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ECONOMIC STRATEGIES FOR RECOVERY

by

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DEPARTMENT OF ECONOMICS

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# ECONOMIC STRATEGIES FOR RECOVERY

## *1 Introduction*

This paper seeks to examine the issues and policies for recovery in the Australian economy over the next eighteen months or more.

During the past two and a half years the economy has experienced turmoil unprecedented in the three decades since the end of World War II. Stagnation and declines in real output for most sectors are being accompanied by historically high rates of inflation. This inflation has been reduced in recent months by a few percentage points; on an annual basis, from a peak of about seventeen per cent to between ten and eleven per cent at present.

There has been substantial underutilisation of productive capacity in the non-farm sectors during the past two years and currently these sectors are operating at about ninety per cent of potential output. Not surprisingly, this position has been associated with much higher levels of unemployment. Aspects of this underutilisation are explored in Appendix A.

The main thrust of economic policies pursued by the present and the previous Treasurer is towards a reduction in the rate of domestic inflation. All other aspects of economic behaviour are judged subservient to this issue. Recovery in real output and employment would be frustrated should inflation persist at the rates of increase in prices and costs experienced during the past two years or more. New investment projects would be in jeopardy because of doubts about final costs of installation and future profitability. International competitiveness of manufacturing activities, as well as the profitability of export activities in primary production and mining, have been undermined by inflation. The indexing of wage rates to rises in consumer prices, though not automatic or necessarily complete, provides a mechanism for the quick transmission of price and cost rises through the economy.

The Federal Treasurer, the Hon. P. R. Lynch, referred to these issues in his recent Budget Speech:

"Yet all the evidence - in Australia and overseas - is that, under the kind of inflationary conditions which we have been and still are experiencing, fiscal and monetary policies of what used to be known as the 'pump-priming' kind no longer prime the pump but serve only to turn off the flow of jobs even further".<sup>1</sup>

and

"But, whether they know it or not, those who, in the name of reducing unemployment, call for higher government spending, or bigger deficits, or full wage indexation, or devaluation of the Australian dollar, are calling for higher - not lower - unemployment in this country".<sup>2</sup>

In these and similar statements the Federal Treasurer is interpreting the present economic circumstances in a fashion similar to his predecessor, the Hon. W. G. Hayden, in his Budget Speech of 19 August 1975. The similarities in analysis and interpretation for purposes of policy are clear:

"We are no longer operating in that simple Keynesian world in which some reduction in unemployment could, apparently, always be purchased at the cost of some more inflation. Today it is inflation itself which is the central policy problem. More inflation simply leads to more unemployment".<sup>3</sup>

Again, the former Treasurer saw the impact of wage claims:

"Meanwhile, however, it is clear that some wage and salary pressures are unrealistic and, when successful, harmful. It does employees generally no good to get higher and higher money incomes if the results are just higher prices, a severe squeeze on profits, a slump in new investment and a contraction of job opportunities".<sup>4</sup>

In the circumstances of a further year in which the economy has continued to experience an historically high rate of inflation with little real recovery in domestic economic performance, the Treasurer places even greater emphasis than hitherto on the need for a rapid decline in inflation. He refers to this specifically in terms of generating new employment opportunities and in the mounting evidence of domestic manufacturers switching from Australian plants to production in neighbouring economies.

Emphasis in recent policy measures has not been exclusively on the shorter term themes of recovery in real output, reducing inflation and achieving a higher rate of growth in employment; this last aspect to be achieved with some delayed response. The double depreciation provisions of the Labor Government and the forty per cent investment allowance inaugurated from 1 January 1976 have sought to encourage private fixed investment. The recent Budget measures providing taxation concessions for petroleum, coal and other mining activities were directed to fostering new exploration and development. Nonetheless, most attention has focussed upon immediate prospects.

Yet, interpretations and policy prescriptions in the current situation cannot be divorced from longer term considerations. Confidence in longer term prospects for the balance of payments and the domestic economy during 1973 created a euphoria in which it was thought possible to initiate many economic reforms [11]. At that time, the common judgement was that an historical watershed had been passed whereby capital inflows were no longer essential for stabilising the balance of payments and financing domestic development. Upvaluations in currency, cuts in tariffs, relatively high rates of growth in wages costs compared to those in most advanced industrial economies, and weaker foreign markets for many exportable goods have long since eroded that ebullience. The sharp changes in Australia's external accounts are summarised in Table 1. At current exchange rates, the domestic cost structure is high by international standards [9, pp.12-13]. The present test is whether or not the mining group can initiate new developments and explore new fields for crude oil and natural gas, thus repeating the expansion of the 'sixties.

Should such an expansion be viable in the sense of further increasing exports and adding to the known reserves of crude oil now largely confined to Bass Strait fields, the economic strategy for the rest of the decade will be determined. The present uncertainties about the trade balance, invisible payments and capital transactions then appear as shorter term

TABLE 1

## The Australian Balance of Payments

1970-1 to 1975-6

(\$ million)

|                                     | 1970-1 | 1971-2 | 1972-3 | 1973-4 | 1974-5 | 1975-6           |
|-------------------------------------|--------|--------|--------|--------|--------|------------------|
| Current Account                     |        |        |        |        |        |                  |
| Visible Trade                       |        |        |        |        |        |                  |
| Exports                             | 4217   | 4740   | 6010   | 6688   | 8434   | 9343             |
| Imports                             | -3790  | -3791  | -3808  | -5753  | -7662  | -7892            |
| Balance of Trade                    | 427    | 949    | 2202   | 935    | 772    | 1452             |
| Invisible Credits                   | 1187   | 1340   | 1554   | 1854   | 2298   | 2283             |
| Invisible Debits                    | -2463  | -2603  | -2998  | -3581  | -4006  | -4575            |
| Net Invisibles                      | -1276  | -1263  | -1444  | -1727  | -1708  | -2292            |
| Balance on Current Account          | -849   | -314   | 758    | -792   | -935   | -840             |
| Capital Account                     |        |        |        |        |        |                  |
| Capital Inflows (Net)               |        |        |        |        |        |                  |
| Govt                                | -63    | -60    | -64    | -4     | -24    | 20               |
| Private                             | 1460   | 1297   | 380    | 133    | 734    | n.a.             |
| Non-Official Monetary Sector Trans. | 28     | 70     | -44    | 154    | 47     | n.a.             |
| Net Identified Capital Inflow       | 1424   | 1306   | 272    | 284    | 756    | 481 <sup>a</sup> |
| Balancing Item                      | 22     | 482    | 40     | 74     | -285   | -660             |
| Net Apparent Capital Inflow         | 1447   | 1788   | 312    | 357    | 471    | -180             |
| Official Monetary Movements         |        |        |        |        |        |                  |
| Changes in Official Reserve Assets  | 742    | 1544   | 1079   | -384   | -460   | -1053            |
| Allocation of S.D.R.                | -64    | -63    |        |        |        |                  |
| Other Transactions                  | -81    | -8     | -9     | -50    | -4     | 33               |
| Net Official Monetary Movements     | 598    | 1474   | 1071   | -435   | -464   | -1020            |

Source: Australian Bureau of Statistics, *Balance of Payments: Quarterly Summary*. (Canberra, various issues). (Ref. No.8.2).

