basis of a 20 per cent depreciation of the currency on a trade-weighted basis since December 1984 and suggest rises in consumer prices (as measured by the private consumption deflator) of about 6 per cent and 7¼ per cent (annual rates) in the first and second halves of 1985. On the assumption of continuing full wage indexation but with the first round of benefits from the anticipated productivity case delayed until the third quarter of 1986, the rate of inflation is projected to remain above 6½ per cent during 1986. The timing of indexation adjustments means that wage rates are likely to rise more slowly than consumer prices during 1985 but for this pattern to be reversed sharply in 1986. This will not necessarily be reflected in higher profitability in the current year since the price of domestically produced goods can be expected to rise more slowly than the average price level and the margin between domestic costs and prices may change little. However, some improvement in profits is likely in the resources and farm sector following depreciation. Profits could come under pressure in 1986 if wages continue to be indexed to movements in the consumer price index. Large increases in wages during 1986 may also result in considerable cost pressures building up towards the end of the forecast period which may inhibit any fall in inflation in 1987. Investment survey results point to a very strong rise in business investment in the first half of 1985 following a rather weak outcome in the last half of 1984. Given continuing strong growth in demand and current levels of profitability, business investment should continue to perform well throughout the forecast period. Investment in the resources sector, however, is likely to remain weak with depressed world commodity prices and over-capacity in many areas.

Private consumption expenditure is expected to provide the most important contribution to growth in 1985 despite anticipated modest wage growth and a decline in farm incomes. Real household disposable income is projected to grow by a little more than 2 per cent but with the savings ratio falling from the historically high levels of 1984, private consumption is forecast to increase by more than 3½ per cent in 1985. The strongest growth is expected in the first half of the year and this is supported by the results for the first quarter which show real private consumption expenditure rising by 2 per cent (more than 8 per cent at an annual rate). The rate of growth of private consumption is projected to slow slightly in 1986, bringing it more in line with the rate of growth of real household disposable incomes, but is still expected to reach about 3¼ per cent. Both public consumption and public investment are expected to grow more slowly over the forecast period as the Government, in line with its commitment to the so-called Trilogy, brings down the deficit without raising the revenue share in GDP. Residential investment now appears to have peaked after rising by more than 23 per cent in 1984. Dwelling approvals have fallen but have been maintained at a high level. Some decline in activity is possible by the second half of 1985 but the fall is expected to be small. Total stockbuilding is projected to slow over the forecast period with stronger non-farm stockbuilding being offset by a decline in farm stocks following two above average harvests.

Taking these developments together, total domestic demand is projected to grow by about 3½ per cent in 1985 and by 2¾ per cent in 1986, compared with 6 per cent in 1984. However, as the devaluation begins to have an impact on volumes, a switch in demand from imports to domestically produced goods can be anticipated, gathering strength in the second half of 1985. Export growth is likely to be somewhat constrained by conditions in international commodity markets, but with imports projected to fall by about 3½ per cent in 1986, the foreign balance could contribute about 1½ percentage points to growth in that year, compared with a contribution of about ½ percentage point in 1985 and a decline of about 1¼ per cent in 1984. Overall, GDP growth is projected at about 4 per cent in each of 1985 and 1986. The terms of trade, after showing some decline through 1984, should deteriorate further during 1985 and 1986 following depreciation. Currency movements are also likely to give rise to a sharp rise in investment income debits since a large proportion of foreign borrowings are denominated in other currencies. The net effect is that the current account deficit could rise slightly in 1985 to about $10.4 billion but is likely to fall during 1986 to an annual rate of about $9.4 billion by the end of the year.

Certain risks and uncertainties attach to these forecasts. The first relates to the extent to which second round effects associated with the devaluation are transmitted to the domestic cost structure, particularly through wages. If these effects can be kept to a minimum, giving a better inflation performance than projected, growth of private demand could be higher in 1986. This could arise from stronger real income growth in 1985 and a further small fall in the savings ratio in 1986. On the other hand, a lack of success on this front could rekindle inflationary expectations and reduce medium-term growth prospects. The second uncertainty relates to the impact of devaluation on import volumes. It is difficult to determine the magnitude of this price elasticity because of changes in the composition of imports. While the impact on demand for capital equipment may be small, a stronger impact can be expected for consumer goods. In addition, the overall impact will depend on the extent to which the nominal fall in the value of the dollar can be maintained in real terms.

VI. CONCLUSIONS

The Australian economy is now entering the third year of economic recovery Although overall growth has slowed since the first half of 1984, the recovery of activity – similar in strength to that of the United States – has been more rapid than the OECD average, and unemployment has fallen. At the same time, inflation has been reduced significantly. This is partly a reflection of the policies undertaken by the Government, on the one hand to stimulate demand and on the other to establish an agreed incomes policy with the union movement to reduce cost pressures. The slow-down in the rate of growth in the second half of 1984 appears to mark a transition phase in the recovery, with weaker stockbuilding and public consumption (two of the more important factors fueling the initial recovery) not yet compensated by stronger private expenditure. Available indicators point to this transition phase being completed in the first half of 1985, with both private consumption and business investment apparently growing more rapidly than in 1984.

The rise in activity should remain relatively strong this year and into 1986, and some further decline in unemployment is likely. The outlook for inflation is more uncertain. The rate of inflation has stopped falling and cost pressures are now building from a number of sources which may jeopardise the gains already made if the current wage fixing system does not respond adequately. Both growth and inflation will depend to a substantial degree on the impact of the large depreciation of the Australian dollar on import volumes and prices. Moreover, the economy is marked by several imbalances and by some potential difficulties which, if not dealt with fairly quickly, could endanger the continuation of non-inflationary growth.

The sharp fall in the Australian dollar was in large part the result of mounting current account deficits (5½ per cent of GDP in the second half of 1984) even if the magnitude and exact timing of the decline were surprising. Other things being equal, the depreciation of the dollar will initially cause a deterioration in the current account position as it will cause import prices to rise more rapidly than export prices. But unless domestic inflation accelerates substantially, the lagged impact on trade volumes should lead to a significant improvement through the course of 1986. Even so, the deficit is still likely to be large even after two years, principally because of mounting liabilities on investment income. The net stock of foreign debt represented about 16 per cent of GDP in fiscal year 1983-84, of which the bulk was liabilities of the private sector. But since much of the total foreign debt is denominated in foreign currencies, recent exchange rate movements and continuing large current account deficits could see this figure at close to 25 per cent by 1985-86. Annual debt servicing payments (interest plus contractual principal repayments) on this stock of debt increased more than four-fold between 1979-80 and 1983-84 to more than a quarter of total revenue from the exports of goods and services. Part of the present problem relates to depressed world commodity markets which lies beyond the control of policy makers. In addition, as a mineral rich nation, Australia can be expected to be a long-run net borrower in order to finance development of mineral reserves. However, current borrowings do not reflect developments in this area since investment in the resources sector is rather subdued. To the extent that the current account position represents an undesirable imbalance between domestic savings and investment, it needs to be addressed by appropriate policy measures.

A major source of the imbalance lies with the public sector borrowing requirement which is expected to be about 6.5 per cent of GDP for the current fiscal year. This has placed upward pressure on domestic interest rates and attracted adequate capital inflow during 1984 to cover the current account deficit at the then existing exchange rate. Given the exchange rate adjustments that have occurred recently and the strong expansion of private sector demand that is now occurring, it is important that the public sector deficit be wound back quickly enough to give the private sector room to expand. The Government is well aware of the need to bring down its deficit and is intent on doing so by expenditure cuts rather than by raising revenue. Commitment has been made not to raise revenues or expenditure as a proportion of GDP over the life of this Government and to reduce the size of the deficit in nominal terms in FY 1985/86. This is clearly a major policy development as it will simultaneously reduce pressure on interest rates and minimise the risk of excess demand pressures developing. Substantial expenditure cuts have recently been announced, indicating the resolve of the Government in this area. It is, however, a difficult task and one made more difficult by the growing stock of public debt, the servicing of which is a rapidly increasing component of total outlays.

The Accord with the trade union movement, which has been central to the Government's prices and incomes policy and has played an important role in the fight against inflation since its introduction in 1983, will continue to provide the framework for wage settlements during 1985. Under present arrangements, wages are adjusted every six months on the basis of movements in the consumer price index while a productivity case may be under way before the end of 1985. With the fall of the Australian dollar that has occurred since February this year, full indexation of wages provides a potentially dangerous situation with regard to inflation. Current OECD forecasts are based on a depreciation of about 20 per cent on a trade-weighted basis and an assumption that any benefits awarded in a future productivity case do not begin to flow until the second half of 1986. This would appear to add about 3 percentage points to the rate of increase of consumer prices in FY 1985/86. In the absence of any policy changes, relatively large increases in award wages can be expected in March and September 1986 which will result in considerable inflationary pressures persisting at the end of the forecast period. For depreciation to have the desired impact on reducing import penetration, it must not be eroded by further increases in domestic labour costs and prices. Failure in this area will result in a resumption of the inflationary spiral, possibly a squeeze in profits and further declines in the currency. A breakdown in the current strategy of the Government in controlling inflation via agreed incomes policy would leave little alternative to the eventual resort to contractionary monetary and fiscal policies which would put downward pressure on wages through increasing unemployment. The success with regard to both lower inflation and higher employment in the past few years has not been achieved without difficulties. If these gains are to be maintained, labour cost pressures must continue to be controlled. At this stage, the Government has not indicated that it would argue for the exclusion of the effects of currency depreciation on consumer prices before adjusting wages and consideration is being given to less direct means which would achieve the same result. One possible alternative could be to delay introduction of any productivity award, but given the magnitude of the added inflationary pressure coming from import prices, this delay would need to be quite long. The trade union movement carries considerable responsibility in this area given the benefits that have been conferred on it through a policy approach based on consultation and consensus.

