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SUMMARY OF SEMINAR

THE PLACE OF THE BUDGET AS THE MAJOR WEAPON OF ECONOMIC POLICY

MEMORANDUM FOR TRUSTEES

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"Economic Trends and the Need for Budgetary Action"
by Professor R. F. Henderson

I'm going to start by trying to say something about the state of the economy as I see it and, therefore, by implication, the position on which the Budget is going to be operated. The main question that I'm here to discuss is in what direction should the Budget be moving: should it be an expansionary budget, a neutral budget, or a restraining budget? I'm prepared to argue that there should be a certain amount of moderate restraint imposed in this Budget.

Changes in productivity go ahead of changes in employment and therefore in the two next years - 1968/69 - with a recovery in demand, we at least expect a rise in productivity; but the rise in productivity in the year ahead is unlikely, I think, to be nearly as great as it was in the previous period of strong rise which was 1962/63/64, because you started in 1962 from a low rate of overtime - only about 30 hours per week in manufacturing industry.

Already, overtime is running at about 36 per quarter, and the historical record shows that this very seldom, if ever, goes up as high as 40. So there isn't much scope for increased production through increased overtime. For this reason our feeling is that the movement from the year June '67 to the year June '68/69 will be a much more moderate rise in real non-farm productivity. A rise of 2.7% in the year '68 and something like 2.9% in the year '68/69.

I want to draw your attention to the much wider degree of variation or fluctuation that there is over the years in imports as compared to gross national expenditure. This is not a projection but a historical observation. Each time gross national expenditure increases substantially you get a much bigger increase in imports We all know why this happens - we all know how there's a certain amount of steel produced at home and when people want more steel they buy it in from overseas and so on; but this is, I believe, significant in considering what is going to happen to the balance of payments next year.

On personal income and taxes - I would draw your attention to the big absolute rise in the figure for Wages and Salaries in '68/69. There is also, of course, going to be a revival of farm income - and a pretty big rise in other incomes. And so, percentagewise, you get this sort of figure that looks like something like an 11% rise in income for '68/69. I would argue that this is going to produce a very substantial rise in household demand - a rise in household demand in total in 1968/69 of something like 10.8%.

The "Australian" has differed from this and has argued that a lot of the rise in farm income is going to be used for repaying debts. I quite agree, that probably some of it will, but the big figure, although percentagewise the rise in farm income has been big, was the rise in wages and salaries and in other income. Now I think this is going to go through into household demand - you can see it already - these household demands includes housing and motor vehicles - and the indications for both housing and motor vehicles are very strong. Moreover, bank credit is still expanding fast and so is hire purchase credit. The latest figures for trading bank advances are up 13.4% in the June quarter, the new and increased lending committments are up 9.1% and there is a further thing to take into account here in considering household demand; we all know there has been a big rise in the price of a number of mining shares in particular on the Stock Exchange. This isn't normally treated as income but a number of people do spend it and this is going to swell household demand.

And so we come to business demand. On Fixed Capital we think there is going to be an increase of 12% in expenditure '68/69 - which sounds quite a lot. It is of course much greater than happened last year. New capital expenditure in manufacturing in the June quarter of 1968 was 21% above the level of the previous year. I know this fluctuates from quarter to quarter but it indicates that this 12% forecast really isn't quite outrageous. We're not forecasting an enormous increase in stocks, and this is borne out by a careful study of the Bank of New South Wales and Chamber of Manufactures' forecasts. And so we come then to public sector demand and as I've been saying for a little while, the public sector is really increasing its demands on the economy at a much higher rate than the National Product is growing and this is the point. It could do this last year because the private sector was not making such demands on the economy, it can't go on doing this indefinitely without forcing inflation. My friends in the "Australian" Newspaper again have differed on this point and said - "Well, look at the Loan Council - our figures show that public demand is being restrained". And on the face of it they do; but really one can't take Loan Council figures for a reliable guide to actual annual expenditure. Because in 1966/67 the total capital expenditure by State and Local Government Authorities and Enterprises amounted to rather over $1,700,000,000 and of this over $700,000,000 was not controlled by the Loan Council. What we have suggested is that capital expenditure grew by 5% in '67/68 - I think it probably did because three of the quarters have already been recorded - 2.7%, 4.6% and 2.7%. And then we went on to say that we thought there was going to be a big growth in 1968/69. If you take the four years '63/64 and '66/67 you find that the average rate of increase of Loan Council approvals was under 6%, but the average rate of increase of capital expenditure recorded in the accounts was 10% - '68/69 the Loan Council approvals have increased by 8% to $1,067,000,000. We are estimating that capital expenditure will increase by 11% to $1,932,000,000. All I can say is that this will not be at all out of line with what has been happening over the past four years. In these figures there is a very big rise in Defence expenditure - this is bec[illegible] on this national accounting basis the F111 purchases, deliveries of which are going to take place in '68/69, are entered up fully in the accounts for that year and on the other side is entered up the borrowing to pay for them. (There are two other ways of working out Defence expenditure which I can enlarge on later if anybody wants me to.) But this does produce a big Defence expenditure.