Note: a. Private Capital Inflow, Non-Official Monetary Sector Transactions and Balancing Item; figures for individual items are not yet available.

issues to be relieved when substantial increases in earnings strengthen the balance of payments between 1978 and 1982. This has further implications for the domestic scene: the manufacturing sector, where it faces import competition, would have a relatively diminished role; local financial institutions would have the prospect of a rapidly expanding international role; and employment prospects would be strongest in the technologically advanced activities associated with mining, petroleum and some branches of engineering, as well as tertiary activities. Such an outcome requires the implementation of medium term policies on the restructuring of some branches of manufacturing and primary industry and the provision of new training and opportunities for a significant part of the work force. These changes cannot be realised quickly; the rest of this decade will witness the use of various devices such as tariffs and quotas to deal with employment and adjustment problems in many industries. Furthermore, development assistance programmes towards neighbouring developing economies should be co-ordinated with any domestic schemes on restructuring.

When there is less optimism about the possibilities for expanding foreign trade and domestic crude oil supplies in the 'seventies, then the emphasis on sharply reducing the rate of domestic inflation becomes all the more imperative. Given the domestic institutional arrangements for the swift transmission of cost and price rises, measures which might give further impetus to those rises - such as devaluation of the present exchange rate system - would risk perpetuating and even accelerating the rate of inflation. Such a position would have every prospect of frustrating real recovery because of impacts on the market sector; the lessons of 1974 and 1975 bear ample witness to this prospect [15]. In this situation, it is not inconsistent to pursue policies for rapidly curtailing inflation while seeking to preserve employment in some industries through quota devices and the like. What is at issue is whether policies for a rapid reduction in domestic inflation are the most appropriate to the circumstances for recovery in output and employment.

## 2 *The Recent Experience*

The Full Bench of the Arbitration Commission provided a succinct appraisal of recent times when handing down the decision in the National Wage Case on 30 April 1975:

"The unemployment rate has risen to the highest level in the post-war period. In real terms, private investment fell sharply during 1974 and private consumption expenditure declined during the second half of 1974. Productivity growth for the second half of 1974 was negative. A very large build-up of unsold stocks has taken place. Inflation has accelerated to the highest rate since the early 1950s but it has been outstripped markedly by pay increases. The combination of these inter-related factors is reflected in the abnormally large increase in the share of wages and salaries in Gross Domestic Product and the corresponding squeeze of profits measured by Gross Operating Surplus of Companies. Because of the reasonably high level of international reserves, the only feature of the economy which has not caused undue concern is the adverse movement in the balance of payments during 1974".<sup>5</sup>

The pattern of price and earnings behaviour is summarised in Table 2. This continuing inflation is best seen as a situation where, from 1973 to 1975, various groups, including the public sector, laid claim to an increasing proportion of total output of goods and services. This came at a time when total resources available were stagnating and then declining. While these claims may well have amounted to more than the total supplies available, all groups could not realise more than the total output. In effect, inflation eliminated excess claims as prices for goods and services rose, so that actual realisations were less than may have been desired. A further consequence of these inflated claims was not foreseen. This was that the dislocation caused by the imposing of inflated claims and the expectation of further claims in the immediate future so weakened confidence in future prospects and potential new investment projects that a down turn in real activity was accelerated. Such a circumstance made for even greater difficulty in reconciling competing claims on resources.

The ensuing mild depression in real activity and employment was, in part, the consequence of efforts to curtail

TABLE 2  
Prices, Earnings and Monetary Aggregates

1973 to 1976

(Indices 1973 = 100)

|  | 1973  |       |       | 1974  |       |       | 1975  |       |       | 1976  |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|  | Jun   | Sep   | Dec   | Mar   | Jun   | Dec   | Mar   | Jun   | Sep   | Dec   | Mar   | Jun   |       |
| Average Weekly Earnings                            | 99.1  | 101.3 | 110.2 | 104.2 | 118.1 | 126.8 | 141.8 | 132.0 | 144.3 | 145.0 | 161.0 | 151.7 | 165.8 |
| Consumer Price Index                               | 98.1  | 101.7 | 105.3 | 107.8 | 112.2 | 118.0 | 122.4 | 126.8 | 131.2 | 132.2 | 139.6 | 143.8 | 147.4 |
| G.D.P. Deflator                                    | 97.5  | 102.3 | 106.1 | 108.0 | 112.9 | 120.9 | 125.6 | 127.1 | 131.5 | 137.0 | 145.3 | 146.6 | 153.9 |
| Export Price Index                                 | 97.5  | 102.2 | 101.1 | 113.7 | 115.1 | 117.8 | 122.9 | 123.8 | 122.5 | 121.3 | 124.5 | 127.2 | 130.8 |
| Import Price Index<br>excluding mineral fuels etc. | 96.6  | 102.8 | 102.8 | 117.3 | 140.3 | 147.6 | 163.6 | 174.9 | 177.6 | 179.5 | 184.8 | 189.4 | n.a.  |
| Money Supply - M3                                  | 101.4 | 98.6  |       | 100.0 | 110.7 | 117.3 | 131.4 | 139.3 | 141.7 | 144.0 | 146.4 | 149.4 | n.a.  |
| Money Base   | 96.7  | 101.7 | 107.7 | 112.2 | 112.1 | 110.4 | 117.3 | 125.5 | 128.0 | 134.0 | 142.2 | 146.3 | 146.2 |
| Money Base, Gross                                  | 95.5  | 101.2 | 110.0 | 107.4 | 106.0 | 96.0  | 95.4  | 97.3  | 97.7  | 102.8 | 121.7 | 126.9 | 122.0 |
| Money Base, Net (SRD)                              | 96.5  | 100.2 | 106.4 | 101.0 | 99.5  | 100.5 | 107.7 | 109.4 | 109.0 | 109.7 | 123.7 | 123.3 | 124.3 |
| Real (AME) Estimates:                              |       |       |       |       |       |       |       |       |       |       |       |       |       |
| M3   | 97.6  | 100.4 | 97.7  | 107.7 | 94.9  | 87.1  | 82.7  | 95.1  | 88.7  | 92.4  | 88.3  | 96.4  | 88.2  |
| Money Base, Gross                                  | 96.4  | 99.9  | 99.8  | 103.1 | 89.8  | 75.7  | 67.3  | 73.7  | 67.7  | 70.9  | 75.6  | 83.7  | 73.6  |
| Money Base, Net (SRD)                              | 97.4  | 98.9  | 96.6  | 96.9  | 84.3  | 79.3  | 76.0  | 82.9  | 75.5  | 75.7  | 76.8  | 81.3  | 75.0  |
| Real (CPI) Estimates:                              |       |       |       |       |       |       |       |       |       |       |       |       |       |
| M3   | 98.6  | 100.0 | 102.3 | 104.1 | 99.9  | 93.6  | 95.8  | 99.0  | 97.6  | 101.4 | 101.9 | 101.7 | 99.2  |
| Money Base, Gross                                  | 97.3  | 99.5  | 104.5 | 99.6  | 94.5  | 81.4  | 77.9  | 76.7  | 74.5  | 77.8  | 87.2  | 88.2  | 82.8  |
| Money Base, Net (SRD)                              | 98.4  | 98.5  | 101.0 | 93.7  | 88.7  | 85.2  | 88.0  | 86.3  | 83.1  | 83.0  | 88.6  | 85.7  | 84.3  |

Sources: Australian Bureau of Statistics, *Average Weekly Earnings* (Ref. No.6.18); *Consumer Price Index* (Ref. No.9.1); *Export Price Index* (Ref. No.9.2); *Quarterly Estimates of National Income and Expenditure* (Ref. No.7.5); *Quarterly Estimates of National Income and Expenditure* (Preliminary) (Ref. No.7.6). (Canberra, various issues).