The process of deregulation of the financial markets, which was set in train in 1979 with the establishment of a committee of inquiry, accelerated during 1984 and early 1985. The major problem associated with the plethora of controls that existed was that they had an uneven impact on the banking sector and caused changes in monetary policy to have distortionary effects within financial markets. The market was also capable of at least partly offsetting monetary policy changes, either through foreign capital flows or by changes in lending by non-bank financial intermediaries which were largely beyond the control of the monetary authorities. With the floating of the Australian dollar in December 1983 and with the removal of most interest rate and deposit taking restrictions, the environment was created within which monetary policy could be far more market oriented in its operations and monetary authorities could exercise greater control over prime liquidity in the system. However, it has created short and medium-term problems relating to monetary targeting. The Government was forced to suspend its conditional projection for M3 growth and this was clearly a correct decision. With M3 having grown at an annual rate of about 13½ per cent in the first half of the fiscal year, the degree of contraction that would have been required to achieve the conditional projection range of 8 to 10 per cent would have been both large and unjustified. The available evidence suggests that the problem is not simply reintermediation by the banking system but increased intermediation by the whole financial system. Some commentators have argued that the Government should have merely revised the projection for M3 growth and that this would have avoided much of the uncertainty that existed in financial markets in early 1985. However, given the problems of trying to interpret what a particular growth rate of M3 currently signals with regard to the stance of monetary policy, it is doubtful if this would have served any useful purpose. However, it is apparent that the market was rather uncertain for a time as to the direction of monetary policy and this was complicated both by the sharp decline in the Australian dollar and the unusually large seasonal fluctuations in liquidity associated with provisional and company taxation payments. Interest rates, particularly the cash rate, are now accepted by the market as being the best indication of monetary stance. All market rates rose substantially in early 1985 and although they have since fallen from peak levels, it is evident that monetary policy is now significantly tighter than was the case in the second half of 1984. This was in fact acknowledged by the Treasurer in May 1985. It will be difficult for monetary targeting to be reintroduced in any meaningful way for some time and the authorities are now providing more information relating to financial market conditions. The authorities are encouraged to continue this process in order to clarify the role being played by monetary policy in economic management and to minimise uncertainty in financial markets.

Deregulation of the financial system should contribute importantly to improving the flexibility and responsiveness of the economy in the long term. In this regard there are a number of areas where greater policy efforts would appear necessary. First, financial deregulation left the control on interest rates on housing loans intact on social grounds. However, in the far more market-oriented financial system this is likely to be self-defeating in its objective. If lending rates for housing are kept below market rates, lending institutions will either divert their loans to other parts of the market or, where this is not possible, face the choice between lower margins on loans or a declining deposit base. Hence, it would appear that neither social goals nor economic efficiency gains would be served by continuing interest rate controls. Second, current marginal income taxation rates in Australia are exceptionally high even for income levels only slightly above average weekly earnings. This gives rise to significant disincentive effects and tax avoidance on a massive scale. Some major taxation reform has been proposed by the Government. The preferred option is for a major broadening of the income tax base and the introduction of a broadly-based consumption tax, offset by a significant reduction in all marginal income tax rates. Given that the proposed indirect tax increases would add an estimated 6½ percentage points to the level of consumer prices, it will be important for the Government to obtain union support for such an approach in order to neutralise inflationary consequences that would flow if wages continue to be fully indexed to the consumer price index. Third, as pointed out, the present wage-fixing apparatus must cope with recent changes in the exchange rate. An ability to do so has yet to be demonstrated. In addition, the present system of wage determination tends to keep the structure of relative wages unchanged, a rigidity which may lead to a weakening in the responsiveness of the economy. However, care should be taken to ensure that any attempts to overcome this problem should not lead to a loss of control over aggregate wage growth. Finally, in contrast with deregulation of financial markets, only slow progress has been made in dismantling barriers to imports, which are high in certain areas.

In summary, the Australian economy is well placed to enter the third year of recovery with demand growing strongly and unemployment falling further. However, if this growth is to be maintained beyond the 1985-86 fiscal year, it is important that wage restraint be sufficiently marked to enable the recent decline in the dollar to be effective and for further progress to be made in reducing inflation. Monetary indicators will need to be monitored very carefully during the current adjustment period to ensure that monetary policy continues to be non-accommodating without being contractionary. Reduction of the fiscal deficit should be a major goal and given the apparent strength of private expenditure, this should in no way endanger the recovery. A reduction in public expenditure of the order of magnitude assumed in the OECD projection should be compensated by a switch in demand from imports to domestically produced goods and services. Over the longer term, decontrol of the financial system should raise economic efficiency and effectiveness of monetary policy. The Government has embarked on a major and overdue programme of tax reform and should be encouraged to strengthen its initial efforts in trade liberalisation and the restructuring of industry. But successful economic management will crucially depend on how effectively the wage-fixing apparatus can be run.

NOTES AND REFERENCES

1. The fiscal year runs from 1st July to 30th June.
2. Legislation froze public servants' wages for twelve months.
3. The Accord, which was announced in February 1983 prior to the elections, set out support for centralised wage determination based on *prima facie* full indexation of wages and movements in prices and the establishment of a price surveillance authority. Agreement was also reached that the maintenance of real wages should be a key objective although this could be temporarily compromised during a period of economic crisis. This was taken one step further at the Summit when it was agreed that this option should be developed under the auspices of the Commission. After a conference convened by the President of the Commission and a hearing of a National wage case at the end of June 1983, the Commission agreed in September to indexation of wages on the increase in the consumer price index over the previous six months. It also introduced a set of wage fixation principles which *inter alia,* provide for full indexation of wages every six months for past movements in the Consumer Price Index except in exceptional circumstances. They require unions to individually give commitments to no extra claims outside the system and allow for a hearing, upon application and not before 1985, of claims for improved wages and/or conditions on account of national productivity improvements. The Principles were to be reviewed after two years.
4. In Australia since the mid-1970s the Budget has included a conditional projection for a money supply growth, primarily M3. While the authorities never referred to this as a money supply target, financial market participants have tended to consider it as such.
5. The "Trilogy" refers to the Government commitment, originally made during the election campaign in late 1984, not to allow expenditure and revenue and deficit to increase as a proportion of GDP. Subsequently the commitment was extended to reducing the size of the Commonwealth deficit in nominal terms in FY 1985/86.
6. Overdrafts over $100 000 have been free of interest-rate ceilings for some time. During the late 1970s, rates on such loans were often as much as 3 percentage points higher than the controlled rate on smaller overdrafts. Since late 1982, there have been periods when the ceiling on small overdrafts (currently 14.5 per cent) has been above the market rate. At such times, average interest rates have generally been lower on large than on small overdrafts. This provides some indication of the effect of interest rate restrictions on bank lending to business.
7. Australian Financial System Inquiry, *Final Report,* A.G.P.S., Canberra, 1981. An interim report was published in 1980.
8. Australian Financial System, *Report of the Review Group,* A.G.P.S., Canberra, 1984.
9. Interest rate developments in the second half of 1984 may have resulted from speculative misjudgement concerning a possible fall in interest rates. This would have had the effect first of all of driving interest rates on securities down and then causing them to rise once it was evident that the Reserve Bank was intent on preventing call rates from falling. It may also be consistent with banks' attempts to compete more actively for market shares in late 1984 and expectations regarding the seasonal tightening in liquidity.
10. The public enterprises are a very important component of the borrowing requirement. In FY 1983/84 they represented roughly half of the total. On a standard national accounts basis (i.e. excluding public enterprises) the general government deficit as a share of GDP would be closer to 4 per cent.

11. Employment and training programmes were strengthened, housing incentives were announced while a number of measures to widen the tax base and cut back on certain types of social security payments (means of testing of old age pensions) were also introduced. However, a number of these were later abandoned or substantially modified.

12. Medicare is a partly public financed health insurance scheme covering basic health care.

13. Aimed at collecting tax at source of certain sectors of self-employed persons where tax evasion was considered to be particularly important.

14. Personal income tax revenues (national accounts basis) were practically 30 per cent higher in the third quarter 1984 year-on-year before the tax changes were introduced.

15. The collection of corporate taxation lags accruals of profits by approximately one year.

16. In particular a tax on imported wine and a pre-budget measure regarding a change in the excise tax on oil discovered after 18th September 1975.

17. These are mainly capital gains or losses, imputed rent from owner-occupied housing and certain pension benefits. Further, it is claimed that many small companies are used as a means of deducting expenses, and there is often considerable non-wage income received which is not taxed. At the same time, income splitting has permitted the reduction of marginal tax rates for certain groups, particularly those household units with substantial property income. Lump sum pension payments were taxed, though at a rate generally lower than for income taxes, as from May 1983 thus partly removing this loophole.

18. The marginal tax rate at average earnings has risen from 19 per cent in 1954/55 to 46 per cent in 1984/85 and the average rate from 10 to 25 per cent. Over the same period, the number of persons paying a marginal rate of 46 per cent rose from roughly 1 per cent of all full-time employed persons to around 39 per cent.

19. The guidelines to tax reform are:

    i) Tax reform should not increase the tax burden;
    ii) Personal income taxes should be cut, and although not explicitly stated, lower marginal tax rates appeared to be an important consideration;
    iii) Reforms should reduce tax avoidance and evasion;
    iv) Reforms must lead to a simpler tax system;
    v) The tax system should be based on ability to pay and be progressive;
    vi) Tax increases must not be disadvantageous to welfare recipients;
    vii) Indirect tax increases must be acceptable to various groups in the community whose response will determine whether moderation in wage movements can be maintained;
    viii) The reform must enhance the climate for investment, growth and employment;
    ix) Reforms must have wide public support.

20. *Reform of the Australian Tax System*, Australian Government Publishing Service, June 1985.

21. In kind transfers would be taxed at the level of the employer.

22. With exemptions for a taxpayer's principal residence.

23. It is also proposed to limit the concessional rebates on certain types of expenditure such as insurance, health and superannuation to health expenditure alone. These currently receive tax rebates at 30 cents to the dollar up to certain ceilings. Additional measures include taxing foreign source income where foreign tax is less than Australian tax, and the removal of a number of concessions to different sectors such as the film industry.

