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**AUSTRALIA IN A COMPETITIVE WORLD:
SOME MORE OPTIONS**

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THE ECONOMIC SOCIETY OF AUSTRALIA AND NEW ZEALAND
VICTORIAN BRANCH

FOREWORD

The Stan Kelly Memorial Lecture has been generously endowed to the memory of William Stanley Kelly, OBE, by his son Charles Robert (Bert) Kelly. The Inaugural Lecture was presented by Sir John Crawford in Canberra in 1977 under the terms of an Agreement between Bert Kelly and the Australian National University, but a new Agreement between the donor and the Victorian Branch of the Economic Society of Australia and New Zealand has established the Lecture in Melbourne.

Stan Kelly, a South Australian farmer, was a member of the Commonwealth Tariff Board in Melbourne from 1929 to 1940, during which time he developed a close connection with the Victorian Branch of the Economic Society. He was also prominent as Chairman of the South Australian Advisory Board of Agriculture 1922-24, as a representative of the Australian Wool Board on the Wool Secretariat in London 1940-41, as advisor to the Commonwealth Prices Commissioner on primary products 1942-48, as Chairman of the Joint Dairying Industry Advisory Committee 1951-53, and as a member of the Consultative Committee on Import Policy 1952-60.

Stan Kelly was a proponent of free international trade, a view shared by his modest Member/Farmer son, Bert. Their preferences are preserved in the theme of the Lecture series: "The desirability of maintaining free the channels of trade throughout the world"

The Economic Society is extremely pleased to present this Lecture series, and to have as its Inaugural Lecturer Mr. John Stone, Secretary of the Commonwealth Treasury. John Stone had an outstanding academic record, reflected in the award to him of the Rhodes Scholarship for Western Australia in 1951, and in further first class honours achievements at Oxford University. He joined the Commonwealth Treasury in 1954 and has served that Department with considerable distinction, including service as Senior Treasury Representative in London 1957-61; as Assistant Secretary, Economic and Financial Surveys Branch 1962-67; First Assistant Secretary, Revenue, Loans and Investment Division 1970-71; Deputy Secretary (Economic) with responsibility for the General Financial and Economic Policy and Overseas Economic Relations Divisions 1971-76; Deputy Secretary 1976-78; Secretary since January 1979.

In addition to his Treasury positions, John Stone served as Executive Director for Australia, New Zealand and South Africa on the Board of the International Monetary Fund in Washington, DC, USA, and on the Board of the International Bank for Reconstruction and Development from 1967 to 1970.

The Victorian Branch of the Economic Society of Australia and New Zealand greatly appreciates Mr. Stone's acceptance of the invitation to him to present their inaugural Stan Kelly Memorial Lecture.

Barry N. Nicholls,
President.

AUSTRALIA IN A COMPETITIVE WORLD: SOME MORE OPTIONS

1. Introduction

There is a famous remark, attributed to Lenin, to the effect that:

"It is true that liberty is precious—so precious that it must be rationed."

Naturally, I do not think of addresses by officials such as myself as being in quite the same exalted category as liberty. Nevertheless—and perhaps for reasons not totally removed from those giving rise to Lenin's chilling observation—there is some tendency for them also to be "rationed".

When, therefore, Bert Kelly approached me almost a year ago to deliver this the third in the series of Memorial Lectures which he established in honour of his father, I told him that I would be glad to undertake the task—notwithstanding my deep sense of inadequacy in doing so—subject to receiving the necessary Ministerial approval. I am glad to say that that approval was readily forthcoming.

The late Stan Kelly was, obviously, not of my own generation. He joined the Tariff Board a few weeks after I was born. However, while I was still a student at the University of Western Australia, the late Phil Roberts once introduced me to him. Roberts, who was both Senior Tutor of St. George's College and a senior officer of the State Department of Agriculture, was eager to show Mr. Kelly, who was passing through Perth, some developments in plant breeding. I chiefly recall the warmth of relationship between a research scientist with a strong bent for practical agriculture and a man who I can now see was a practical agriculturalist with a strong bent for scientific research.

I recently read Mr. Kelly's little book "Remembered Days". What emerges is the image of a simple man—not highly educated in the over-academic sense in which, these days, we have too readily come to define that term—but one whose straightforwardness of character and fundamental decency stand out from every page.

As I was reading this little book, I was reminded of something that the American Dwight Morrow wrote in a letter to his son and which might well serve as a motto for public servants:

"The world is divided into people who do things and people who get the credit. Try, if you can, to belong to the first class; there is far less competition."

Both Stan Kelly and his truly "modest" son—whom I have had the privilege of knowing for many years—never worried much about "getting the credit" but each of them, in his own way, devoted much of his lifetime to "doing things" not principally for themselves but for Australia. Neither was a Public Servant in the sense in which that term is normally understood; but each was (and one still is) a great servant to the Australian public.

Let me now outline the gist of what I wish to say tonight.

Some of you may recall my address two years ago to the Australian Institute of Management entitled "Australia in a Competitive World: Some Options". That address concentrated upon the "external" options confronting Australia in the face of a resources investment upsurge. I did also make some scattered references to certain "domestic" aspects of my thesis, but time alone did not permit their extensive development.

Nevertheless, economies are not in practice to be separated into their domestic and external components — no matter how analytically convenient that may be.

We hear a lot these days internationally about the concept of "interdependence". Notwithstanding its recent discovery by political scientists and other preachers, that concept is to economists one of the oldest and best known in their world. The Australian economy, and every other economy, is a living example of interdependence in action — interdependence between the various elements of the domestic economy and between each of those elements and the rest of the world.

Tonight therefore I would like to develop what I have called "Some More Options" confronting Australia in what is now the thick of our resources investment upsurge, concentrating in this case on the domestic options. In the process, I shall draw out some of the "linkages" — the interdependence if you like — between, first, those domestic options themselves and, secondly, between them and the external options I discussed almost two years ago. I shall hope to do so in a manner which does not rest upon assertion but which, starting from some simple premises, proceeds by way of development of a series of purely logical propositions.