Reserve Bank of Australia, *Statistical Bulletin*. (Sydney, various issues).

Notes: Money Supply - M3 = Currency and deposits in all trading and savings banks, including certificates of deposit.  
 Money Base, Gross = Currency of private sector and bank reserves. This includes notes and coin in hands of the public, statutory reserve deposits, bullion and deposits of all banks at the Reserve Bank.  
 Money Base, Net (SRD) = As for Money Base Gross less statutory reserve deposits.  
 Real (AME) Estimates = Money Supply and Money Base divided by Average Weekly Earnings.  
 Real (CPI) Estimates = Money Supply and Money Base divided by Consumer Price Index.

accelerating inflation by monetary restraint on the private sector. But because inflation reduced the real value of working capital, erosion of the real financial basis of the private sector was instrumental in causing short-term reductions in employment and in hampering production and investment planning. Severe monetary restraint reduced the ability of firms to sustain claims for maintaining profits, and cash flows to preserve financial liquidity were a dominant theme for many firms. This restraint is evident in the monetary series shown in Table 2. Hence price rises were minimised as the selling of goods as the best basis for gaining cash became a dominating business concern; the position has been somewhat relieved in recent months. In this way, profit margins were squeezed. Lack of clarity in the purposes of government policy during 1974 and 1975 and confusions in implementation heightened uncertainty about future prospects for the private or market sector; the outcome was the weakening of investment prospects. Thus, recognition of the problems of inflation and the effects on output, investment and employment proceeded well ahead of the then Government's capacity to implement more effective restraint. The attempts by the Treasurer, the Hon. F. Crean, in mid-1974 to change the direction of government policies were thwarted by his colleagues [10]. It took another year for his second successor as Treasurer, the Hon. W. G. Hayden, to initiate policies which would attempt to meet the circumstances described by the Full Bench of the Arbitration Commission.

The result of these events has been a redistribution of resources to the bulk of salary and wage earners and government sector shown in Tables 3-4. But the complications have been many. The gainers are unsure of their gains, hardly surprising when the available real output of goods and services has fallen. For the salary and wage earners, the apparent gains have been thought ephemeral as the tax structure has shifted potential claims to the government.

### *3 Government Policies*

In an effort to gain control of inflation and to restore the rate of real growth in the non-farm sectors, the Government has brought in a series of policy measures developed over the preceding two years.

TABLE 3  
*Wages and Profit Shares*  
*in Gross Domestic Product at Factor Cost*  
*1972-3 to 1975-6*  
 (Per cent)

|                  | Wages, Salaries<br>and Supplements | Gross Operating<br>Surplus of Companies |
|------------------|------------------------------------|---|
| <b>Annual</b>    |                                    |   |
| 1972-3           | 59.63                              | 15.82                                   |
| 1973-4           | 60.72                              | 14.59                                   |
| 1974-5           | 66.56                              | 12.19                                   |
| 1975-6           | 66.27                              | 12.29                                   |
| <b>Quarterly</b> |                                    |   |
| 1972-3           |                                    |   |
| Sep              | 59.24                              | 16.17                                   |
| Dec              | 56.17                              | 16.75                                   |
| Mar              | 60.05                              | 14.73                                   |
| Jun              | 63.24                              | 15.90                                   |
| 1973-4           |                                    |   |
| Sep              | 58.81                              | 16.94                                   |
| Dec              | 56.04                              | 15.68                                   |
| Mar              | 59.96                              | 13.25                                   |
| Jun              | 68.15                              | 12.87                                   |
| 1974-5           |                                    |   |
| Sep              | 67.65                              | 11.60                                   |
| Dec              | 62.27                              | 13.05                                   |
| Mar              | 67.65                              | 9.86                                    |
| Jun              | 69.30                              | 14.00                                   |
| 1975-6           |                                    |   |
| Sep              | 67.14                              | 12.26                                   |
| Dec              | 62.06                              | 12.60                                   |
| Mar              | 68.09                              | 10.35                                   |
| Jun              | 68.36                              | 13.78                                   |

*Source:* Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No.7.5).

*Note:* Quarterly estimates are derived from current price series, not seasonally adjusted.

The immediate situation is dominated by efforts to gain control of the monetary and fiscal situation arising from a fiscal deficit forecast at about \$4525 million on 11 December 1975. In late January 1976 a series of monetary and debt management measures were directed to controlling the rate of growth of the money supply, restraining government spending, and funding the deficit through borrowings from the market sector rather than the Reserve Bank. On 20 May 1976 a "mini-budget" provided for the indexing of personal income tax to ensure that, at a given progressive tax scale, the real value of rising money incomes would be preserved. A revised scheme was introduced for the payment of family allowances favouring the lower income earners. In the recent Budget, stimulus to the market sector was provided through tax concessions in petroleum, coal and other mining activities, as well as in the announcement of stock valuation adjustments for partial implementation in 1977-8. These efforts were directed to restoring the financial basis of many companies handicapped by inflation in immediate past years and to stimulating investment spending. All these measures were in addition to a forty per cent investment allowance introduced at the beginning of the year.

The strategy behind these policy measures may be interpreted in the following way:-

- (i) The purpose of the investment stimulus emanating from the forty per cent investment allowance and the Budget measures is to hasten recovery by bringing forward investment spending in addition to any resurgence in real consumption spending. The longer term balance of payments impacts are evident in this approach. This stimulus is also seen as important to the taking up of any "slack" from curtailment in government spending. This approach has the endorsement of the Organisation for Economic Co-operation and Development [20,21].
- (ii) The provision of a funding programme for the estimated deficit of \$4525 million less any gains from the

spending cuts was aimed at reducing the monetary expansion associated with deficit financing through the Reserve Bank. Because some revenue collections were seriously underestimated, the actual course of events was different from the anticipated position. The recent fiscal experience is shown in Table 4. This experience only emphasises the need to retain flexibility in short term monetary policies in order to contain unexpected repercussions on liquidity in the market sector stemming from fiscal performance.