24. As this alternative would lead to a once-and-for-all rise in the CPI of 6.5, per cent it would adversely affect some income groups, particularly those not paying income tax at the moment. Careful attention therefore has been paid in the White Paper to proposing a system of compensation which would avoid detriments to needy income earners and could even improve their relative income position.

25. Under this approach the maximum marginal rate would be 50 per cent at over $35 000 compared to the current 60 per cent.

26. There are a number of additional proposals regarding the integration of the corporate and income tax system and adjustment for inflation in business taxation.

27. The Loan Council co-ordinates the borrowings of the Commonwealth and the States and consists of representatives of the Commonwealth and each State Government. It limits the total amount of borrowing by the Commonwealth for its own purposes and on behalf of the State Governments. A relaxation of controls in the early 1980s led to a marked increase in borrowings by public enterprises outside the Loan Council. This led to the current "Global Approach" which increased the scope of oversight on borrowings by public enterprises and other semi-public bodies but increased the authorities' flexibility to borrow as they see fit.

28. The wage determination system is described in some detail in the 1984 OECD Economic Survey of Australia. The system was essentially based on minimum wages (awards) established for each group of workers by the wage tribunals at the Commonwealth and state levels. The national tribunal, the Arbitration Commission, sets national awards for all workers under its jurisdiction. From mid-1981 through to the end of 1982, negotiations on an industry-by-industry basis resulted in many consent agreements being ratified by the industrial tribunals. These agreements related to movements in prices and productivity and usually incorporated commitments by unions not to pursue extra claims for award or over-award payments during the life of the agreement. As strategic unions won increases in pay and reduced hours, the concept of comparative wage justice was invoked to spread these to other sectors.

29. Increases are set on the cumulative price increases in the preceding two quarters. This differs from the figures in Table 6 which shows growth rates on the basis of half-yearly averages.

30. It should be noted that while there was agreement on a return to a centralised system, there was no agreement by employers to wage indexation.

31. To obtain the indexation increases, individual unions are required to make a commitment not to pursue claims other than in accordance with the principles. The wage fixation principles provided that the Commission will adjust award wages and salaries in relation to movements in the CPI unless it is persuaded to the contrary, and that the form of indexation will be a uniform percentage adjustment unless the Commission decides otherwise in light of exceptional circumstances. The principles are intended to relate to both award wages and salaries and over-award payments.

32. The Committee of Review into Australian Industrial Relations Law and Systems (the Hancock Committee) has made some recommendations relevant to these questions.

33. From the first quarter of 1984, both the public and private consumption expenditure aggregates should be adjusted to allow for the impact of the introduction of Medicare which transferred certain expenditures on health care, formerly included as private consumption expenditure, to public consumption expenditure.

Private consumption before and after adjustment

Per cent change, annual rates

	1983 II	1984 I	1984 II
Unadjusted	3.0	2.4	2.4
Adjusted	3.0	3.2	2.8

34. For the methodology of this adjustment see the footnote to Diagram 8.

35. After adjustment for the introduction of Medicare and sale/leaseback transactions, public final demand in the two half years of 1984 averaged 5.6 per cent. The sale/leaseback transactions refer to sales of certain assets (primarily electricity generating capacity) to the private sector and their subsequent leasing by the public sector. This was introduced as a method of financing public investments.

36. A greater amount of funds became available in the housing market in 1983 as savings banks, major suppliers of housing finance, became better able to compete for deposits and this was enhanced by declines in interest rates generally which made their rates relatively more attractive. The government incentive schemes, the Home Deposit Assistance Scheme and the First Home Owners Scheme (FHOS) – the latter introduced on 10th October 1983 – were designed to either cushion borrowers from very high interest rates or subsidise first home purchases. The latter provided assistance of up to $7 000 for families with two dependents and a taxable income of $24 300 or less and with reduced benefits for those with income up to $27 900. These income limits were reduced slightly in the August 1984 Budget. The Government estimated that 55 250 persons benefited in 1983/84 and a further 80 000 were expected in 1984/85.

37. See Annual Survey of Australia 1984, pp. 18-20.

38. The fall in the growth rate was less pronounced once leaseback sales with the public sector are taken into account (Diagram 7).

39. The statistical information in this paragraph was drawn from flow of funds rather than budgetary data. While levels may be slightly different from the budgetary concepts, the magnitude and direction of change is broadly similar.

40. This will be tempered as the devaluation – if maintained in real terms – feeds through into lower imports.

41. The recent fall in the Australian dollar appears to be sufficient to have returned competitiveness to the level of the late and early 1970s.

42. Direct investment was particularly strong in 1979/80, 1980/81 and 1982/83.

43. The unemployment rate remains roughly 3 percentage points above the trough in 1981.

Annex I

AUSTRALIAN FINANCIAL SYSTEM POLICY CHANGES

A description of the major policy decisions influencing the regulation of the financial system, particularly the banking industry, and an assessment of the consequences of these changes is provided below.

A. Banking policy changes

Bank interest rate ceilings

In December 1980 the ceilings on interest rates offered by trading and savings banks on deposits were removed. This removed a significant constraint on the ability of the banks to attract deposits and to respond to increased demands for finance. It allowed the banks to adopt a more flexible approach to portfolio management and led to the introduction of new financial packages such as statement savings accounts. These developments in turn have provided scope for increased return on the savings held by the household sector with the banks. A very recent decision by the Government has seen the removal of all interest rate controls except in the area of loans of less than $100 000 for owner-occupied housing.

Bank quantitative lending restrictions

In June 1982 the Reserve Bank withdrew its previous practice of establishing quantitative lending guidelines for trading banks, i.e. to keep growth in their advances outstanding to not more than 12 per cent per annum.

These lending restrictions had become increasingly ineffective as demand for finance turned down by banks was satisfied through other lenders. The restrictions also reduced competition by freezing market shares of individual banks. The removal of direct restrictions on bank lending put greater reliance on market operations for the attainment of monetary policy objectives. This was consistent with the development of measures introduced for the issuing of government securities.

Savings Banks Regulations

In August 1982 the Banking (Savings Banks) Regulations were amended such that each savings bank was required to invest a minimum of 15 per cent of depositor's balances in cash, deposits with the Reserve Bank and Commonwealth Government Securities. Previously, savings banks had been required to maintain 40 per cent of depositors' balances in certain liquid assets and government and semi-government securities, of which at least 7½ per cent was to comprise deposits with the Reserve Bank and Treasury notes. In addition Regulations were amended such that savings banks were permitted to invest up to 6 per cent of depositors' balances in assets of their own choice. Previously, savings banks had been required to invest 100 per cent of depositors' balances in prescribed assets. The Regulations were also amended to allow savings banks to accept deposits from profit-making bodies up to a limit of $100 000 for any one depositor. Savings banks were not previously allowed to accept deposits from profit-making entities.

The amendments to the Banking (savings Banks) Regulations provided for a greater degree of flexibility in the investments of savings banks. In addition, the range of possible sources of bank deposits has been extended. These moves have enhanced the competitive position of the savings banks.

Bank maturity controls

In April 1984, the Treasurer announced the removal of all remaining maturity controls on deposits of trading and savings banks. As from 1st August 1984, there are no minimum or maximum periods for which trading and savings banks may offer interest on deposits. In addition, the savings banks are allowed to offer cheque facilities on accounts of all customers, and there is no restriction on size of deposits from trading or profit-making bodies.

The removal of these restrictions has enhanced the ability of the banks to compete with non-bank financial institutions in the short-term money market. While consequential developments need to be monitored to assess the full impact of the removal of these restrictions it is already clear that reintermediation by the banks is occurring.

Participation in banking

The reduction in controls over the operation of banks, and the resultant improvement in the capacity of banks to compete with other financial institutions, called into question the appropriateness of restrictions preventing or limiting the entry of new participants into banking. With the objective of increasing competition in banking, the Government has initiated a number of steps to facilitate entry into the industry by both domestic and foreign interests, including increasing the threshold limit on individual shareholders in a bank from 10 to 15 per cent and providing scope for shareholdings in excess of the threshold where it is considered appropriate.

On 10th September 1984, the Government called for applications for a limited number of new banking authorities from domestic and foreign interests. Foreign interests had previously not been permitted to have more than a small portfolio investment in Australian banks. It was recognised that participation by foreign interests would be required for an early and effective increase in competition.

On 27th February 1985, the Treasurer announced that the Government had selected sixteen new banks which would be invited to establish operations in Australia. The selected banks are proceeding with discussions with the Reserve Bank of Australia and the Treasury to develop the proposals put forward to the point where a recommendation could be made to the Governor-General for the granting of an authority to carry on banking business.

The entry of new banks into Australia is expected to bring substantial benefits to Australia through the development of a more innovative, efficient and competitive financial sector. Particular benefit will be derived from the extensive involvement of parent banks in overseas markets of interest to Australian exporters and access to the world's capital markets.

In making its decision, the Government also had particular regard to the need to secure an appropriate regional distribution, taking account of trade and other economic factors, foreign relations and reciprocity considerations.

The Government does not envisage issuing a further invitation to foreign interests to establish banking operations in Australia. Banking applications from domestic interests, however, will continue to be considered in accordance with established policy.

B. Foreign exchange policy changes

Float of the Australian dollar

In December 1983, the Treasurer and the Reserve Bank announced that the spot exchange rate, as well as the forward market, would be determined by the market and that a major part of the existing exchange controls would be abolished. The float of the dollar was a major step towards a more market-oriented financial system. The exchange rate for the Australian dollar is now free to settle at the level required to clear the market.

The Government now has a greater capacity to maintain monetary conditions appropriate to domestic needs. Furthermore, the removal of exchange controls has increased the potential involvement of Australian enterprises in international transactions.