As the main propositions advanced in that earlier address were quite elementary, and as the passage of time has perhaps begun to bear out their inevitability even to the initially sceptical, I need recall only their essential elements here.

1. "Australia in a Competitive World: Some Options". Paper presented to the 21st General Management Conference of the Australian Institute of Management, Sydney, 19 November 1979.

In addressing itself to some consequence of a substantial prospective expansion of our resource-based sector — an expansion now well into its third year — that earlier paper started from the basic assumption that Australia in the 1980s will continue to need foreign capital to assist us in our developmental investment task. There has since been some — though not much — tendency to challenge that assumption; in part this paper seeks to spell out the consequences of doing so.

Remembering that, as a matter of mere arithmetic, domestic investment in Australia equals domestic savings plus the deficit on the current account of our balance of payments, the following propositions were advanced:

- if we do wish to draw on foreign savings (i.e. resources) to assist our development, we will need to continue to run a deficit on our current account; and
- on any plausible set of assumptions about our long run export prospects that means, in turn, that we shall have to import more.

As to the manner in which that inescapable increase in imports might occur, two broad options for policy were identified, namely:

- either to act positively to ensure that import growth substitutes for the production of our own least efficient producers; or
- passively to allow the economic forces involved to produce the required current account readjustment by affecting our efficient producers (both exporters and our more efficient import-competing industries) as well as our inefficient ones.

The logic of that earlier stated series of propositions would doubtless be accepted by most. However there are still those who continue to search for, and advance, "alternatives" which purport to allow us to enjoy the benefits of resource development without the adjustment that that development must necessarily bring with it².

2. Adjustment Under Way

It is now a matter of record that the last two years have seen a very substantial build up in business fixed investment in Australia, particularly but by no means solely in the resource-based sector. Partly as a consequence, the current account deficit on the balance of payments widened to just over 4 per cent of GDP in 1980-81, a figure well above the average of the last decade. That development, in turn, was facilitated (in

2. Which makes them worthy of addition to that collection of "most unbelievable" statements which I heard recounted recently by the Deputy Prime Minister: viz, "Of course I'll still respect you in the morning"; "Don't worry, my cheque is in the mail"; and "I'm from the Government and I'm here to help you".

the absence of any significant change in our protective arrangements) by the appreciation of the exchange rate by around 10 per cent on a trade weighted basis over the course of 1980-81.

Not surprisingly, some reactions to this adjustment have also emerged. The exchange rate appreciation has been affecting the incomes and competitive positions of our farmers, miners and manufacturers, whether exporters or those competing with imports. The demand for loanable funds to finance the investment upsurge involved has been putting pressure on interest rates with implications for small borrowers, home purchasers, State Governments and so on.

On a different level, and partly having in mind the role which reductions in protection could play in helping to contain inflationary pressures and accommodate the surge in business investment, the Government has forwarded a reference to the Industries Assistance Commission seeking its advice on ways to achieve a further general reduction in long term protection. There has also been substantial dismantling of the "Australian preference" policy in respect of Commonwealth Government purchases; while, on another front, Australia recently joined the GATT Subsidies and Countervailing Duties Code.

Naturally, some of those concerned see in these developments an increasing threat to the privileged positions which they have hitherto been enjoying. Concerns are being voiced about the wisdom of allowing resource development to proceed so rapidly, and the wisdom, as part of that process, of continuing to allow our savings to be supplemented from abroad by the inflow of foreign capital, at least at the recent rate.

It is inevitable that strains should appear in particular adjustment areas before significant tangible benefits from the resource developments are perceived by the community at large. The construction of investment projects must necessarily precede the increase in production, earning of additional export income and so on — that is, the benefits — that flow from them.

Beyond that, many of the benefits will accrue only fairly indirectly. For example, in due course increased taxation payments by the resource sector pave the way for some easing of other taxation burdens. Cheaper imports, resulting from the appreciated exchange rate or reduced protection that such developments make possible, provide indirectly an increase in consumers' real incomes. Meanwhile, however, it may be difficult for the average person facing, say, higher interest payments on his mortgage to "trade-off" that quite direct cost now with those indirect benefits either now or in the future.

It should however be noted that some of the potential benefits have already begun to appear:

- some of the strong expansion in employment over the last two years can undoubtedly be traced back, either directly or indirectly, to resource developments and to the improved level of confidence and stronger growth they have helped generate;
- the sharp increase in the current account deficit over the last year — itself partly reflecting the sharp rise in the level of business fixed investment and facilitated by the exchange rate appreciation already referred to — has added to the goods and services available to the community; and
- that same exchange rate appreciation has made imports relatively cheaper and in the process has helped to dampen down domestic inflationary pressures.

Everyone will have his own view as to the validity of the concerns being voiced about the adjustment processes on which the Australian economy is now embarked. My own views about those concerns — understandable though the latter are — will, I think, be clear. Nevertheless, such concerns do exist — which brings me to the question of whether there are "Other Options" open to us by which those concerns might be assuaged at least in part.

3. Some More Options for the 1980s

If we go back to our basic economic identity:

$$\text{Domestic Investment} = \text{Domestic Savings Plus Deficit on the Current Account of the Balance of Payments}$$

then it must follow that if we did wish to reduce our reliance on foreign capital, either:

- domestic investment would need to be reduced; or
- domestic savings would need to rise; or
- some combination of these would need to occur³.

Before exploring in turn each of these "other options", however, it is worth digressing briefly on two counts. First, there is an essential difference between these "other options" and the external policy options referred to previously. It is only the external option — i.e. increasing the current account deficit on the balance of payments — which increases the totality of resources available to the community and thereby gives an immediate increase in growth potential.