- (iii) The rate of growth in the money supply from domestic sources would be curtailed by absorbing the substantial growth in household savings into the public sector. The position has been clouded by instability in external capital flows and some difficulties with defining various elements in money supply. Despite these difficulties, the Government has chosen a policy of announcing monetary targets, the apparent reason being to give stronger indications to the market sector than hitherto of the general directions being adopted in domestic monetary management.
- (iv) It would be stressed before the Full Bench of the Arbitration Commission that their own principles did not provide for the automatic application of increases in the consumer price index to award rates. With this went the need to emphasise the cost inflation problems associated with the sharp rise in wage rates and the implications for employment, investment, output, and the balance of payments. The indexation of personal income tax was seen as a measure which would preserve real "take-home" pay.

The real challenge for the Government is how appropriate to present circumstances is the policy designed to meet the circumstances of the economy as seen in the latter months of 1975. Two features in the very recent experience suggest a need for care; the sharp deterioration in the economy between

TABLE 4

## Federal Government Receipts and Outlays

1971-2 to 1976-7

|                                     | 1971-2       | 1972-3       | 1973-4       | 1974-5                |              | 1975-6                |              | 1976-7                |                    |
|-------------------------------------|--------------|--------------|--------------|-----------------------|--------------|-----------------------|--------------|-----------------------|--------------------|
|                                     | Actual (\$m) | Actual (\$m) | Actual (\$m) | Budget Estimate (\$m) | Actual (\$m) | Budget Estimate (\$m) | Actual (\$m) | Budget Estimate (\$m) | Rise on 1975-6 (%) |
| Receipts                            |              |              |              |                       |              |                       |              |                       |                    |
| Total General Tax Revenue including | 7966         | 8488         | 10938        | 14519                 | 14084        | 17608                 | 16843        | 19957                 | 18.49              |
| Customs Duty                        | 468          | 514          | 605          | 770                   | 840          | 978                   | 1044         | 1222                  | 17.08              |
| Excise Duty                         | 1212         | 1268         | 1555         | 1765                  | 1729         | 2408                  | 2332         | 2510                  | 7.64               |
| Sales Tax                           | 683          | 765          | 969          | 1105                  | 1154         | 1425                  | 1408         | 1700                  | 20.71              |
| Income Tax                          |              |              |              |                       |              |                       |              |                       |                    |
| Individuals - PAYE                  | 2889         | 3161         | 4238         | 6189                  | 6071         | 8683                  | 7020         | 8775                  | 25.01 <sup>a</sup> |
| Individuals - Other                 | 880          | 929          | 1252         | 1777                  | 1643         | 1657                  | 2200         | 2532                  | 15.11              |
| Companies                           | 1478         | 1561         | 1954         | 2480                  | 2359         | 2160                  | 2523         | 2900                  | 14.95              |
| Dividends, Interest                 | 58           | 73           | 79           | 86                    | 88           | 90                    | 95           | 96                    | 1.05               |
| Total Receipts                      | 8947         | 9518         | 12002        | 15704                 | 15264        | 19117                 | 18273        | 21713                 | 18.81              |
| Expenditure                         |              |              |              |                       |              |                       |              |                       |                    |
| Total Expenditure                   | 9081         | 10227        | 12295        | 16274                 | 17831        | 21915                 | 21859        | 24321                 | 11.26              |
| Outcome (deficit -, surplus +)      |              |              |              |                       |              |                       |              |                       |                    |
| On Total Transactions               | -134         | -709         | -293         | -570                  | -2567        | -2798                 | -3585        | -2608                 | -                  |
| On Domestic Transactions            | +405         | -215         | +211         | +23                   | -1949        | -2068                 | -2905        | -1879                 | -                  |
| Gross Domestic Product              | 36729        | 41852        | 50693        | 59552 <sup>b</sup>    | 59552        | 69622 <sup>b</sup>    | 69622        | 81051 <sup>c</sup>    | -                  |
| Ratio of Expenditure to G.D.P.      | 24.72        | 24.44        | 24.25        | 27.33                 | 29.24        | 31.48                 | 31.40        | 30.01 <sup>c</sup>    | -                  |

Sources: Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No. 7.5).

*Budget Speech and Statements*. (Canberra, various issues).

Notes: a. Gross collections are estimated to rise from \$8362.4m to \$9875.0m, a rise of 18.09 per cent.  
b. Actual.

c. Estimate based upon interpretations of Budget Speech 1976-7 and attached papers.

June and December 1975 and the much larger deficit than was planned in fiscal operations. Further, wage indexation procedures ensure the rapid transmission of cost increases into money wage rates. Hence, new sources of revenue from sales taxes or similar charges risk accelerating inflation through costs/price/wage movements. Yet this is the one sphere where State governments have a good measure of autonomy in revenue raising and have exercised it, as was the case in 1975. Indeed, there are many advocates of a reduction in sales taxes as having a "once and for all" impact on the consumer price index, so as to halt the transmission of price rises into increased wage rates [6,16]. Speculation about future exchange rate and balance of payments policies is most important but subsidiary to the domestic issues; nonetheless, there is at least one advocate of *upvaluation* in the Australian dollar to offset imported cost rises [12]. Clearly, the Government now faces a much more onerous fiscal position than was thought to be the case in August or later months last year. The scope for tax concessions in the personal and company sphere was less than anticipated were the deficit to be sharply reduced or eliminated within two fiscal years. The important question has become not so much the size of the deficit but the methods by which it is being financed. By attracting funds from non-bank sources the Government has gained a command over debt management, so ensuring a more co-ordinated approach to monetary as well as fiscal policies.

The goals set by the Government cannot be met at once; for example, the curtailment of government spending has repercussions for cost problems through the transfer of some proportion of health costs to income earners for direct payment. Yet the reductions in spending programmes will only reduce the ratio of Federal Government expenditure to expected gross domestic product in 1976-7 by a small amount compared with the previous year; see Table 4.

#### 4 *A policy for Recovery*

The recent experiences with policy measures for stimulating increases in real output are reviewed in Appendix B. In the last two Budgets the expectation has been for a rise in real

consumption spending to provide the basis for recovery. The failure of Mr. Hayden's economic strategy, with its reliance on such an increase in conjunction with wage indexation, must be a source of concern for the current fiscal year when, once again, economic strategy rests heavily upon consumption.

Nevertheless, it should be noted that employment has been rising in recent months. The attention given to unemployment problems, and the potential problems when school leavers seek to enter the work force between December 1976 and February 1977 has diverted appraisals from recent improvements. The position is summarised in Table 5. Employment in May 1976 was 2.27 per cent above the level of May 1975 and 1.57 per cent above that for May 1974. While the position for employment opportunities is a serious challenge to economic policy, the evidence is for an acceleration in the numbers working during recent months.