Dealing in foreign exchange

In April 1984, the Treasurer announced that the Government had decided to increase the number of foreign exchange dealers by authorising non-bank financial institutions that meet certain criteria and agree to certain conditions. At present there are 56 authorisations to deal in foreign exchange, 16 of which are for banks. The decision to remove foreign exchange dealing from the exclusive reserve of the banks was in recognition of the fact that in moving to a market-determined exchange rate there would be a need for additional dealers in foreign exchange in order to add depth and competition.

As a result of this change, the only remaining distinction between banks and merchant banks, in terms of activities undertaken, is that the latter do not have direct access to the payments system; nor do they have access to lender of last recourse facilities provided by the Reserve Bank.

C. Shareholdings in merchant banks

In August 1984, the Reserve Bank announced the removal of the requirement that banks limit their equity interest in merchant banks to a maximum of 60 per cent. Subsequently, in conjunction with the invitation for new banking authorities, the Treasurer announced that the Government would waive, for twelve months, aspects of foreign investment policy relating to the merchant banking sector. These measures are designed to facilitate the rationalisation of shareholdings in merchant banks and allow for 100 per cent foreign owned merchant banks. Already, the shareholdings in a number of merchant banks have been consolidated.

D. Securities market

From 1 April 1984, changes to the Stock Exchanges' rules permitted the negotiation of brokerage rates (previously fixed rate brokerages). At the same time, the membership rules were changed permitting brokers to incorporate, and allowing non-members to acquire up to 50 per cent shareholding in an incorporated stockbroking business. From 1 April 1987, it is likely that membership rules will permit 100 per cent ownership of stockbroking firms by outside interests.

On 18 April 1984, the Treasurer announced that foreign interests would be permitted to acquire individual interests in stockbroking firms up to 15 per cent and that foreign portfolio shareholdings in a stockbroking firm could aggregate up to 40 per cent. On 18 December 1984, the Treasurer announced the Government's decision to increase to 50 per cent, the maximum permitted shareholding in Australian stockbroking businesses that may be held by foreign interests. The Government intends to review developments in the stockbroking industry prior to 1 April 1987, when stock exchange rules are scheduled to be further liberalised.

In the period since the introduction of the amended AASE rules and the Government's policy announcements, the stockbroking industry has undergone some major changes. Many major broking firms have announced their intention to incorporate in order to strengthen their capital base; the three major private trading banks and a number of Australian non-bank institutions have announced equity linkages with stockbrokers; several foreign interests have announced acquisitions of equity interests in stockbroking firms; and commission brokerage rates are reported to have fallen generally by about 40 per cent.

All the major Australian stock exchanges are in various stages of establishing Second Board Markets for listing small to medium size companies on less onerous terms than are required for listing on the main boards.

E. Life insurance assets

On 10 September 1984, the Treasurer announced that the Government had abolished the "30/20" rule which required life insurance companies and some superannuation funds to hold 30 per cent of their assets in public securities (and at least 20 per cent in Commonwealth securities) in return for certain tax concessions. The tax concessions have been retained.

Annex II

CALENDAR OF MAIN ECONOMIC EVENTS

1984

1st January

The new prices and excises to apply to indigenous crude oil came into effect. The new price for Bass Strait was set at $34.68 per barrel, a reduction of $1.85 per barrel on the prevailing price.

25th January

The Treasurer announced that it now seemed likely that GDP growth in FY 1983/84 would be close to 5 per cent, compared to 3 per cent envisaged in August 1983.

31st January

The Reserve Bank announced that it had sold almost all of its outstanding forward exchange contracts.

2nd February

Excise duty on beer, spirits and tobacco products and refined petroleum products would rise in line with movements recorded in CPI in September-December quarters of 1983.

9th February

Australian Conciliation and Arbitration Commission ratified a union/employer agreement over the introduction of a 38 hour week.

1st March

Announcement of a government package aimed at increasing apprenticeship opportunities in 1984.

8th March

Establishment of a Small Business Council to provide a forum for consultation and advice on matters affecting small business.

19th March

The Prices Surveillance Act 1983 came into operation with petroleum product prices and principal postal and telecommunications charges under surveillance.

26th March

Completion of arrangement to improve consultation between industry and unions which involved restructuring of the Australian Manufacturing Council and the establishment of ten industry councils.

28th March

New pricing and subsidy arrangements announced for liquid petrol gas.

1st April

Changes in rules regarding foreign ownership of stockbroking firms allowing up to 50 per cent foreign ownership.

2nd April

Changes to regulations concerning banks (see Annex I).

4th April

The Australian Conciliation and Arbitration Commission awarded a 4.1 per cent increase in wages.

10th April

The number of exchange dealers increased and further changes to banking regulations announced (see Annex I).

18th April

New taxation measures for the petroleum sector to take effect from 1st July 1984.

- Present excise arrangements to apply to "old oil";
- A lower excise scale to apply to production of "new" oil onshore and existing projects offshore;
- Offshore petroleum projects not yet in development stage will be subject to a resource rent tax with no excise or royalty applied.

29th May

Announcement of a new policy for the automobile industry: import restrictions to be gradually decreased, reclassification of some types of vehicles as passenger vehicles, amendment of the export facilitation scheme and establishment of an Automobile Industry Authority to oversee restructuring.

1st June

Announcement of the form of the assets test for pensions which excludes pensioner's home (with allowances for non-home owners) from the test.

Increase in quotas for most textile clothing and footwear categories.

19th June

Forty non-bank financial institutions meeting certain criteria would be authorised to act as foreign exchange dealers.

21st June

The results of the Loan Council/Premiers Conference meetings which included an increase in real total payments to the States of 2 per cent in FY 1984/85, the adoption of global limits on Commonwealth and State public enterprise borrowings and an increase in the ceiling of total overseas borrowings.

25th June

The Resource Rent Tax to apply to new offshore oil projects from 1st July 1984. The tax is to be levied on projects prior to company tax at a rate of 40 per cent on income over a profit threshold set at the long-term bond rate plus 15 percentage points.

29th June

Changes to the marketing of Government securities to make them easier to purchase but reductions in the facilities for early redemption of Australian savings bonds.

1st July

The import parity prices for Bass Strait crude oil increased by $0.63 per barrel and the excise rate on liquid petroleum gas reduced by $12.27 per kilolitre to $36.96 per kilolitre.

5th July

Reductions in duties on certain electrical components and computer software. Increased subsidies (bounties) for computer hardware and software.

1st August

A number of controls on interest rates on deposits lifted (see Annex I).

2nd August

The Australian Conciliation and Arbitration Commission decided on guidelines relating to job termination, change, and redundancy.

20th August

The Treasurer accepted certain recommendations of the Price Surveillance Authority on petroleum prices and surveillance procedures.

Reduction in prime rate of Westpac Bank of ¼ of a percentage point.

21st August

The Commonwealth Budget for FY 1984/85 brought down. Key measures included a $1.3 billion in tax cuts, a $430 million welfare package, an extension of the investment allowance and tax concessions for business, a tightening in the first home-owners scheme, a 20 per cent sales tax on low alcoholic beer and a 10 per cent tax on wine and cider.

27th August

Government decided to subsidise selected organisations introducing industrial democracy measures.

3rd September

Westpac Bank reduces prime rate by ½ a percentage point.

5th September

National wage case suspended for the second half of 1984.

7th September

New housing agreement announced between Commonwealth, State and Territory governments regarding low cost loans, eligibility and rents.

10th September

The 30/20 ruling abolished (see Annex I).

11th September

Announcement of tougher penalities for taxation offences (legislation enacted 19th October).

17th September

Reduction of ¾ percentage point in prime rate of Westpac Bank.

21st September

Amendments to the Life Insurance Regulations permitting life offices to offer annuities at more attractive rates.

25th September

Announcement of a voluntary and unilateral additional contribution to the International Development Agency of the World Bank.

Increase of a minimum of 10 per cent in grant levels from 1st November 1984 for the Community Youth Support Scheme.

1st October

A small reduction in liquid petroleum gas prices announced.

9th October

Government announced modified allocation arrangements for the sale of indigenous oil production from 1st January 1985.

19th October

Legislation to counter tax avoidance in connection with certain employer sponsored employee superannuation funds enacted.

23rd October

Special excise tax to encourage development of "old" oil fields which have not been developed to date.

25th October

Report by the Prices Surveillance Authority on principal Telecom charges.

1st November

As foreshadowed in the FY 1984/85 Budget, tax reductions and increases in pension benefits were implemented. The new tax scale included five steps with a new 25 per cent lower band. Basic pension benefits were raised by 2.7 per cent.

9th November

New arrangements for bond sales announced by the Reserve Bank.

13th November

Approval for the construction of a new steel plant in Queensland.

17th November

The Australian Clearing House Committee announced that any new bank will have access to the cheque clearing system.

1st December

Australian Commonwealth elections. Labor Party returned to power.

4th December

Revised parity prices announced for crude oil produced from the Cooper Basin and Jackson area to take account of quality differentials.

12th December

The Price Surveillance Authority reported its conclusions on charges by the Australian Post with some increase to the rates recommended.

Revised arrangements announced for trans-Tasmen trade in motor vehicles and components between Australia and New Zealand.

14th December

Interest tax withholding provisions strengthened to counter techniques of reducing non-residents' tax liability.

Supplementary decision by the Australian Conciliation and Arbitration Commission regarding the form of termination redundancy and changes of employment.

16th December

Accrued interest on deferred interest bonds to be treated as taxable in the year accrual takes place.

17th December

Decision to increase to 50 per cent the maximum permitted shareholdings that may be held by foreign interests in domestic stockbroking firms.

18th December

Price Surveillance extended to wholesale prices of beer, cigarettes, float glass and concrete roofing tiles. The Price Surveillance Authority isssued a draft of general pricing guidelines which could be adopted voluntarily by business and public authorities.

24th December

Ratification by the Australian Conciliation and Arbitration Commission of an oil industry agreement which centres on improved long-service leave.