Secondly, I should perhaps say a word about the context in which I am addressing myself to both sets of options. Nor surprisingly, while resource-

3. There are some who would seek to "qualify" these logical deductions on the basis that much of recent capital inflow has been of a "speculative" nature. Quite apart from the evidence, as far as we know it, not supporting that as a factual proposition, such a "qualification" confuses financial flows with real resource flows.

based investment has been expanding strongly over the last two years and all the indications are that it will continue to do so in the immediate future at least, the circumstances in which that investment has been taking place have not stood still. Without going into detail, the net result has been that, apart from some inevitable sorting out of priorities as between projects competing for a share of the same market, developments in the world economy generally and in world energy markets in particular are undoubtedly being seen as reducing the urgency of some of the investment that is currently on the drawing boards.

For those who might see those developments as implying some corresponding reduction in the relevance of any of these options — external or domestic — let me make two brief points. First, while the timing and scale of particular projects and, perhaps, aggregate investment, will inevitably be influenced by shorter term economic developments, what underlies all these options is the sense of purpose and the rationality with which we move to take advantage, over the 1980s and beyond, of our rich endowment of natural resources.

I am talking, in other words, about the choices that have to be made and the degree of flexibility required to take maximum advantage of opportunities for economic advancement (which happen, at this stage of our development, to be more than usually favourable in the resource-based area of our economy).

Secondly, it is already clear that we have a significant relative expansion of the resource-based sector on our hands, and the sorts of options I am addressing are concerned, not only to ensure that we make the necessary "room" for the investment giving rise to that expansion, but also that the on-going viability of those expanded operations is not itself impaired by a failure to make the necessary adjustments in our economy.

4. Lower Domestic Investment

In its narrowest form this option would involve holding back resource-based investment itself⁴. A wider interpretation would involve holding back investment generally, including non-resource-based investment — i.e. other business investment, private investment in dwellings and

4. When I say holding back I mean, of course, holding back in some way relative to other forms of investment, or demand more generally. There is a need to maintain an overall policy environment conducive to containing and reducing inflationary pressures, but within that overall framework the Government's present policy is to provide scope for the orderly accommodation of as much genuinely viable investment in the resources area as practicable. Indeed, it is not too much to say that that represented one of the central strands of policy underlying the Government's approach to the 1981-82 Budget.

investment by governments at all levels⁵. Let us consider each of those areas.

As noted earlier, resource-based investment provides opportunities for new and more productive use of our resources and a decision deliberately to restrain it would be a decision for lower future living standards than we could otherwise enjoy.

As for business investment more generally, I think it would be widely acknowledged that deliberately holding back such investment is an option that does not obviously commend itself even to those who are most vocal in their criticisms of some of the consequences (e.g. higher interest rates) of not doing so.

The fact is that we hear a great deal less today than we did a decade ago from the proponents of "zero growth" and the "Club of Rome" school more generally. That reflects both the fact that many of their arguments did not stand up to more than the merest scrutiny, and the fact that most of the industrialised world has now had a fairly lengthy taste of "low growth" since the early 1970s and has found it — let alone "zero growth" — distinctly unpleasant.

That is not to say that all business investment is necessarily desirable. Where governments, by one form of intervention or another, distort the framework within which businessmen take their decisions, some business investment may be undertaken which, however profitable it may be from the viewpoint of that investor, may be less than desirable from the national viewpoint. In this sense, reduced business investment in certain avenues has the capacity either to make capital more readily available for use in more nationally productive avenues or to reduce the pressure on our capital markets, thereby lowering interest rates and the need to supplement our own savings from abroad.

That said, I do not think we need spend further time on the lower business investment option. It would involve clear and substantial economic costs for Australia — costs that do not begin to be matched by accompanying economic (or other) benefits⁷.

5. Some investment by governments is also, of course, resource-based.

6. A scrutiny of those arguments was given in Treasury Economic Paper No. 2, "Economic Growth: Is It Worth Having?" (1973).

7. A conclusion I strongly commend to those who, both in Australia and elsewhere (e.g. many of the developing countries), continually bemoan their country's inability to provide more of this or that assistance to the poor, the disadvantaged, the elderly and so on in their communities; and who, in the next breath, disparage the "foreign devils" whose savings and resources are, at the margin, indispensable for generating the productive wealth without which those and other social priorities (assuming them to be that) simply will not be capable of being met.

Let me move on from there to observe that — on strictly economic grounds alone — the same unambiguous conclusion cannot be drawn with respect to investment in housing. As you know, all governments in Australia have traditionally chosen to encourage home ownership or, to put that point another way, to bestow some measure of advantage in the market for investible funds on individuals wishing to invest in their own home.

Those judgements are basically social ones, made by governments also taking into account reasons other than economic ones. There are, however, strictly economic consequences of doing so.

Policies that succeed in making home ownership relatively more attractive have the effect, by definition, of bringing about more investment in dwellings than would otherwise occur. Increased investment thus generated in one sector of the economy can only reduce the availability of savings to finance resource development and/or render such development more reliant upon the savings of foreigners.

Governments (including State and local governments) account for the other component of investment demand. Increased restraint at all levels of government can make a substantial contribution, directly or indirectly, to making "room" for new private investment. Significant steps in that process were taken at the May 1981 Premiers' Conference when the lowered basis for the revised tax sharing arrangements was decided and at the June 1981 Loan Council meeting when State and Commonwealth borrowing programs for 1981-82 were determined.

Much investment that is undertaken in Australia by the public sector is, of course, necessary and need not be less productive than investment undertaken by the private sector. Nevertheless there is room for a more economical use of capital by governments in Australia. By using public capital more productively there is a sense in which we could reduce total domestic investment without adversely affecting future living standards; or, alternatively, in which we could maintain the private investment level while financing more of it ourselves.