TABLE 5  
*Employment and Unemployment*  
1972 to 1976

|      | Employment<br>Actual<br>(000) | Unemployment    |                             | Labour Force<br>Actual<br>(000) |
|------|-------------------------------|-----------------|-----------------------------|---------------------------------|
|      |                               | Actual<br>(000) | Per cent of<br>Labour Force |                                 |
| 1972 |                               |                 |                             |                                 |
| May  | 5432.1                        | 109.7           | 2.0                         | 5541.9                          |
| 1973 |                               |                 |                             |                                 |
| May  | 5575.8                        | 100.3           | 1.8                         | 5676.1                          |
| 1974 |                               |                 |                             |                                 |
| Feb  | 5748.6                        | 120.2           | 2.1                         | 5868.8                          |
| May  | 5750.1                        | 95.2            | 1.6                         | 5845.3                          |
| Aug  | 5691.8                        | 115.7           | 2.0                         | 5807.6                          |
| Nov  | 5751.7                        | 201.0           | 3.4                         | 5952.7                          |
| 1975 |                               |                 |                             |                                 |
| Feb  | 5704.0                        | 291.8           | 4.9                         | 5995.9                          |
| May  | 5710.6                        | 252.5           | 4.2                         | 5963.0                          |
| Aug  | 5688.1                        | 243.8           | 4.1                         | 5931.8                          |
| Nov  | 5799.1                        | 274.5           | 4.5                         | 6073.6                          |
| 1976 |                               |                 |                             |                                 |
| Feb  | 5810.6                        | 304.5           | 5.0                         | 6115.1                          |
| May  | 5840.6                        | 247.6           | 4.1                         | 6088.1                          |

Source: Australian Bureau of Statistics, *The Labour Force*. (Canberra, various issues). (Ref. No.6.20).

Statement No. 2 attached to the Budget Speech 1976-7 permits an interpretation of the official assessment of the economy in the current fiscal year [18]. The main features of the statement on immediate prospects are:

- (i) Real gross non-farm product will grow by about four per cent in 1976-7 when compared with 1975-6.
- (ii) Employment will rise by about 1.5 per cent, perhaps more, over the year; this implies a growth in productivity per head averaging about 2.5 per cent for the year.
- (iii) Real private consumption spending will rise faster than real income during 1976-7 thus implying a rate of growth in excess of four per cent.
- (iv) Increases in stocks will be substantial during 1976-7.
- (v) Private fixed investment will recover to a modest extent during the year.
- (vi) Real government spending will remain at or slightly below the levels of the past year.
- (vii) Imports will grow.

In effect, the performance of the economy in 1976-7 depends heavily upon the revival in real private consumption spending; a position not dissimilar from the unsuccessful outcome in the previous year. Stimulus to investment spending provided in various ways by the Government is not seen as having significant *net* benefit this fiscal year; it may have limited and reversed real declines which would otherwise have taken place.

In Table 6 estimates are shown comparing the relative contributions to gross domestic product in recent years with *an interpretation* of the official viewpoint on economic prospects in 1976-7. With the assumption of a four per cent growth in real gross non-farm product during 1976-7, the dominance of consumption in the immediate recovery phase is clear. Unless the rise in imports is much greater than anticipated, the rise

in stocks will be modest, while private fixed investment would not be a source of much stimulus. Although arguments about the interpretation of the official commentaries can provide adjustments to the pattern of change during 1976-7 shown in the penultimate column of Table 6, the overall position would be much as depicted. There are two dominant impressions of this set of estimates:

- (i) The reliance on rises in real consumption indicates modest calculations of the effect of government policies towards investment. Moreover, the basis of revival in consumption is not clear; while household savings have declined slightly from the peak in 1974-5, they remain very high by past standards.
- (ii) The expected rate of real non-farm growth is modest in circumstances of underutilisation of resources; this aspect is treated in Appendix A.

The estimates shown in Table 6 may do no more than indicate a conservative assessment of likely outcomes, with some real expectation of an achievement well in excess of the announced target. But there are grounds for arguing that an alternative approach with a higher expectation about performance could have been offered. The reasons for this relate to employment prospects. In the current circumstances where wage costs dominate many business judgements, the expected gain in productivity of about 2.5 per cent during 1976-7 is most conservative. The market sector is now strongly oriented to the reduction of unit labour costs wherever possible. Hence the thrust to gain improvements in efficiency will be sustained during recovery. A modest growth target will be realised through productivity increases rather than generating higher output from an expanding work force.

Additional stimulus could be provided from the public sector. Rather than the small reduction in real contributions from government shown in Table 6, a small rise by between \$50 and \$100 million would have secured this added stimulus. However, such a shift, if it were to fall exclusively on the Federal

TABLE 6

## Contributions to Real Gross Domestic Product

1973-4 to 1976-7

(\$ million, constant 1966-7 prices)

|  | 1973-4                |                       | 1974-5 |                       | 1975-6 |                       | 1976-7 |  |
|--|-----------------------|-----------------------|--------|-----------------------|--------|-----------------------|--------|--|
|  | Change from<br>1972-3 | Change from<br>1973-4 | Total  | Change from<br>1974-5 | Total  | Change from<br>1975-6 | Total  |  |
| Final Consumption Spending               |                       |                       |        |                       |        |                       |        |  |
| Privately                                | +1116                 | +586                  | 20717  | +684                  | 21401  | +909                  | 22310  |  |
| Government                               | +242                  | +246                  | 3923   | +297                  | 4220   | +100                  | 4320   |  |
| Fixed Capital Spending                   |                       |                       |        |                       |        |                       |        |  |
| Private                                  | +394                  | -515                  | 4843   | +40                   | 4883   | +80                   | 4963   |  |
| Public                                   | +39                   | +365                  | 2928   | -27                   | 2901   | -150                  | 2751   |  |
| Changes in Stocks                        | +1141                 | -409                  | +568   | -840                  | -272   | +360                  | +88    |  |
| Exports of Goods & Services              | -226                  | +337                  | 5830   | +211                  | 6041   | +150                  | 6191   |  |
| Imports of Goods & Services <sup>b</sup> | -1516                 | -54                   | -6485  | +257                  | -6228  | -270                  | -6498  |  |
| Statistical Discrepancy                  | +575                  | -638                  | +119   | -190                  | -71    | +71                   | -      |  |
| Gross Domestic Product <sup>c</sup>      | +1765                 | -81                   | 32443  | +431                  | 32874  | +1250                 | 34124  |  |
| Gross Non-Farm Product                   | +1683                 | -350                  | 29614  | +243                  | 29857  | +1190                 | 31047  |  |
| Gross Farm Product                       | +84                   | +267                  | 2829   | +289                  | 3018   | +60                   | 3078   |  |

Source: Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No.7.5).

Notes: a. Real private consumption rises by 4.25 per cent in 1976-7.

b. Imports and an increase in imports = minus, decrease in imports = plus.

c. Alternative growth estimates for 1976-7 are:

+1974 = 6%  
+1810 = 5.5%  
+1645 = 5%

Government, would mean a rise in spending *at current prices* of between \$250 and \$350 million. Such an approach would require a careful review of the basis for funding a higher deficit or the foregoing of concessions offered in May or August 1976. The expansion of the deficit, funded from borrowings in the market sector or from trading banks, would risk further rises in domestic interest rates with the possibilities for "crowding out" investment programmes in the private sector which the Government has sought to encourage by other means [7].