1985

1st January

Import price parities on crude oil adjusted. Price of Bass Strait crude oil raised by $1.42 per barrel.

2nd January

The Commonwealth Government approved two contracts to supply uranium to United States electricity utilities.

10th January

The Australian Conciliation and Arbitration Commission rejects the claim by the Commonwealth Public Servants for an 8.3 per cent wage claim.

13th January

Treasurer announces a taxation summit to be held in the first week of July.

15th January

Removal of interest rate restrictions on interest-bearing deposits by foreign banks.

23rd January

Release of the Final Report of the Committee of Enquiry into Labour Market Programmes (Chairman, Mr. Peter Kirby). Recommended the establishment of a new traineeship system for 16 to 17 year olds in place of the traditional apprenticeship system.

29th January

Abandonment of the conditional projections of M3 growth (8 to 10 per cent) stated in the FY 1984/85 Budget.

30th January

Agreement in principle by the Government of a system of traineeship for young people aged 16 to 17 years as recommended by the Kirby Report.

4th February

Non-monetary benefits received by business tax-payers to be taxed.

The New South Wales Building Society announced its intention to become a savings bank.

6th February

Pressure on Australian dollar as US dollar rises.

18th February

Tax loophole associated with lump-sum superannuation closed.

19th February

Australian dollar under further pressure.

24th February

Agreement between Victorian, South Australian and New South Wales governments to construct an electricity grid linking the eastern seaboard states by 1990.

27th February

Selection of sixteen new banks to be offered banking licences (authorities) in Australia (see Annex I).

1st March

Import price parity for crude oil adjusted. Bass Strait crude oil raised $1.66 to $38.44 per barrel.

7th March

Price surveillance extended to wholesale prices of packet tea, tea bags and instant coffee.

The Commonwealth Government announced a review of the two airline policy.

13th March

The Treasurer instructed the Price Surveillance Authority to enquire into the price of fruit juice supplied by certain firms which recently negotiated wage increases with the Food Preserves Union.

Additional assistance to honey industry rejected.

22nd March

Announcement of new Federal arrangements for the dairy industry to reduce the complexity and intensity of regulation and to move the industry towards a more market-oriented approach.

26th March

Provision of adjustment assistance to the dried-vine fruits industry.

1st April

The Prices Surveillance Authorities endorsed a uniform maximum wholesale price of 45.59 cpl for 91-93 octane unleaded petrol (ULP) and 97 octane leaded petrol (super). This price was 0.15 cpl above the previous price for 97 octane, reflecting higher production costs for ULP. In some States, 97 octane continues to be subject to low-lead price premiums.

2nd April

The Commonwealth Grants Commission presented its 1985 *Report on State Tax Sharing Relativities* to the Special Minister of State. The Commission made recommendations concerning new relativities for the distribution of general revenue assistance to apply after 30 June 1985.

3rd April

A full bench of the Australian Conciliation and Arbitration Commission awarded a 2.6 per cent increase in award wages and salaries. This increase reflected the increase in the Consumer Price Index over the year to the December quarter 1984.

22nd April

The Minister for Resources and Energy announced the adjustment of the import parity prices for indigenous crude oils from 1 May 1985 to reflect exchange rate changes since the previous adjustment on 1 March. From 1 May the Bass Strait import parity price would be increased by $6.53 to $44.97 a barrel.

24th April

A full bench of the Queensland Industrial Commission exempted the sugar industry in that State from the 2.6 per cent national wage increase, on the grounds that the industry did not have the capacity to pay the increase. The Commission refused to grant any increase to field hands, and granted an increase of 1.6 per cent to mill workers.

Amendments to the Life Insurance Regulations were gazetted allowing life offices to offer annuities on more attractive terms than at present.

29th April

The Treasurer and the Minister for Industry, Technology and Commerce announced that interest rate controls on bank loans under $100 000 for all purposes other than owner-occupied housing (including overdrafts, fully drawn advances, term and farm development loans, personal instalment credit and bankcard credit) would be removed. It was also announced that legislation would be introduced to broaden the charter of the Commonwealth Development Bank to enable it to lend for all business purposes and to provide equity finance and packages of equity and debt.

8th May

Introduction of a prime assets ratio (PAR) for trading banks to replace the liquid assets and government securities (LGS) ratio convention.

14th May

The Treasurer announced expenditure cuts from forward estimates for FY 1985/86 totalling $1 259 billion. The majority of these cuts are on recurrent expenditure.

20th May

Release of the report of the Committee of Review into Australian Industrial Relations Law and Systems (Hancock Committee).

3rd June

Release of the white paper *Reform of the Australian Tax System* regarding proposed changes to the tax system.

STATISTICAL ANNEX

Selected background statistics

	Average 1975-84	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
A. Percentage changes from previous year at constant 1979/1980 prices											
Private consumption	2.6	4.0	2.8	1.0	3.0	2.5	3.3	3.5	2.9	1.5	2.5
Gross fixed capital formation	1.4	–0.4	3.5	–1.5	2.1	2.1	4.3	9.9	–3.0	–9.3	5.5
Public	0	12.2	–8.4	2.3	–2.3	–2.1	–1.9	–4.2	11.1	0.3	6.9
Private	2.2	–7.5	11.5	–3.5	4.7	4.5	7.6	16.6	–8.5	–13.9	4.6
Residential	2.6	–13.3	29.9	–5.9	–6.8	9.9	13.5	3.1	–14.9	–16.4	21.3
Other	2.1	–5.4	5.6	–2.6	9.2	2.7	5.5	21.7	–6.5	–13.1	–0.1
GDP	2.7	2.7	3.3	1.0	2.8	4.6	1.8	3.9	0.3	0.9	6.2
GDP price deflator	9.7	15.7	13.5	9.1	7.5	9.7	11.4	9.3	11.3	8.8	6.8
Employment	1.2	1.2	1.4	0.9	0.3	1.6	2.8	2.1	0	–1.8	3.0
Compensation of employees (current prices)	11.4	21.5	15.1	10.3	8.3	9.6	14.4	15.1	16.5	3.8	10.5
Productivity (GDP/employment)	1.6	1.5	1.9	0.1	2.5	3.0	–1.0	1.8	0.3	2.7	3.1
Unit labour costs (Comp./GDP)	11.3	18.4	11.5	9.2	5.4	4.8	12.4	10.8	16.1	2.9	4.0
B. Percentage ratios											
Gross fixed capital formation as % of GDP at constant prices	23.6	24.5	24.5	24.0	23.7	23.2	23.8	25.1	24.3	21.8	21.7
Stockbuilding as % of GDP at constant prices	0.5	–0.4	0.8	0.8	0.1	1.9	0.4	1.2	–0.5	–0.5	1.1
Foreign balance as % of GDP at constant prices	–1.5	–0.7	–1.4	–1.1	–1.2	0.4	–0.8	–3.1	–2.8	–1.3	–2.2
Compensation of employees as % of GDP at current prices	54.8	57.8	56.8	56.9	55.7	53.3	53.7	54.5	56.8	53.7	52.3
Direct taxes as per cent of household income	15.3	13.2	14.7	15.9	14.7	14.6	14.9	15.6	16.6	14.7	16.2
Unemployment as per cent of total labour force	5.7	4.9	4.8	5.7	6.4	6.3	6.1	5.8	7.2	10.0	9.0
C. Other indicator											
Current balance (bill.$US)	–4.8	–1.0	–2.0	–3.1	–4.5	–2.6	–4.1	–8.3	–8.1	–5.8	–8.3

Source: Australian Bureau of Statistics.

Table A. **Gross domestic product**

$ million, current prices

Calendar year	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Expenditure										
1. Private consumption	40 406	47 413	52 907	59 168	66 558	75 773	85 560	97 562	108 561	118 801
2. Government current expenditure	10 173	12 281	13 826	15 682	17 076	19 985	23 096	26 422	29 689	33 794
3. Gross fixed capital formation	16 311	19 137	20 890	22 984	25 563	29 826	34 208	39 313	38 618	43 199
a) Private[1]	9 683	12 239	13 144	14 884	16 931	20 196	25 983	26 292	24 429	27 372
b) Public enterprises[1]	2 965	3 240	3 806	4 042	4 392	5 149	5 509	7 668	8 106	8 748
c) Government[1]	3 663	3 658	3 940	4 058	4 240	4 481	4 716	5 353	6 083	7 079
4. Change in stocks	–196	405	614	233	2 023	815	1 419	–649	–1 295	2 763
5. Exports of goods and services	10 359	12 258	13 749	14 534	19 340	22 089	21 847	24 249	25 548	30 102
6. Imports of goods and services	9 898	12 148	14 642	16 355	19 053	23 100	26 344	29 444	28 075	34 637
7. Statistical discrepancy	365	–773	–130	122	–941	45	505	1 552	1 241	4 765
8. **Gross domestic product at purchasers' values**	67 520	79 173	87 213	96 368	110 566	125 394	142 291	159 006	174 287	198 787
Origin										
1. Agriculture, hunting, forestry and fishing	..	..	..	..	..	..	..	..	..	..
2. Manufacturing	..	..	..	..	..	..	..	..	..	..
3. Other industry	..	..	..	..	..	..	..	..	..	..
4. Services	..	..	..	..	..	..	..	..	..	..
5. Indirect taxes less subsidies	7 087	8 884	9 534	10 476	12 314	14 637	16 336	18 819	21 264	24 418
6. **Gross domestic product at purchasers' values**	67 520	79 173	87 213	96 368	110 566	125 394	142 291	159 006	174 287	198 787

1. Published data for 1981, 1982 and 1983 have been adjusted to remove the impact of the sale to the private sector of public sector assets under leaseback arrangements. In the adjustment, estimates of the value of such sales are substracted from the published estimates of private investment expenditure and added back to the public investment figures.

Source: Quaterly Estimates of National Income and Expenditure, March quarter 1985, ABS Cat. 5206.