We hear a great deal about how the climate of expenditure restraint that the Commonwealth has sought to impose in recent years has been giving rise to a "shortage" of public capital and a so-called "imbalance" between public and private investment.

What constitutes an "adequate" level of public investment at any time is a matter of judgement. Yet we are continually being treated to proposals, supported also by some quarters of the business community, that we should squander many hundreds of millions of dollars of our scarce savings in one public project or another. I wonder if the proponents of such fantasies ever consider that one consequence of their acceptance

would probably be a higher level of foreign ownership of some *productive* investment project in Australia? That, I suggest, is the kind of "interdependence" to which our editorialists could spend a great deal more time pointing.

Fortunately, the development potential ahead of us and the need to make "room" for the private investment that will be required if that potential is to become a reality, have sufficiently focused at least some minds on the costs, in terms of opportunities forgone, of such decisions that there is nowadays less chance than, say, at the time of the Ord River dam decision, that such proposals will fall upon receptive ears. Nevertheless, it cannot be too often stressed that whether such "monumentalism" takes the form of an over-extravagant Opera House or a bridge or dam which cannot be economically justified, a decision to undertake it ultimately has consequences elsewhere in the system. Those consequences may take the form of leaving more productive investments uninitiated; or of requiring governments to drive up interest rates, or to raise taxes or charges, so that they may be initiated also; or of increasing our dependence upon foreign capital as an alternative.

As noted earlier, waste of this kind is not confined to the public sector. In the private sector, however, the profit and loss account provides at one level a constraint over such waste of capital. Evaluation of proposals can, on average, be expected to be more rigorous and, with costs borne by investors themselves rather than the general community and bureaucratic/political reputations not so paramount, bad investments are more likely to be admitted and even terminated. Nevertheless, "monopolistic" positions that have been fostered in the private sector in various forms over the years detract substantially from the efficient workings of the market place and, by so doing, encourage that same waste of capital that I have been referring to in the public sector.

The first of the "Other Options" for Australia in the 1980s therefore is that, if we are concerned to minimise our reliance on foreign savings in the development of our natural resources, one choice we do have is to cut down the usage of our own savings in relatively unproductive investment tasks⁸, whether in the public or private sectors.

5. Increased Domestic Savings

In considering our next option, of increasing domestic savings, it may be well to have a few statistics in mind.

8. Of course, the alternative even in that case would be to continue to utilise foreign savings in the same order and maintain a similar overall level of investment in Australia — but one leading to, in that case, a faster rate of growth in productivity and real living standards.

The first and most obvious consequence of the decline in aggregate national savings performance was the more or less matching decline in gross investment. A very strong recovery in investment as a proportion of GDP got under way in 1980-81 but that was facilitated primarily by increased reliance on foreign savings.

The changes in sectoral saving performance during the 1970s also had important consequences for net borrowing and lending between sectors. As can be seen from Chart 1, households became a much more important source of loanable funds for other sectors. Despite the relative decline in corporate investment, increased corporate borrowing took up part of those increased household savings. More importantly, public sector

The aggregate domestic savings ratio in Australia was reasonably stable throughout the 1960s and early 1970s, averaging close to 25 per cent of GDP⁹. Household savings were generally around 10 per cent of GDP, while corporate and public sector savings were each around 7 per cent of GDP¹⁰.

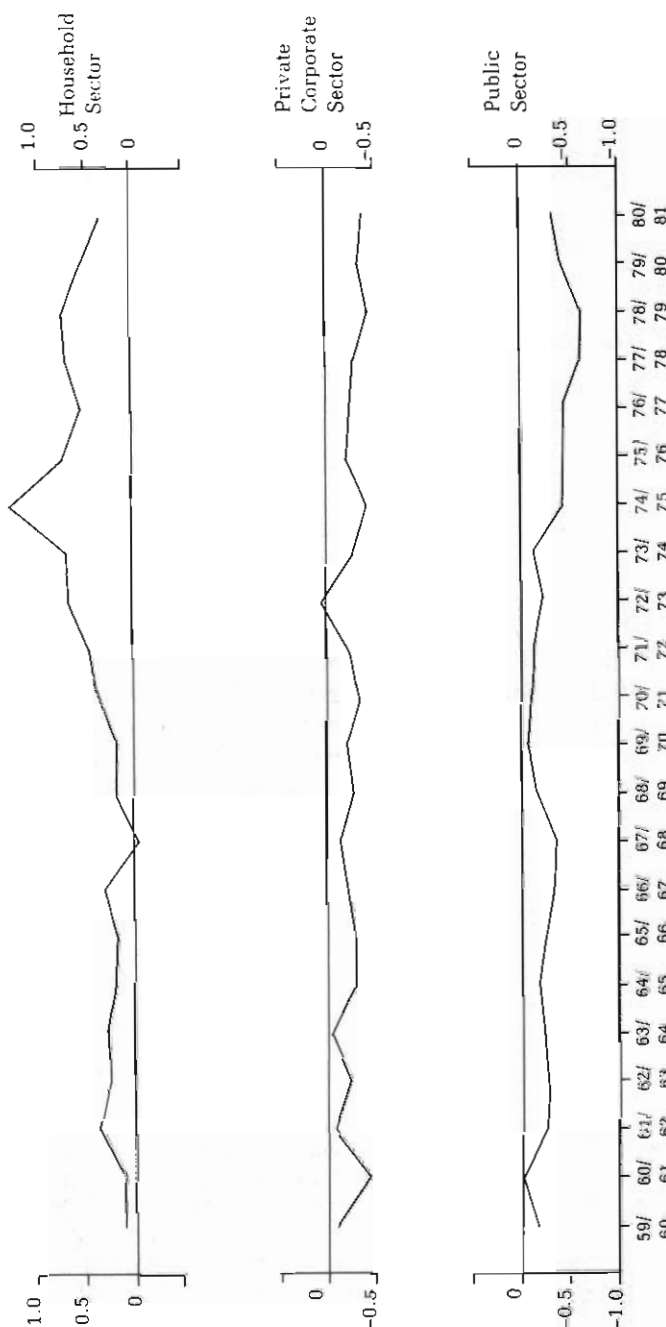
As Table 1 shows, since the early 1970s there have been significant changes in the aggregate saving ratio and even more marked changes in its composition. After reaching a peak of close to 27 per cent in 1973-74, the aggregate ratio slipped back sharply and, despite some slight recovery in the last few years, was still 5 percentage points below that level in 1980-81. Within the aggregate, household saving rose sharply as a proportion of disposable income, and of GDP, in the early part of the 1970s but has returned slowly to more "normal" levels as inflation has been wound back¹¹. The substantial fall in profits associated with the wage explosion and other events of 1974-75 was, naturally, reflected in a corresponding fall in corporate savings in that year and although there has since been some improvement in profitability, corporate savings remain well below earlier levels. Public sector savings also began to fall sharply in 1974-75 as the Commonwealth Budget, in particular, was moved strongly into deficit; for the public sector as a whole this fall has been arrested, and to a limited degree reversed, only in the last couple of years.