The arguments for a higher level of real government spending than provided for in the Budget rest upon three issues:

- (i) The worries about restoration of substantial growth in real private consumption spending when past experience shows the risks of such a strategy.
- (ii) The scope for attaining a significantly higher rate of real growth during 1976-7 and securing a more effective basis for increasing employment during 1977.
- (iii) The evidence from the 1975-6 Budget that estimates of revenue collections cannot be accepted as very certain, so that short-term management of the economy rests upon monetary and debt management policies.

On present evidence, each has a convincing basis for arguing for a rise in government spending.

Other policies have been advanced for reducing taxes in order to negotiate a lower rate of wage adjustment to price rises, should the downward adjustment be on income taxes, or on sales and excise taxes in order to directly influence the consumer price index and so wage claims. On the first proposal, personal tax indexation measures have already provided a major contribution. Furthermore, the problem of stimulating consumption in support of the apparent economic strategy is not one of lack of disposable income in households. The reduction in sales

and excise taxes would have some immediate impact on the consumer price index, but the gains can be exaggerated. It would provide little stimulus to consumption spending.

#### 5 *The Prospects in 1977*

The scope for adapting policies has become more restricted than anticipated because of deficits in the public sector, the sustained rate of inflation and the continuing stagnation in real activity. But the main focus cannot be on monetary and fiscal issues exclusively. Problems in the balance of payments have heightened uncertainty about future prospects for the economy. Some aspects of this problem would be removed with the inauguration of new projects in mining. In the interim, arguments about devaluation are fraught with difficulty. A devaluation would have every prospect of delaying recovery through its immediate impacts on costs and by accelerating inflation[1]. But the lesson of our current position is that, when a measure of domestic stability has been achieved in the latter part of 1977 comparable to the performance of our major international competitors, a greater measure of market orientation should be introduced into foreign exchange transactions.

Issues arising in the National Wage Case are equally important to restoring real growth in the economy, while reducing inflation [17]. The strong influence on wage claims and industrial unrest has been the level of unemployment during the past twelve to fifteen months. With some real recovery, or indeed the prospects of it, a few trade unions seem less committed to compliance and there is every prospect that some firms would be willing to accept wage demands beyond those provided for in indexing guidelines. Public service associations, especially those with skilled tradesmen and technicians in their ranks, might see the basis for additional claims on a comparative wage justice argument.

The unwillingness of the Full Bench of the Arbitration Commission to accept arguments about the advantages of six

monthly rather than quarterly hearings for the National Wage Case in curtailing the transmission of cost inflation is worrying. The relative weakness of the Commonwealth Submission in pursuing this important aspect may have prejudiced acceptance of this approach [3, 5, 8]. Furthermore, interventions by the Federal Government have not always ensured a strengthening of the authority of the Full Bench [4]. This quest for maintaining real wages has come at a time when national productivity has been falling [17]. So recovery means some restraint on real wages in 1976 if improvements are to be achieved in output, investment and employment. The great risk is that the attempt at restoring profit margins to a level for encouraging production and investment will further stimulate inflation. Only if recovery can be identified with rapid productivity gains will this impetus be avoided. The risk of a modest target for recovery is that such gains will be frustrated. The restoring of profits through increased prices alone will generate further wage claims easily realised under existing wage determination procedures.

What is the role for monetary policy? The close ties between fiscal actions and wage determinations have serious implications for implementing tax measures by government. They are, in turn, most significant for the level of Government spending unless the relationship between revenue collections and spending is ignored. This circumstance has every prospect of neutralising fiscal policy as a major device for pursuing national economic policies; this is evident in some current choices of action. Stabilisation policies then must be sought in debt management and monetary programmes in order to finance deficits while curtailing inflation. This dilemma is as relevant to the circumstances of 1976-7 as to the past two years. Issues in wage determination cannot be separated from the problems of funding large fiscal deficits. Thus the weight of short term policies remains hard upon monetary policy. The Federal Treasurer gives recognition to this in his announcement of the 10-12 per cent monetary target for the volume of money, M3. Yet if reliance on monetary and debt management policies remains dominant over the next few years, and circumstances indicate this outcome, then the public development of monetary

policy must become more complicated. The money supply, M3, is influenced by many features outside the control of the authorities. Hence attention must turn to those aspects of monetary performance which are effective instruments to the authorities rather than to the gross calculations of the money supply which are notorious for their variability.

## APPENDIX A

*Actual and Potential Gross Domestic Product*

The peak quarter for output prior to the onset of the mild depression was that for January-March 1974. The level of real gross domestic output achieved in that quarter was effectively regained only in the March quarter 1976, though the estimates for the June quarter 1975 show an equalling of the past peak.<sup>6</sup> This interval of seven quarters before the previous peak was regained contrasts with experience in 1960-1 when the interval was five quarters. Such a comparison is not satisfactory because of the structural changes in the economy during the fifteen years. The farm sector provided some 10.50 per cent of gross domestic product in 1960-1 whereas the ratio had fallen to 8.59 per cent in 1973-4.

Within the economy distinctions must be made between the farm sector and the rest of the economy. Real output in the farm sector has shown stronger recovery than for other sectors as was the experience in 1961-2. The farm sector has problems of costs and prices rather than output; so far as earnings are concerned this is largely a reflection of difficulties in foreign markets and domestic cost problems. But for the rest of the economy, especially manufacturing, reductions in output have been severe. Estimates for the non-farm sectors on a similar basis to that for gross domestic product reveal a worse position. The peak quarter for output from all sectors, other than farm activities, has yet to be regained. The interval now extends over nine quarters. There is a sharp difference in the experience of the farm sector and the rest of the economy in terms of real output. Should allowance be made for the inevitable queries about using quarterly data, the contrast is not weakened. At best, it might be suggested that real gross non-farm product was near the levels recorded during the six months to March 1974.

In Table A1 the recent performance of the Australian economy is summarised. As the farm sector is greatly influenced

by external events as well as the weather, its short-term performance should be distinguished from all other sectors. In this table the evidence shows how the fall in output across all the non-farm sectors during 1974-5 has been sustained through the first half of the present fiscal year. Between July and December 1975 the rate of decline accelerated by comparison with the 1974-5 fiscal year. In the two most recent quarters improvement has been recorded though its basis is not broadly based.