Table B. **Gross domestic product**

$ million, average 1979-1980 prices

Calendar years	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Expenditure										
1. Private consumption	63 761	65 531	66 164	68 178	69 881	72 155	74 706	76 885	78 036	80 056
2. Government current expenditure	15 317	16 281	16 698	17 733	17 910	18 754	19 488	19 549	20 769	22 083
3. Gross fixed capital formation	25 393	26 276	25 894	26 442	27 007	28 172	30 967	30 027	27 237	28 970
a) Private	15 109	16 851	16 257	17 024	17 784	19 129	22 302	20 402	17 585	18 800
b) Public enterprises	4 629	4 430	4 709	4 675	4 671	4 850	4 726	5 735	5 617	5 736
c) Government	5 655	4 995	4 928	4 743	4 552	4 193	3 939	3 890	4 035	4 434
4. Change in stocks	–392	838	911	151	2 197	517	1 468	–570	–538	1 956
5. Exports of goods and services	16 753	18 275	18 454	19 038	21 206	20 906	20 050	21 582	20 779	23 905
6. Imports of goods and services	17 526	19 719	19 616	20 335	20 714	21 902	23 900	25 049	22 449	27 061
7. Statistical discrepency	550	–243	–152	153	–989	6	454	1 193	886	3 182
8. **Gross domestic product at purchasers' values**	103 856	107 239	108 353	111 360	116 498	118 608	123 233	123 617	124 720	133 121

Sources: Quarterly Estimates of National Income and Expenditure, Australia, March quarter 1985, ABS Cat No. 5206.0.

Table C. **Income and expenditure of households (including unincorporated enterprises)**

$ million, current prices

Calendar year	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
1. Compensation of employees	39 056	44 966	49 597	53 717	58 890	67 392	77 576	90 345	93 771	103 745
2. Income from property and entrepreneurship	12 765	14 357	16 571	19 012	23 755	25 520	28 429	30 819	37 281	43 355
a) Farm	2 074	1 856	2 155	2 551	5 436	4 543	4 168	2 238	3 674	5 247
b) Non-Farm	10 691	12 501	14 416	16 461	18 319	20 977	24 261	28 581	33 607	38 108
3. Current transfers from government	5 499	6 967	8 087	8 896	9 821	10 922	12 210	14 433	17 934	20 450
4. Grants from non-profit institutions	430	530	626	718	838	984	1 258	1 335	1 584	1 799
5. Third party insurance transfers	179	209	228	265	333	413	520	670	794	903
6. Current transfers from the rest of the world	401	293	320	422	472	679	739	878	953	1 024
7. **Income**	58 330	67 322	75 429	83 030	94 109	105 910	120 732	138 480	152 316	171 276
8. *less:* Direct taxes paid on income	7 681	9 911	12 025	12 095	13 776	15 824	18 816	22 953	22 376	27 588
9. Consumer debt interest	552	651	795	895	986	1 151	1 569	2 095	2 373	2 604
10. Other direct taxes, fees, fines, etc.	623	738	812	830	820	809	881	949	1 021	1 116
11. Current transferts to the rest of the world	304	297	320	380	382	401	448	545	643	639
12. **Disposable income**	49 170	55 725	61 477	68 830	78 145	87 725	99 018	111 938	125 903	139 329
13. Consumption expenditure	40 406	47 413	52 907	59 168	66 558	75 733	85 560	97 562	108 561	118 801
14. Food	6 623	7 668	8 773	9 941	11 280	13 025	14 673	16 327	17 932	13 945
15. Clothing	3 378	3 768	4 171	4 588	4 911	5 466	6 045	6 578	7 174	5 367
16. Rents	5 607	6 866	8 244	9 620	11 141	12 720	14 775	17 962	21 063	24 173
17. Other	24 798	29 111	31 719	35 019	39 226	44 522	50 067	56 695	62 392	75 316
18. **Saving**[1]	8 764	8 312	8 570	9 662	11 587	11 992	13 458	14 376	17 342	20 528
(Per cent of disposable income)	17.8	14.9	13.9	14.0	14.8	13.7	13.6	12.8	13.8	14.7

1. Obtained as the difference between disposable income and consumption expenditure.

Sources: Quarterly Estimates of National Income and Expenditure, Australia, March quarter, 1985, A.B.S. Catalogue No. 5206.0.

Table D. **Labour market**

Calendar year averages	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
	Thousand persons									
1. Total employment	5 866.4	5 946.0	6 000.1	6 015.6	6 110.6	6 284.3	6 416.5	6 414.9	6 300.4	6 490.6
a) Non-farm	5 498.6	5 575.5	5 622.8	5 660.8	5 740.0	5 906.5	6 030.0	6 031.2	5 910.4	6 112.9
b) Farm	380.3	370.5	377.3	354.8	369.7	372.0	386.5	383.7	390.0	379.7
2. Unemployment[1]	302.5	298.1	358.1	413.1	408.4	408.6	393.9	474.9	696.0	647.4
3. Unfilled vacancies[2]	..	..	38.9	34.1	33.9	32.8	35.2	24.2	20.3	39.1
	Per cent									
4. Unemployment rate	4.9	4.8	5.6	6.4	6.3	6.1	5.8	6.9	9.9	9.1
5. Participation rate: Male	81.1	80.7	80.1	78.8	78.4	78.3	78.0	77.5	76.7	76.3
Female	43.7	43.6	44.2	43.6	43.6	44.8	44.7	44.6	44.7	45.3
	Hours									
6. Average weekly hours paid for[3], all industries	..	..	..	39.8	39.4	39.0	39.3	38.3	38.3	38.8

1. These estimates are derived from the labour force survey which is now conducted monthly. Until February 1978, surveys were conducted in February, May, August and November each year. Estimates are averages of all surveys conducted in each of the years shown.
2. Registered with Commonwealth Employment Service.
3. Refer to full-time employees. Figures are lower than for hours paid for; fractions of an hour are disregarded and persons stood down because of bad weather or breakdown are considered as working no hours.

Source: Australian Bureau of Statistics: Time Series Data.

Table E. Prices and wages

Calendar years	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
	Index 1979-1980 = 100									
1. Price deflators										
a) Gross domestic product	65.0	73.8	80.5	86.5	94.9	105.7	115.5	128.6	139.5	149.2
b) Private consumption	63.4	72.4	80.0	86.8	95.2	105.0	114.5	126.9	139.0	148.3
c) Gross fixed capital formation	64.2	72.8	80.7	86.9	94.7	105.9	116.9	130.9	141.8	149.6
d) Exports	62.3	66.5	73.9	75.1	90.8	105.6	108.0	110.5	121.1	123.9
e) Imports	56.5	61.6	74.7	80.5	92.2	105.5	109.8	117.8	125.0	128.6
2. Terms of trade	110.3	108.0	98.9	93.3	98.5	100.1	98.4	93.8	96.9	96.3
	Index, 1980 = 100									
3. Consumer price index										
a) Total	60.5	68.6	77.1	83.2	90.8	100.0	109.6	121.9	134.2	139.5
b) Food	56.8	63.8	71.1	77.9	88.8	100.0	109.3	117.7	129.5	136.6
4. Award rates of pay[1]	61.8	71.0	78.7	84.1	90.3	100.0	111.1	128.6	134.2	143.5
5. Average weekly earnings[2]	59.6	68.2	75.1	81.6	88.7	100.0	111.0	128.6	137.9	151.7
	Dollars									
6. Hourly earnings[3]										
a) All industries	4.05	4.61	5.10	5.47	5.94	6.70	7.61	8.91	9.30	10.05
b) Mining and quarrying	5.32	6.11	6.84	7.45	8.22	9.36	10.82	13.16	12.96	14.48
c) Manufacturing	3.82	4.33	4.79	5.11	5.66	6.37	7.13	8.41	8.88	9.31
d) Construction	3.97	4.54	4.98	5.30	5.74	6.44	7.65	8.87	9.22	10.47

1. Award rates of pay for adult wage and salary earners linked on to the old weekly rates of pay for adult male wage earners series at 1976-77.
2. Average weekly earnings for all employees linked to the old male units series at the september quarter 1981.
3. Refers to full-time adult males (other than managerial, etc., staff) excluding rural industries and private domestic service, as at a pay period in october/november each year. Changes in the sample survey in 1981 and in 1983 introduce discontinuities into the series.

Source: Australian Bureau of Statistics, Catalogue Nos. 6302.0, 6304.0 and 6312.0

Table F. General government receipts and expenditure

$ million

Year ended 30th june	Total[1]				Commonwealth Government			
	1981	1982	1983	1984	1981	1982	1983	1984
I. Current receipts	43 199	50 371	55 540	61 154	35 176	40 938	44 635	48 809
1. Direct taxes	22 398	26 483	28 075	29 644	22 398	26 483	28 075	29 644
a) On income: households	17 532	21 205	22 943	24 691	17 532	21 205	22 943	24 691
b) On income: corporations	4 706	5 073	4 874	4 649	4 706	5 073	4 874	4 649
c) Withholding taxes	161	205	258	304	161	205	258	304
2. Indirect taxes	17 416	19 880	22 832	26 065	10 217	11 423	12 910	15 059
3. Income from property and entrepreneurship	2 551	3 065	3 653	4 386	2 511	2 972	3 589	4 042
4. Compulsory fees, fines, etc.	833	942	980	1 059	50	59	61	64
II. Current disbursements	39 590	45 592	53 478	60 870	33 280	37 941	44 511	51 445
1. Goods and services	21 581	24 716	28 303	31 343	7 438	8 610	9 886	11 032
2. Subsidies	1 951	2 300	2 782	3 003	943	1 055	1 154	1 309
3. Interest on public debt	2 954	3 329	3 950	5 029	2 576	2 886	3 390	4 343
4. Current transfers to domestic sectors	12 476	14 514	17 640	20 635	21 697	24 657	29 278	33 887
5. Current transfers to the rest of the world	627	733	803	860	627	733	803	860
III. Surplus on current transactions	3 609	4 779	2 062	284	1 896	2 997	124	–2 636
IV. Gross fixed capital formation	4 576	5 041	5 726	6 725	294	409	596	616