9. For those who argue that Australia should be financing more of its investment from its own savings it is worth remarking that, by international standards, such a ratio was already rather high.

10. Unincorporated enterprises are included in the household sector. Corporate savings are defined as undistributed income plus depreciation. Public sector savings represent the excess of government current revenues over current expenditure on goods and services (final expenditure) and transfer payments, plus the surpluses and depreciation provisions of government enterprises.

11. It should be noted that the measure of household saving being employed here — household saving as a proportion of GDP — differs from the usual household savings ratio which expresses household saving as a proportion of household disposable income.

CHART 1
NET LENDING BY SECTOR (a)



(a) The ratio of net lending (borrowing if negative) to capital acquisition for each sector. Net lending figures from 1978-79 are based on Treasury estimates.

SOURCES: See sources for Table 1.

TABLE 1
GROSS SAVING AND GROSS FIXED CAPITAL EXPENDITURE

Year	Household Sector (1)	Private Corporate Sector (2)	Public Sector (3)	Total National Saving (4)	Foreign Saving (5)	Gross fixed capital expenditure (6)
Per cent of GDP						
1959-60	9.6	6.4	7.2	23.2	3.4	24.8
1960-61	9.9	5.1	8.5	23.5	5.1	25.2
1961-62	10.2	5.4	7.0	22.6	0.1	25.0
1962-63	9.8	6.6	6.6	23.0	2.9	24.9
1963-64	11.0	7.0	6.9	24.9	0.3	25.2
1964-65	10.5	7.0	8.0	25.5	4.0	26.7
1965-66	9.2	6.3	7.6	23.1	4.3	27.6
1966-67	10.8	6.6	6.8	24.2	2.9	26.3
1967-68	7.6	6.9	6.6	21.1	4.7	26.8
1968-69	9.9	7.0	7.9	24.8	3.7	26.4
1969-70	9.1	7.6	8.6	25.3	2.3	25.9
1970-71	9.8	6.8	8.3	24.9	2.4	26.0
1971-72	10.4	6.7	8.2	25.3	0.9	25.5
1972-73	12.2	7.0	6.7	25.9	-1.6	23.7
1973-74	13.5	5.7	7.3	26.5	1.8	22.8
1974-75	14.1	4.2	6.2	24.5	2.1	23.0
1975-76	12.3	4.4	5.4	22.1	2.0	23.4
1976-77	11.8	4.9	5.0	21.7	2.9	22.8
1977-78	11.6	4.3	3.7	19.6	3.4	22.9
1978-79	11.9	5.0	3.1	20.0	3.8	22.7
1979-80	10.3	5.2	4.4	19.9	1.9	21.9
1980-81	10.2	5.5	4.9	20.6	4.2	23.9

NOTES

- (1) Household saving plus depreciation allowances, see also footnote 11 in text;
- (2) Undistributed income (including undistributed income from overseas but excluding undistributed income payable overseas) less income tax paid plus depreciation allowances of trading enterprise companies and private financial enterprises. An alternative approach (which is less conceptually appropriate for the purpose of this paper) would be to include total corporate sector undistributed income (including that payable overseas) in this item with a corresponding adjustment to item (5). In practice the difference in trends resulting from the two approaches is marginal.
- (3) General government receipts (excluding income from public trading and financial enterprises) less outlays on current transactions plus income and depreciation provisions of public trading and financial enterprises.
- (4) $(1) + (2) + (3)$ = Total national gross saving.
- (5) The deficit on the current account of the balance of payments.
- (6) Change in total stocks plus the statistical discrepancy make up the difference between total gross saving (the sum of (4) and (5)) and gross fixed capital expenditure.

SOURCES

- (1) 1981-1982 Budget Paper No. 9, *National Income and Expenditure 1980-81*, ABS Cat. No. 5213.0.
- (2) Australian National Accounts, *Quarterly Estimates of National Income and Expenditure, Australia, June Quarter 1981*, ABS Cat. No. 5206.0.
- (3) Australian National Accounts, *National Income and Expenditure*, ABS Cat. No. 5204.0 (various issues).
- (4) *Balance of Payments, Australia*, ABS Cat. No. 5303.0.
- (5) *Foreign Investment, Australia*, ABS Cat. No. 5305.0.

borrowings have been laying claim to a significantly increased share of the proportionately smaller national savings cake.

It follows that, if we really do want to increase total domestic savings and/or utilise them in a way that minimises the dependence of private investment on foreign savings, then some of the possibilities open to us — some of the "Other Options" for Australia in the 1980s — presumably must include:

- inducing households to save more;
- facilitating the recovery of corporate savings through an enhanced level of profits; and
- restoring savings by the government sector.