TABLE A1  
*Changes in Gross Domestic Product*  
 1972-3 to 1975-6  
 (Per cent, constant 1966-7 prices)

|                              | Gross<br>Farm<br>Product | Gross<br>Non-Farm<br>Product | Gross<br>Domestic<br>Product |
|------------------------------|--------------------------|------------------------------|------------------------------|
| <b>Annual<sup>a</sup></b>    |                          |                              |                              |
| 1972-3                       | -9.83                    | 6.18                         | 4.69                         |
| 1973-4                       | 3.39                     | 5.95                         | 5.74                         |
| 1974-5                       | 10.42                    | -1.17                        | -0.25                        |
| 1975-6                       | 6.68                     | 0.82                         | 1.33                         |
| <b>Quarterly<sup>b</sup></b> |                          |                              |                              |
| 1974                         |                          |                              |                              |
| Mar                          | -8.90                    | 3.14                         | 2.14                         |
| Jun                          | -                        | -3.01                        | -2.79                        |
| 1974-5                       |                          |                              |                              |
| Sep                          | 6.79                     | -2.09                        | -1.41                        |
| Dec                          | 8.37                     | 1.40                         | 1.96                         |
| Mar                          | 4.29                     | -0.47                        | -0.06                        |
| Jun                          | 3.98                     | 2.39                         | 2.53                         |
| 1975-6                       |                          |                              |                              |
| Sep                          | -1.45                    | -2.19                        | -2.12                        |
| Dec                          | -4.28                    | -0.77                        | -1.10                        |
| Mar                          | 7.97                     | 3.22                         | 3.65                         |
| Jun                          | 1.42                     | 0.53                         | 0.60                         |

*Source:* Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No.7.5).

*Notes:* a. Percentage change on previous year.  
 b. Percentage change over previous quarter; seasonally adjusted data in this comparison.

The impact of this experience may be glimpsed by comparing recent performances with that for potential output. There are difficulties in estimating and interpreting this potential but it is essentially a linking of recorded peaks in output to give a trend for future expectations. In Table A2 the trend was estimated by linking identified peak quarters and two quarters on each side of each peak for the period from the final quarter 1959 to the third quarter 1975. The estimates are in seasonally corrected constant prices. Alternative measures for linking through this period give very similar results, the outcome being to derive a trend which measures potential output as slightly less than that recorded in and about peak quarters.

Caution must be exercised in the interpretation and use of this data. The potential capacity of the economy cannot go uninfluenced by the downturn, so that the estimates for the potential of the economy and the non-farm sectors would, in all likelihood, be an overstatement of what would be potentially available. With near stability in real outlays on industrial and commercial investment during the past five fiscal years, a rising proportion of total spending would be on maintenance of existing stock of plant, equipment and buildings. A small part of that stock has been made obsolete by irreversible shifts in foreign trade patterns. Further, the calculations are based upon seasonally corrected data derived from national income estimates subject to frequent revision and some reservations must be expressed about the effectiveness of the seasonal corrections.

This set of calculations permits some indication of the loss of resources stemming from the mild depression. With the series expressed in 1966-7 prices, the differences between actual and potential performance would be much higher were they expressed in current prices. For example, this difference in the December quarter 1975 for gross domestic product would amount to about \$1,880 million in current prices.

TABLE A2

*Actual and Potential Gross Domestic Product*  
1973-4 to 1976-7

(Constant 1966-7 prices; quarters seasonally adjusted)

|           | Gross Domestic Product |                    |                               | Gross Non-Farm Product |                    |                               |
|-----------|------------------------|--------------------|-------------------------------|------------------------|--------------------|-------------------------------|
|           | Actual<br>(\$m)        | Potential<br>(\$m) | Ratio<br>Actual/<br>Potential | Actual<br>(\$m)        | Potential<br>(\$m) | Ratio<br>Actual/<br>Potential |
| 1973-4    |                        |                    |                               |                        |                    |                               |
| Quarterly |                        |                    |                               |                        |                    |                               |
| Sep       | 8057                   | 7965               | 101.2                         | 7376                   | 7277               | 101.4                         |
| Dec       | 8115                   | 8064               | 100.6                         | 7452                   | 7372               | 101.1                         |
| Mar       | 8289                   | 8165               | 101.5                         | 7686                   | 7469               | 102.9                         |
| Jun       | 8058                   | 8267               | 97.5                          | 7455                   | 7567               | 98.5                          |
| Annual    | 32519                  | 32461              | 100.2                         | 29969                  | 29685              | 101.0                         |
| 1974-5    |                        |                    |                               |                        |                    |                               |
| Quarterly |                        |                    |                               |                        |                    |                               |
| Sep       | 7944                   | 8370               | 94.9                          | 7299                   | 7666               | 95.2                          |
| Dec       | 8100                   | 8475               | 95.6                          | 7401                   | 7766               | 95.3                          |
| Mar       | 8095                   | 8581               | 94.3                          | 7366                   | 7868               | 93.6                          |
| Jun       | 8300                   | 8688               | 95.5                          | 7542                   | 7971               | 94.6                          |
| Annual    | 32439                  | 34114              | 95.1                          | 29608                  | 31271              | 94.7                          |
| 1975-6    |                        |                    |                               |                        |                    |                               |
| Quarterly |                        |                    |                               |                        |                    |                               |
| Sep       | 8124                   | 8797               | 92.3                          | 7377                   | 8075               | 91.4                          |
| Dec       | 8035                   | 8907               | 90.2                          | 7320                   | 8181               | 89.5                          |
| Mar       | 8328                   | 9018               | 92.3                          | 7556                   | 8288               | 91.2                          |
| Jun       | 8378                   | 9131               | 91.8                          | 7596                   | 8397               | 90.5                          |
| Annual    | 32865                  | 35853              | 91.7                          | 29849                  | 32941              | 90.6                          |
| 1976-7    |                        |                    |                               |                        |                    |                               |
| Quarterly |                        |                    |                               |                        |                    |                               |
| Sep       | -                      | 9245               | -                             | -                      | 8507               | -                             |
| Dec       | -                      | 9361               | -                             | -                      | 8618               | -                             |
| Mar       | -                      | 9478               | -                             | -                      | 8731               | -                             |
| Jun       | -                      | 9596               | -                             | -                      | 8845               | -                             |
| Annual    | -                      | 37680              | -                             | 31043 <sup>a</sup>     | 34701              | 89.5 <sup>a</sup>             |

Source: Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No.7.5).

Note: a. Estimated from [18, p.25].

Estimates of the potential for output in 1976-7 are also shown in Table A2. Information provided in the Budget Speech 1976-7 and attached papers suggests an expected rate of growth in gross non-farm product of four per cent. This is represented in the table and compared with potential gross non-farm product. The ratio of the two series - 89.5 per cent - is almost certainly an understatement for reasons stated in earlier paragraphs. Nevertheless it shows the sense in which current strategy may be deemed modest in its ambition. Moreover, the series on potential output in these sectors indicates a scope for high real rates of growth for two years, and possibly longer, before restraints on the overall expansion of output would be felt.

## APPENDIX B

*Economic Strategies, 1975-7.*

The economic strategy enunciated by the then Federal Treasurer, the Hon. W. G. Hayden, in the Budget of 19 August 1975 was not realised. The main points of the strategy were:

- (i) A Budget deficit of \$2798 million based upon a high estimate of the rate of increase of average weekly earnings, twenty-two per cent, not supported by the evidence on wage trends during the first half of 1975.
- (ii) Restoration of economic growth dependent upon an increase in real consumption spending, even though provision was made for some increase in real government outlays.
- (iii) The inauguration of new tax scales and arrangements intended to achieve a redistribution of the tax burden between households with some expected impact upon real consumption spending.
- (iv) The rate of growth of government spending to be greatly reduced by comparison with the previous fiscal year, 1974-5, though allocations to State governments were to be increased sharply by about thirty-two per cent.