1. Combined Commonwealth, State and Local Sectors.
Source: Quarterly Estimates of National Income and Expenditure, ABS, *March quarter '85, Cat. 5206.0*

Table G. **Balance of payments**

$ A million

Calendar years	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Current account										
1. Exports, fob	8 855	10 614	11 897	12 328	16 635	18 928	18 463	20 472	21 630	25 769
2. Imports, fob	7 229	8 959	10 980	12 247	14 379	17 698	20 373	22 993	21 618	27 005
3. Trade balance	1 625	1 656	919	82	2 256	1 230	–2 033	–2 521	12	–1 236
4. Invisibles, net	–2 408	–3 256	–3 718	–4 042	–4 609	–4 843	–5 150	–5 400	–6 455	–8 230
5. **Current balance**	–783	–1 600	–2 799	–3 959	–2 355	–3 613	–7 183	–7 921	–6 443	–9 466
Capital account										
6. Government	–124	434	709	1 655	439	–81	314	1 065	485	1 162
7. Trade credit n.e.i.	11	153	–226	152	–533	–255	79	–58	–152	–489
8. Other private capital	788	863	1 230	1 395	1 971	3 783	5 368	9 958	8 039	5 933
9. Non official monetary sector transactions	–146	85	71	–23	15	11	148	561	387	1 324
10. Balancing item[1]	–504	–220	–7	748	–152	650	1 118	1 278	1 028	98
11. **Apparent capital balance**	27	1 314	1 776	3 926	1 740	4 108	7 026	12 805	9 786	8 028
Official monetary movements										
12. Change in official reserve assets	–741	–9	–852	–165	–525	259	74	4 744	3 343	–1 421
13. Allocation of SDR	–	–	–	–	–94	–98	–86	–	–	–
14. Other transactions[2]	–15	–277	–171	131	3	334	–146	141	–	–18
15. *Net official monetary movements*	–756	–286	–1 023	–34	–616	495	–158	4 885	3 343	–1 438
16. **Changes in market value of official reserve assets**[3]										
a) Gold[4]	–	669	169	331	1 918	674	–1 120	718	–182	–348
b) Currency assets	–618	318	–822	–104	–434	91	19	5 236	3 311	–1 205
c) IMF : gold tranche	–7	24	–2	6	3	90	–16	–260	126	96
d) Special Drawings Rights	–3	–50	–16	89	–74	–38	46	42	1	164
Total[5]	–629	962	–671	321	1 414	816	–1 070	5 734	3 256	–1 292

1. Includes discrepancies in the current account as well as errors, omissions and timing differences related to capital transactions.
2. Includes:
   - Drawings and repayments made by Reserve Bank of New Zealand under a special loan arrangement with the Reserve Bank of Australia for the purposes of financing Australian exports to New Zealand.
   - Purchases by Australia of shares in the Bank for International Settlements.
   - Government working balances, other than London, held overseas.
   - Changes in the balance of foreign central monetary institutions with the Reserve Bank of Australia and changes in Australian currency liabilities (notes and coins in circulation) in Papua New Guinea.
   - Changes in investments of the Bank of Papua New Guinea.
   - Deposits of the Bank for International Settlements with the Reserve Bank of Australia.
   - Use of IMF credit.
3. Includes changes due to fluctuations in the foreign currency value of assets, variations in exchange rates and the receipt of compensation under the Sterling Agreement. Foreign currency value of currency assets has been based on market quotations.
4. Prior to 1976 gold is valued at the IMF official price in SDRs converted to Australian dollars at the derived SDR/dollar a rate. From 1976, gold holdings are valued at the average London gold price for the month, converted to dollars a at market rate applying on last day of month.
5. Any discrepancy in the table between the sum of the components and the total is due to rounding.

Source: Australian Bureau of Statistics.

Table H. **Foreign trade-commodity and geographic structure**

Per cent

Calendar years	Imports 1982	Imports 1983	Imports 1984	Exports 1982	Exports 1983	Exports 1984
SITC sections:						
1. Food and live animals chiefly for food	3.3	4.2	4.1	29.6	22.6	25.8
2. Beverages and tobacco	0.8	0.8	0.8	0.3	0.3	0.3
3. Crude materials, inedible, except fuels	2.9	3.3	3.1	31.0	28.6	26.0
4 Mineral fuels, lubricants and related materials	14.3	10.8	8.9	18.1	22.0	22.3
5 Animal and vegetable oils, fats and waxes	0.3	0.4	0.4	0.5	0.4	0.5
6. Chemicals and related products, n.e.s.	7.7	8.8	8.7	1.9	2.2	1.8
7. Manufactured goods classified chiefly by material	16.6	15.9	16.8	9.7	11.0	9.5
8. Machinery and transport equipment	39.0	38.8	38.2	5.7	5.7	5.0
9. Miscellaneous manufactured articles	11.8	13.1	12.8	1.5	2.3	2.0
10. Commodities and transactions not classified according to kind[1]	3.3	3.8	6.2	1.7	4.9	6.9
Total (merchandise and non-merchandise)	100.0	100.0	100.0	100.0	100.0	100.0
1. OECD countries	71.8	74.2	74.8	57.2	60.2	58.4
a) North America	24.1	23.9	23.9	11.8	11.8	12.2
b) Japan	20.2	22.0	21.8	25.8	27.5	25.7
c) EEC	21.0	21.0	21.0	12.9	14.4	13.4
d) Other	6.7	7.3	8.1	6.7	6.5	7.1
2. Non-OECD countries	28.2	25.7	25.2	42.8	38.8	41.6
a) Sino-soviet area[2]	1.7	1.7	1.7	7.7	5.3	6.7
b) Other developed countries	0.3	0.4	0.5	0.7	0.7	1.1
c) Developing countries	25.8	23.1	22.4	31.3	29.1	31.1
3. Unspecified	0.4	0.5	0.5	3.2	2.8	2.7
Total	100.0	100.0	100.0	100.0	100.0	100.0

1. Including non-merchandise.
2. Including Mainland China, Viet Nam and North Korea.
Source: OECD, *Foreign Trade Statistics, Series A.*

BASIC STATISTICS :

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece	Iceland	Ireland
Population Total	Thousands	1984	15 379 (83)	7 552	9 856 (83)	25 150	5 111	4 882	54 947	61 181	9 848 (83)	237 (83)	3 508 (83)
Inhabitants per sq.km	Number		2	90	323	3	119	14	100	246	75	2	50
Net average annual increase over previous 10 years	%		1.3	–0.1	0.1	1.2	0.1	0.4	0.5	–0.1	1.0	1.1	1.3
Employment Total civilian employment (TCE)[2]	Thousands	1983	6 471 (84)	3 199	3 577	11 000 (84)	2 389	2 404 (84)	20 839	24 649 (84)	3 508	114	1 111
of which: Agriculture	% of TCE		6.2	8.7	3.0	5.3	7.4	12.2	8.1	5.6	30.0	10.5	17.0
Industry	% of TCE		28.1	37.5	30.9	25.9	28.4	32.6	33.8	41.6	28.6	36.8	29.8
Services	% of TCE		65.7	53.8	66.1	68.8	64.2	55.2	58.1	52.8	41.4	52.6	53.2
Gross domestic product (GDP)													
At current prices and current exchange rates	Billion US$	1983	155.5	67.1	80.1	324.0	56.4	49.4	519.2	653.1	34.5	2.3	18.0
Per capita	US$		10 119	8 892	8 126	13 008	11 020	10 155	9 538	10 633	3 505	9 523	5 120
At current prices using current PPP's[3]	Billion US$	1983	..	75.6	105.4	343.8	59.0	49.7	613.8	703.1	54.3	..	23.6
Per capita	US$		..	10 010	10 690	13 803	11 538	10 220	11 276	11 447	5 512	..	6 740
Average annual volume growth over previous 5 years	%		2.2	2.1	1.1	1.3	1.4	4.1	1.5	1.2	1.0	0.9	2.3
Gross fixed capital formation (GFCF)	% of GDP	1983	21.4	22.2	16.1	19.4	16.3	24.6	19.6	20.8	20.5	23.0	22.7
of which: Machinery and equipment	% of GDP	1982	12.4 (81)	10.8	5.8	7.6	7.4	9.4	9.1	7.8	8.3	6.8	13.2 (81)
Residential construction	% of GDP	1982	4.8 (81)	3.5	3.4	3.5	3.5	6.3	5.7	6.1	4.8	5.0	6.7 (81)
Average annual volume growth over previous 5 years	%		0.7	–0.8	–4.6	0.2	–5.2	4.4	0.6	0.8	–1.8	–1.2	–0.3
Gross saving ratio[4]	% of GDP	1983	18.0	22.8	14.8	19.2	14.1	24.1	18.6	21.8	17.0	18.9	16.6
General government													
Current expenditure on goods and services	% of GDP	1983	17.6	18.7	17.7	21.0	27.2	19.4	16.3	20.0	18.8	12.3	20.2
Current disbursements[5]	% of GDP	1983	32.8 (82)	45.5	53.5	43.0	58.2	36.1	48.2	44.4	38.3	27.6 (80)	48.3 (81)
Current receipts	% of GDP	1983	34.3 (82)	46.6	44.6	39.0	53.1	37.4	47.0	45.2	33.1	36.0 (80)	40.5 (81)
Net official development assistance	% of GNP	1983	0.49	0.23	0.59	0.45	0.73	0.33	0.74	0.49	..	..	..
Indicators of living standards													
Private consumption per capita using current PPP's[3]	US$	1983	6 287*	5 716	6 669	7 858	5 900	5 359	7 110	6 287	3 570	6 024*	3 775
Passenger cars, per 1 000 inhabitants	Number	1983	..	306 (81)	328 (82)	421 (82)	272	288	374 (82)	402	102 (82)	405	205 (82)
Telephones, per 1 000 inhabitants	Number	1983	540	460	417	664	719	570	541	571	336	525	235
Television sets, per 1 000 inhabitants	Number	1983	..	300 (81)	298 (80)	471 (80)	370	370	297 (80)	362	158 (80)	282 (82)	181 (80)
Doctors, per 1 000 inhabitants	Number	1983	..	1.7 (82)	2.5 (82)	1.8 (82)	2.4 (82)	2.1 (82)	2.1 (82)	2.4	2.5 (82)	2.2 (82)	1.3 (82)
Infant mortality per 1 000 births	Number	1983	9.6	11.9	11.2	9.1	7.7	6.2	8.9	10.3	14.6	6.2	9.8
Wages and prices (average annual increase over previous 5 years)													
Hourly earnings in manufacturing	%	1984	14.9 (83)	5.7	6.9	8.5	8.4	11.4 (83)	12.5	4.4	25.4 (83)	..	15.7 (83)
Consumer prices	%	1984	9.0	5.5	7.4	8.7	9.5	9.6	11.1	4.5	21.8	54.0	14.9
Foreign trade													
Exports of goods, fob*	Million US$	1984	23 856	15 720	51 840 (83)[7]	86 868	15 912	13 464	93 120	171 012	4 812	744 (83)	9 672
as % of GDP	%		15.3	23.4	64.7	26.8	28.2	27.3	17.9	26.2	13.9	32.9	53.9
average annual increase over previous 5 years	%		5.1	0.4	3.0	9.2	1.7	3.8	–1.0	–0.1	4.4	–1.2	6.2
Imports of goods, cif*	Million US$	1984	23 424	19 596	54 096 (83)[7]	74 004	16 584	12 432	103 440	152 016	9 612	828 (83)	9 684
as % of GDP	%		15.1	29.2	67.5	22.8	29.4	25.2	19.9	23.3	27.8	36.6	53.9
average annual increase over previous 5 years	%		7.2	–0.6	2.3	6.7	–2.1	1.9	–0.7	–0.7	–0.2	3.9	–0.4
Total official reserves[6]	Million SDR's	1984	7 869	5 070	5 853[7]	3 246	3 127	2 854	24 227	44 282	1 117	132	2 412
As ratio of average monthly imports of goods	Ratio		4.0	3.0	1.3	0.5	2.2	2.7	2.8	3.4	1.4	1.9	2.9