Household Savings

Traditionally, more than 70 per cent of national disposable income accrues to households, which account for nearly half of total saving and have typically been an important source of net lending to the rest of the economy¹². Our present interest in this area is in the scope that might exist to raise that "traditional" level of household savings, so as to reduce our dependence on foreign savings without having to have recourse to the "lower investment" options.

In that context, there are from time to time suggestions for introducing so-called "incentives" of one kind or another to encourage household savings, enhance the part played by the "small investor" in resource development and in the economy more generally, and so on. Without commenting in detail on these suggestions, I can observe — if only because it is so obvious — that in considering them, and in particular if we are to

12. Which suggests, incidentally, that notwithstanding the widespread objections which are voiced when interest rates affecting the household sector rise, there are benefits to household sector lenders which, financially speaking at least, must on balance be greater.

reach sensible judgements about them, it is important that we be clear in our minds about what they can or cannot reasonably be expected to achieve.

First, there are obvious limits to the extent to which governments can influence, in a direct sense, the overall household savings ratio. Individuals make their own evaluations in deciding how much they will spend out of their incomes and the extent of the present sacrifice they are prepared to make in order that they (and others) may be better off in future. Secondly, while no doubt devices are available that would influence the forms of saving by individual households, if that is achieved at the expense of other forms of saving it will not meet the objective of increasing total domestic saving.

If, for example, the aim were to augment the overall rate of household saving through fiscal incentives of one kind or another, the range of privileged assets would probably have to be rather wide, entailing substantial government revenue losses and thus a decrease in government savings. With much of that revenue loss inevitably accruing to households which would have saved anyway (albeit, perhaps, in different forms), the marginal cost of any increased household savings so induced would thus be very high indeed. Expressed in the more traditional form of an interest rate on the marginal savings increase involved, it would be astronomical.

In short, while the forms in which people save will undoubtedly be very sensitive to differences in the way in which particular savings media are taxed or subsidised, it is very unlikely that such differences have any significant effect on the overall savings rate. Thus, while all sorts of ostensibly laudable reasons can be advanced¹³ in support of encouraging "small savers" or "small investors" — e.g. to encourage a wider spread of direct small holdings of equities in the economy, a greater direct participation by small investors in the wealth generated in our resource sector and so on — I think we have to conclude that, in practice, raising the overall savings rate is not among them.

In the end, if we are really interested in increasing household and, in the process, national savings we can only do so by making the act of saving relatively more attractive. So far as households are concerned that means that we would need to stop favouring borrowers and start favouring lenders¹⁴.

13. Not to mention the not so laudable reasons (which of course are generally not advanced).

14. Of course, if the role of foreign capital in the Australian economy were to be reduced, that would, by reducing the supply of savings, also have implications for factors (e.g. real interest rates) affecting the savings habits of households among others.

Corporate Saving

If, in circumstances in which the role of foreign capital were to be reduced, it were desired that domestic savings should rise to enable the total level of domestic investment to be maintained, I do not think there can be any reasonable doubt that an increase in corporate saving would have to be an essential element in that process. The fact that the profit share still remains appreciably below the level of earlier years in itself suggests that conclusion. That experience of recent years also underlines the point that a return to more buoyant — and more economically appropriate — profit levels will not come about automatically, but will require the maintenance of an overall economic environment in which, *inter alia*, the wage share¹⁵ of the national product can be restrained so that, in part at least, increases in productivity can accrue, in the form of higher profits, to capital. At the same time, of course, any rise in the profit share will be associated, *ceteris paribus*, with a somewhat slower relative rate of growth of household incomes: as usual in matters economic, this in turn would tend to produce some (partial) offsetting influence on household saving.

As in the case of household saving, it is sometimes suggested that governments can help to raise corporate saving by taxation relief of one kind or another. Such measures would tend to have a direct positive effect on the rate of corporate saving. However — and quite apart from the effects which such measures would tend to have, within any given overall economic environment, upon, say, the wage bargaining process or the proportion of profits retained — any resultant increase in corporate saving achieved in that way would tend to be offset, within the national saving context, by a decline in government saving. That is not to say that it should not be done, but simply that it does not appear directly relevant to our present concerns in this paper.

Public Sector Saving

As can be seen from Table 2, a large factor underlying the decline in public sector saving in the mid-1970s was the movement of the Commonwealth's own budget into massive deficit. Similarly, the improvement in total public sector saving in the last couple of years has been largely the result of the whittling away of that deficit to the point where the Commonwealth 1981-82 Budget is estimated to be almost in balance. As the table shows, savings in the Commonwealth general

15. Restraint of the wage share of the national product does not mean, of course, that real wages cannot increase.

TABLE 2
PUBLIC SECTOR GROSS SAVING

Year	Public Sector Gross Savings					
	Total (a)	General Government (b)		Trading Enterprises (d)		
		Commonwealth	State and Local (c)	Commonwealth	State and Local	
Per cent of GDP						
1959-60	7.2	3.4	0.8	-3.2	na	na
1960-61	8.5	4.6	0.6	-3.5	na	na
1961-62	7.0	2.9	0.7	-3.8	0.8	2.2
1962-63	6.6	2.1	0.7	-3.8	0.9	2.4
1963-64	6.9	2.6	0.5	-3.8	0.9	2.5
1964-65	8.0	3.8	0.3	-3.7	1.0	2.4
1965-66	7.6	3.3	0.4	-3.9	1.0	2.4
1966-67	6.8	2.6	0.5	-3.8	0.9	2.4
1967-68	6.6	2.3	0.5	-3.9	1.1	2.4
1968-69	7.9	3.4	0.5	-3.8	1.2	2.4
1969-70	8.6	4.2	0.4	-4.0	1.2	2.4
1970-71	8.3	4.1	0.4	-4.6	1.1	2.1
1971-72	8.2	3.9	0.5	-4.2	1.2	2.0
1972-73	6.7	2.4	0.8	-4.0	1.2	1.8
1973-74	7.3	3.6	0.8	-4.1	1.0	1.4
1974-75	6.2	2.9	1.1	-5.0	0.8	1.0
1975-76	5.4	0.7	1.9	-5.7	1.1	1.1
1976-77	5.0	0.7	1.3	-6.0	1.2	1.1
1977-78	3.7	-0.6	1.3	-6.7	1.2	1.1
1978-79	3.1	-1.2	1.2	-6.8	1.2	1.1
1979-80	4.4	0.2	1.2	-6.8	1.1	1.2
1980-81	4.9	0.8	1.0	-6.9	na	na
1981-82	na	1.5(e)	na	na	na	na