Some part of the failure with the economic strategy may be attributed to the disturbed economic conditions stemming from the political turmoil arising in the latter part of September 1975; the main influences would have been on uncertainty and expectations. The extent of the departure from the Budget strategy can be gauged from an examination of recent estimates of quarterly national income. Although there was no specification of the expected pattern for real recovery, this could be derived from the Budget Papers. Gross non-farm product was \$29,119 million in constant 1966-7 prices during 1974-5, according to official estimates at that time. A five

per cent rise in output, as was anticipated in that Budget, would give a non-farm product in constant prices of \$30,575 million. Non-farm product in the June quarter 1976 was expected to be eight per cent above that for the June quarter 1975. The quarterly estimate for June 1975 was shown as \$7374 million, giving a maximum expected non-farm product in the June quarter 1976 of \$7964 million. But the average non-farm output for each of the four quarters in 1975-6 would have to be \$7644 million; this matches with the annual comparisons referred to above. Assuming the increased activity planned for in the Budget is evenly distributed over the year and allowing for normal seasonal patterns in non-farm output, real output in 1975-6 was expected to be akin to the distribution shown in Table B1. But the outcome for the first six months of the fiscal year was well below those expectations, while the improvement in the March quarter was not sustained into the June quarter 1976. Indeed, the contrast is greater than at the time of the Budget, because subsequent revisions in quarterly national income series mean higher estimates of expected outcomes for each quarter in 1975-6. The budget strategy has not been realised as a comparison of the budget expectations with the outcome clearly reveals. It was significantly "off-track" at the time of that Budget.

TABLE B1  
Gross Non-Farm Product, 1974-5 and 1975-6<sup>a</sup>  
(\$ million, constant 1966-7 prices, not seasonally adjusted)

|                  | 1974-5  |         | 1975-6   |         |         |
|------------------|---------|---------|----------|---------|---------|
|                  | Actual  |         | Expected |         | Actual  |
|                  | 19-8-75 | 10-9-76 | 19-8-75  | 10-9-76 | 10-9-76 |
| Quarterly        |         |         |          |         |         |
| Sep              | 7160    | 7279    | 7520     | 7646    | 7353    |
| Dec              | 7763    | 7877    | 8010     | 8147    | 7788    |
| Mar <sup>b</sup> | 6822    | 6946    | 7081     | 7201    | 7147    |
| Jun              | 7374    | 7512    | 7964     | 8101    | 7569    |
| Annual           | 29119   | 29614   | 30575    | 31095   | 29857   |

Source: Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No. 7.5).

- Notes:
- Estimates shown in cols. 1 and 3 are based upon national income series announced at the time of the 1975-6 Budget. Estimates in cols. 2, 4 and 5 are adaptations of the original interpretation based upon or taken from the most recent official series for June quarter 1976.
  - Estimates for expected gross non-farm product in March quarter 1976 were set too low by comparison with other quarters in that fiscal year; the December quarter expectation should have been relatively lower, compensated by a higher estimate for the March quarter.

When allowance is made for seasonal variations, private consumption spending was not increasing in real terms until the final quarter in 1975-6. The Micawber-like strategy of waiting for something - consumption - to turn up was of no benefit to the economy. This disappointing experience has serious implications for the present economic strategy as revealed in the 1976-7 Budget. In the recent Budget the expectation of a four per cent growth in real gross non-farm product is based upon a greater than four per cent rise in real private consumption spending and increases in inventories. As in the previous fiscal year, there was a significant rise in real consumption spending during the June quarter prior to the Budget. This pattern is shown in Table B2. The reasons for judging that 1976-7 will not repeat the experiences of the past fiscal year would appear to be:

- (i) Slackening in the rate of inflation will restore confidence in future economic prospects so that incentives to save because of uncertainty will diminish;
- (ii) Households adjust slowly to the sharply changed experiences of historically high inflation rates; and
- (iii) The rise in stock exchange prices over the past eighteen months has restored the real value of marketable financial assets, thus curtailing the need for proportionately high savings out of current income in order to attempt the restoring of real value of past financial accumulations.

Expectations about the pattern of consumption spending have been notoriously fickle over the past three years.

The Budget Speech 1976-7 and attached papers are less revealing of the likely pattern of gross non-farm product over the fiscal year than in the previous year. But an interpretation of the commentary suggests some acceleration during the course of the fiscal year. The estimates in Table B3 are an attempt to indicate the pattern to be anticipated for each quarter; they are on the same basis as in Table B1.

TABLE B2  
*Real Private Consumption Spending*  
 1973-4 to 1975-6  
 (\$m, constant 1966-7 prices, seasonally adjusted)

| Quarters | 1973-4 | 1974-5 | 1975-6 |
|----------|--------|--------|--------|
| Sep      | 4932   | 5097   | 5312   |
| Dec      | 5034   | 5113   | 5300   |
| Mar      | 5071   | 5193   | 5310   |
| Jun      | 5105   | 5321   | 5455   |

*Source:* Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No. 7.5).

TABLE B3  
*Gross Non-Farm Product*  
 1975-6 to 1976-7  
 (\$m, constant 1966-7 prices, not seasonally adjusted)

|           | 1975-6<br>Actual | 1976-7<br>Expected |
|-----------|------------------|--------------------|
| Quarterly |                  |                    |
| Sep       | 7353             | 7533               |
| Dec       | 7788             | 8068               |
| Mar       | 7147             | 7467               |
| Jun       | 7569             | 7979               |
| Annual    | 29857            | 31047              |

*Source:* Australian Bureau of Statistics, *Quarterly Estimates of National Income and Expenditure*. (Canberra, various issues). (Ref. No. 7.5).

This view of the immediate prospects plays down the contribution of private fixed investment to recovery during 1976-7. The stimulus to investment in the market sector has been a prominent feature of economic policy measures taken since the beginning of the year. The forty per cent investment allowance and the concessions made in the Budget to the petroleum, coal and other mining groups have been substantial. On this interpretation of the Budget's economic strategy, few benefits in terms of stimulus to recovery are seen as likely during 1976-7; an impact may be anticipated in the final quarter.

## FOOTNOTES

<sup>1</sup> [18, p.3]

<sup>2</sup> [18, p.4]

<sup>3</sup> [13, p.3]

<sup>4</sup> [13, p.4]

<sup>5</sup> [2, pp.2-3]

<sup>6</sup> The accuracy of the quarterly national income estimates is a matter of increasing concern. The Australian Statistician gave added weight to warnings about interpreting quarterly data when announcing the estimates for the June quarter 1976 on 10 September 1976. In that publication (Reference No.7.5) this warning was given added strength by the insertion of a new section comparing trends on a half-year basis; see pp.5-6.

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