	Italy	Japan	Luxembourg	Netherlands	New Zealand	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Yugoslavia
Population Total	56 983	120 018	366 (83)	14 420	3 245	4 141	10 099 (83)	38 173 (83)	8 337	6 482 (83)	47 804 (83)	56 377 (83)	236 634	22 855 (83)
Inhabitants per sq.km	189	322	141	387	12	13	110	76	19	157	61	230	25	88
Net average annual increase over previous 10 years	0.3	0.9	0.4	0.6	0.7	0.4	1.2	0.9	0.2	0.1	2.2	0.0	1.0	0.9
Employment Total civilian employment (TCE)[2]	20 439 (84)	57 660 (84)	157	4 929	1 266	1 970 (84)	3 892	10 382 (84)	4 255 (84)	2 994	14 912	23 470	105 005 (84)	..
of which: Agriculture	11.9	8.9	4.5	5.1	11.2	7.1	24.6	18.0	5.1	7.1	58.9	2.7	3.3	..
Industry	34.5	34.8	35.7	27.8	32.2	28.3	37.5	32.7	29.8	37.6	16.7	33.6	28.5	..
Services	53.7	56.3	59.9	67.1	56.6	64.6	38.0	49.3	65.1	55.3	24.3	63.8	68.2	..
Gross domestic product (GDP)														
At current prices and current exchange rates	352.8	1 156.0	3.2	132.0	23.0	55.1	20.7	158.2	91.9	97.1	49.7	455.1	3 275.7	62.8 (82)
Per capita	6 208	9 693	8 721	9 190	7 183	13 333	2 055	4 137	11 029	14 930	1 041	8 072	13 969	2 774 (82)
At current prices using current PPP's[3]	495.1	1 280.7	4.2	147.2	..	53.7	45.7	266.7	..	..	..	552.6	3 275.7	..
Per capita	8 711	10 739	11 381	10 247	..	12 999	4 549	6 977	..	..	..	9 802	13 969	..
Average annual volume growth over previous 5 years	1.4	4.1	0.0	0.3	1.9	2.8	2.8	1.0	1.7	1.6	2.3	0.8	1.1	..
Gross fixed capital formation (GFCF)	18.0	28.4	23.2	18.2	23.1	25.1	28.9	18.8	18.7	23.3	18.7	16.5	16.8	27.1 (82)
of which: Machinery and equipment	7.7	10.2	9.2 (80)	7.6	9.1 (81)	8.9	13.8 (81)	7.0 (81)	8.0	6.9	8.7 (77)	7.6	7.4	..
Residential construction	5.3	6.0	5.5 (80)	5.2	4.0 (81)	4.7	7.8 (81)	5.5 (81)	4.3	16.2	2.7 (77)	2.2	2.9	..
Average annual volume growth over previous 5 years	0.9	2.6	–1.9	–3.5	4.0	0.5	1.8	–1.6	0.5	3.7	–1.2	–0.3	–0.2	..
Gross saving ratio[4]	17.5	30.3	40.0	20.8	18.0	28.5	21.3	17.6	16.3	27.7	16.3	18.1	15.2	..
General government														
Current expenditure on goods and services	19.5	10.2	17.3	17.7	17.0	19.5	14.6	12.3	28.5	13.5	10.8	22.0	19.3	15.8 (82)
Current disbursements[5]	51.5	28.1	45.7 (80)	58.3 (82)	..	45.9	37.4 (81)	31.8 (82)	61.7 (82)	30.8	..	44.3	36.9	..
Current receipts	45.3	30.4	51.5 (80)	55.7 (82)	..	52.6	33.0 (81)	30.7 (82)	59.3 (82)	33.9	..	42.5	31.7	..
Net official development assistance	0.24	0.33	..	0.91	0.28	1.06	..	..	0.85	0.32	..	0.35	0.24	..
Indicators of living standards														
Private consumption per capita using current PPP's[3]	5 408	5 877	7 195	6 415	4 260*	5 893	2 936	4 690	5 728*	9 354*	769*	5 706	9 451	1 426 (82)
Passenger cars, per 1 000 inhabitants	346 (82)	215 (82)	398	331 (84)	446 (84)	334	135 (82)	228	361	392	18 (82)	292 (82)	547 (82)	118
Telephones, per 1 000 inhabitants	404	535	589 (82)	390 (84)	622	580	166	345	890	1 269	55	524	760 (82)	111
Television sets, per 1 000 inhabitants	234 (80)	250 (80)	335 (81)	313 (84)	..	318	140 (80)	252 (80)	390	326	76 (79)	331 (80)	621 (80)	174 (82)
Doctors, per 1 000 inhabitants	3.6 (82)	1.3 (82)	1.7	2.1 (84)	..	2.1	1.8 (82)	2.7 (82)	2.2 (82)	2.6 (82)	0.6 (82)	1.7 (82)	1.8 (82)	1.5 (81)
Infant mortality per 1 000 births	12.4	6.2	11.2	8.4	12.5	7.9	19.0	9.6 (82)	7.0	8.0	..	10.2	11.2	29.9 (82)
Wages and prices (average annual increase over previous 5 years)														
Hourly earnings in manufacturing	17.9	5.3	..	3.6	..	9.9	..	16.2	8.9	5.1 (83)	..	11.9	6.5	..
Consumer prices	16.1	3.9	7.6	5.0	12.3	10.1	22.7	13.6	10.2	4.4	46.0	9.5	7.4	32.3
Foreign trade														
Exports of goods, fob*	73 428	169 776	..[8]	65 652	5 518	18 888	5 172	23 508	29 316	25 812	7 068	94 224	217 884	8 700
as % of GDP	20.8	14.7	..	49.7	24.0	34.3	25.0	14.9	31.9	26.6	14.2	20.7	6.7	13.8
average annual increase over previous 5 years	0.4	10.6	..	0.6	3.2	7.0	8.2	5.3	1.3	–0.5	23.4	0.7	3.7	6.9
Imports of goods, cif*	84 336	136 080	..	61 980	6 192	13 860	7 752	28 800	26 340	29 376	10 728	105 180	325 728	10 200
as % of GDP	23.9	11.8	..	47.0	26.9	25.2	37.5	18.2	28.7	30.2	21.6	23.1	9.9	16.2
average annual increase over previous 5 years	1.6	4.2	..	–1.6	6.3	0.2	3.5	2.6	–1.6	0.0	13.5	0.5	9.5	–3.8
Total official reserves[6]	23 527	27 811	..	10 961	1 824	9 596	1 237	12 709	4 135	18 520	1 418	10 297	33 517	1 247
As ratio of average monthly imports of goods	3.3	2.4	..	2.1	0.3	8.1	1.9	5.2	1.8	7.4	1.6	1.2	1.2	1.4

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour force Statistics*.
3. PPP's = Purchasing Power Parities.
4. Gross saving = Gross national disposable income *minus* Private and Government consumption.
5. Current disbursements = Current expenditure on goods and services *plus* current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDR's per ounce.
7. Including Luxembourg.
8. Included in Belgium.

Sources:
Population and Employment: OECD *Labour Force Statistics*.
GDP, GFCF, and General Government: OECD *National Accounts*, Vol. I and OECD *Economic Outlook, Historical Statistics*.
Indicators of living standards: Miscellaneous national publications.
Wages and Prices: OECD *Main Economic Indicators*.
Foreign trade: OECD *Monthly Foreign trade Statistics, series A*.
Total official reserves: IMF *International Financial Statistics*.

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