NOTES

- Column (3) of Table 1. The difference between this column and the sum of general government plus public trading enterprise gross saving is gross saving of public financial enterprises. Data required for the derivation of gross saving of public financial enterprises, on a Commonwealth and State and local basis, are not available.
- General government receipts (excluding income from private enterprises) less outlays on current transactions. See also note (d).
- Excluding grants from Commonwealth Government.
- Public trading enterprise income plus depreciation provisions. Public trading enterprise income is equal to net operating surplus, being exclusive of interest received and before charging interest costs relating to the enterprises. In principle, interest receipts and payments of public trading enterprises should be netted out, but as both are included with other interest transactions in the general government income and outlay account, pending satisfactory identification of the interest relating to public trading enterprises, the gross saving figures shown here are gross operating surpluses of public trading enterprises.
- Estimated.

SOURCES

- See sources (1), (2) and (3) to Table 1.
- Commonwealth Government Finance, Australia, ABS Cat. No. 5502.0 (various issues).
- Public Authority Finance 1969-70, ABS Ref. No. 5.33.

government sector have, as a consequence, begun to recover although they are still below earlier levels¹⁶.

The saving performance of Commonwealth trading enterprises has remained largely unchanged over the last two decades¹⁷.

Table 2 shows State and local government "saving" on two bases. It shows that when revenue grants to the States are included as State revenues and hence as contributing to State government "saving", there appears to have been an improvement in recent years in their "saving" performance. When adjustment is made for those grants, however — which allows an (albeit imperfect) assessment to be made of the States' own revenue raising effort — a steady decline in "saving" effort continues in recent years¹⁸. It can also be seen that there was a substantial decline in the saving effort of State and local government trading enterprises in the mid-1970s¹⁹.

What does appear to emerge from all this is that, in any attempt to offset the effects of a reduced role for foreign capital on the rate of domestic investment, an increase in the level of public sector saving would almost certainly need to figure prominently. In turn, such an increase would need to be attained either by way of more vigorous restraint (or even actual cuts) in public sector spending; by putting up taxes further; or by the earning of higher returns by government enterprises at all levels of government (e.g. by putting up public enterprise charges or achieving

16. The important thing, of course, is that Commonwealth general government savings should be adequate, rather than conform to some predetermined proportion of GDP. Although circumstances will vary in accordance with particular budgetary requirements, the fundamental reason, in the long run, for Commonwealth general government saving — i.e. the collection of current receipts in excess of current outlays — is to finance its own capital program and to advance funds to other sectors (primarily to the States) for capital purposes. With Commonwealth capital expenditures on its own account and capital advances to the States through the Budget and subject to restraint for some years now a correspondingly lower level of "saving", expressed as a proportion of GDP, is required to finance them. To the extent that such restraint endures, such a lowering in the need for Commonwealth general government saving can only enhance the scope for a reduction in the relative burden of taxation with, in turn, consequential beneficial effects on saving by households and/or the corporate sector.

17. That in itself implies nothing about the adequacy of those savings.

18. What this principally illustrates is the generosity of the new revenue-sharing arrangements which were introduced in 1974-75 and confirmed in 1976-77 and which, following an "interregnum" year in 1980-81, have only recently been amended.

19. In terms of the point made earlier about the efficiency with which we use our capital, the community is currently earning a rate of return on the large blocks of capital tied up in public trading enterprises that is much lower than those earned in comparable parts of the private sector.

greater economies of operation, with a view to the achievement of a greater degree of self-financing)²⁰.

The extent to which increases in public sector saving achieved in one or more of those ways might be associated with partly offsetting changes in household and/or corporate saving would seem to depend importantly on how those increases were achieved. Increases in taxes and charges, for example, would be likely to have some offsetting effect on the saving as well as consumption behaviour of the private sector; from this standpoint, clearly, reductions in public sector expenditures are greatly to be preferred. It may be worth examining that point in a little more detail.

The major areas of growth in government expenditure in Australia over the 1970s were health, education and welfare. However, some of the fundamental reasons for which individuals save are precisely to provide (for their children as well as themselves) against illness, education expenses and retirement. There is thus undoubtedly a significant degree of substitutability between public and private provision in these areas.

If, for example, governments are to provide more for people's retirement (e.g. by non-means tested age pension arrangements or by other arrangements that have the effect of sharply increasing the proportion of welfare recipients in the relevant age groups), it will hardly be surprising if people's own provision for retirement should, over time, fall off. *Per contra*, if — as is the case, for example, in Japan — governments were to provide less in that and similar areas (e.g. by catering only for the genuinely needy), that would permit either government saving to rise, or taxes to be cut with beneficial consequences for private disposable incomes and hence private saving. In those circumstances it seems reasonable to expect total national savings to rise and either our national level of investment to increase or our dependence upon foreign capital for its financing to diminish. In short, these appear to be some areas where changes in government and private saving could be mutually reinforcing rather than, as in many other cases, offsetting.

Reductions in the public sector borrowing requirement brought about by restraint over public capital expenditure (i.e. quite apart from increased government saving as such) would also have the desirable effect of providing greater scope for private borrowing from within a given level of national savings. In addition to making "room" for the financing of a greater proportion of resource (or other) investment from domestic savings, such restraint could also be expected to have the effect of desirably "sharpening" public capital expenditure priorities.

20. There is some very recent evidence of this last phenomenon at work.

6. Some Conclusions

Let me begin to pull the threads of these "other options" together by observing, self-evidently, that the extent to which we are able to take maximum advantage of the opportunities presented by resource development will depend, *inter alia*, on the extent to which we are able:

- to "make room" for that investment — i.e. make adjustments on the demand side of our economy; and
- to facilitate the movement of domestic resources to those new efficient areas of production while at the same time supplementing those resources from abroad — i.e. make adjustments on the supply side.

Within the "other options" I have been discussing tonight there are adjustments open to us in the way we conduct our economic affairs which would clearly assist in "making room". As part of that, some modest steps have, indeed, been taken in recent years directed to winding back the public sector's proportionate call on available resources. Opportunities also exist in both the public (particularly) and private sectors to improve things on the supply side by cutting down the waste of our scarce capital resources in the pursuit of unproductive, or less productive, ends.

On the savings side, closer scrutiny suggests that, whatever other ends they might serve, some of the proposals commonly advanced to lift particular forms of saving would do little to raise the total level of national savings — primarily because what is typically involved in such proposals amounts largely, on examination, to "shuffling the pack" of savings forms rather than increasing its absolute size.

While some deregulation of our financial system could have desirable consequences for the level and disposition of household savings, one of the other conclusions to emerge is the pressing need to improve the saving performance of our corporate and public sectors before we can hope, even with continued substantial reliance on foreign savings, to finance in a non-inflationary manner the kind of overall investment task which the resource potential of Australia holds out to us in the 1980s.

This discussion of "other options" also highlights the interdependence between the choices we make on the domestic front and those external choices I discussed two years ago. To take one example, when a new spending program is promised, by one level of government or another, which will have the effect of increasing the public sector's call on our resources, what is also being "promised" (although not usually very vocally) is either:

- an increase in taxes or charges and a consequent tendency for private saving to fall; or
- a reduction in government saving and a corresponding increase in the call of government upon private savings.

Either way the carrying out of such promises will tend, sooner or later, to have the effect of:

- producing a cut in some investment in the private sector; or
- if investment in the private sector is maintained, bringing about an increase in the extent of foreign ownership of Australian private assets²¹.

While there are many in our community who, at one and the same time, hanker after bigger government, just as much private investment and less reliance on foreign capital, *the point that emerges is that if, in practice, the first were not to prove inconsistent with the second* — and there is an overwhelming body of evidence that it would — *those two in combination would certainly rule out the third*.

Similarly, if we choose to continue to divert, by one means or another, a higher proportion of our own savings into "preferred" or less productive (e.g. public sector projects or highly protected private investment) uses, the maintenance of any given level of (efficient) business investment will require either:

- an increase in our overall saving effort — which will certainly not be achieved by continuing to depress returns to savers; or
- a continuing (or increased) reliance on foreign savings.

There are, finally, two other dimensions to the interdependence about which I have been speaking that need to be borne in mind.

The first is that while there are "options" which would improve our domestic saving performance and the efficiency with which we utilise those savings, it is only the "external" option — i.e. increasing the current account deficit of the balance of payments — which can increase the totality of resources available to the community in the short to medium term and provide an immediate increase in growth potential. In other words, while these "other options" contain improvements that would be desirable in their own right — and have become even more so in the context of the opportunities currently available to us — they fall short, in that very fundamental respect, of what is required if we wish to take *full* advantage of those opportunities.

Secondly, what this discussion of "other options" underlines is that we will benefit from the opportunities afforded by resource development only according to how rationally we approach the processes of economic change which such development inevitably entails — or, to put the point more bluntly, according to how willing we are as a community to face up to difficult as well as the not so difficult choices.

21. Nor does deferring the day of reckoning (the tax liability) by the financing of such programs by government borrowing abroad, provide a way out.

In recent times much public debate has focused, correctly enough, on the external adjustments we will need to make if we are to take the rational approach to change. That is to be welcomed. But the implications of seeking a more rational approach to the adjustment processes flowing from the resources investment upsurge do not stop there. More efficient workings of our financial markets, for example, would first require a similarly rational approach to the various "protective" devices that have grown up in that area over the years. Similarly, the process of restoring sectoral saving performances to more appropriate levels would also bring with it changes in the composition of demand²² — and hence in the real economy — which, however desirable, could be expected, as always, to be staunchly resisted by those whose interests would be affected.

I was recently asked by a foreign journalist what I consider to be the greatest single danger to Australia's prospects for economic progress in the 1980s. I suspect that he had in mind some response referring to "wage explosions", "industrial relations", "trade union militancy" or something equally apocalyptic. However, after thinking for a few moments I said "ignorance".

I do not have time to elaborate on that response but I refer you to what was said in Statement No. 2 attached to the Treasurer's 1980-81 Budget Speech:

"With its abundant natural resources Australia has frequently been characterised as 'the lucky country'. But the realisation of our good fortune in those natural resource endowments will be dependent not on luck but on the intelligence with which policy is conducted."

In turn that latter process, while ultimately dependent upon the courage and farsightedness brought to bear by governments, also depends generally on the intelligence with which public policy debate is conducted.

It is in that wider context that I have been grateful to have the opportunity of delivering this Memorial Lecture. I can only hope that even in some minor way my remarks might contribute to a wider understanding of the process that was so close to the interests of Stan Kelly. I refer to the process of *economic change*. Without an increased willingness to accept that process, Australia will not be as responsive, vibrant, efficient — and in the process exciting — a country as it could, and I trust will, be.

22. Toward more productive forms of investment, as between investment and consumption and — if the consumption ratio were reduced — between more "essential" and more "marginal" forms of consumption.