And so we come to this final Table of Aggregate Demand and Supply. In '67/68 you have this small rise in the business sector - 4.3% - which meant that the big rise in the public sector of 11.6% could still be accommodated and leave a total of 8.5%. But in '68/69 it looks as if all of these are going to be substantial - household 10.8, business sector 12.0, public sector 15.7. Making the most generous allowance for the amount of the public sector demand which will be Defence expenditure going overseas with no immediate inflationary effect at home, one still is left with a much bigger rise in expenditure in money terms than can be accommodated in my view. This is after allowing for the increase in employment, the increase in productivity, the increase - the recovery - in farm output; this still leaves us with what seems to me, to be a desirable rate of increase in prices of not more than 3% per annum. This seems to me to be the way that the figuring is coming out on the internal side. I would argue that for the moment, although the external side a substantial deficit on trading account would lead one to advocate some mild restraint in the Budget, I don't think the arguments on the external side are terribly strong. You can perfectly well argue that '68/69 is going to be a bad year - but reserves are there to tide us over bad years. We have large borrowing powers from the International Monetary Fund, in '69/70 mineral exports will be higher, and there will start to be some import saving from oil with luck. Therefore, the external arguments are no means overwhelming. It is the internal arguments that I think are stronger and I think that this is in line with what the Treasury has been saying in the White Paper on the Australian Economy 1968:-

"The increased call in Imports and the big current account Deficit in Balance of Payments give warning that spending for current and capital purposes combined has moved further ahead of domestic output." That's the way they put it. And they have a substantial section on the problem of costs of production - wages costs in particular - rising more than is desirable and in some senses pricing us out of international markets and in another sense putting pressure on the rural producer.

I would like to broaden the argument a little bit and say that we really can't have figures adding up to 12%; but if we must have as high a level of public expenditure as this then extra taxation must be imposed to restrain private expenditure by the private sector to make room for the public sector to grow at this rate. I'm not expressing a view at the moment as to whether the right thing to do is to cut back on the public expenditure or to increase taxes - I'm suggesting that unless one or the other is done there will be an undesirable degree of inflationary pressure next year. The people who doubt this, naturally are people in manufacturing industry at the moment who are conscious that they are by no means flat out, that there's by no means negligible unemployment, that prices are not rising fast yet. I point out that the rise in prices and the rise in employment historically comes a bit late in the boom. Surely we all want to avoid letting the economy run into a strong boom as it did in 1960 so that it has to be hit hard on the head with a sledgehammer? It's surely much preferable for mild restraint to be exercised at an early stage to prevent this happening. Precisely because the business sector has not been growing strongly, because you only have that 4.3% growth in the business sector in '67/68, it would not seem to me to be appropriate to increase taxes that fall in the first instance on the business sector. The taxation increase, if that's the way the restraint is to be done and because, in fact, public expenditure is in fact about fixed, this in the very short run is what's likely to happen. The taxation, in may view, should fall on the personal sector. I'm a great chap for making friends as well as influencing people and that's why I think it would be so nice to have an increase in the income tax and I'm sure you'll all agree.

Explanatory Memorandum by Professor R.F. Henderson.

Capital Expenditure by State and Local Government Authorities and Enterprises must be distinguished from approvals for borrowing at Loan Council meetings. Not only are there differences in timing, but more important there are other large sources of funds used to finance this expenditure. In 1966-67, for instance, of the capital expenditure which amounted to $1,783

Other sources were -	Depreciation allowances	$170
	Surplus on State & local government authorities and enterprises	512
	Other funds available less addition to cash balances	47
		$729 million

For these reasons Loan Council approvals are not a reliable guide to actual annual capital expenditure. Our estimate of an increase of expenditure of only 5% in 1967-68 compared to the previous year has been criticised as too low; the figures for the first three quarters of that year had already been published and shown in the Review and the increases over the same quarter in the previous year were 2.7%, 4.6% and 2.7%. Over the previous four years 1963-64, 1964-65, 1965-66 and 1966-67 the average rate of increase of Loan Council approvals has been under 6%, and of capital expenditure has been 10%. For 1968-69 Loan Council approvals have increased by 8% to $1,067 million and we have estimated that expenditure will increase by 11% to $1,932 million. In other words, we are assuming that the low rate of expenditure in the first three quarters of 1967-68 will prove a temporary lag that will be made good in 1968-69.

Personal Income and Household Demand: It has been suggested that household demand is unlikely to rise as fast as personal income because farmers will use part of their increased income to repay debt. They may indeed do so, but the main part of the rise in personal income forecast for 1968-69 is not farm income - $88 million a quarter - but wages and salaries - $321 million a quarter. Other income is also expected to rise by $73 million a quarter. Even if farmers do devote some of their increase in income to repayment of bank debt, wage and salary earners, and those who have received increased other income from profits, may use hire purchase finance and other forms of credit to achieve an expansion of household demand that is faster than that of personal income. This will be assisted by the spending of some capital gains made on the stock exchange.

It should be noted that household demand as we have measured it includes expenditure on dwellings and on motor vehicles. Both these types of expenditure are running at a high level and it seems reasonable to expect them to continue to do so.

The official survey of the Australian Economy in 1968, issued after we had composed the Review, is considerably more optimistic than we were as to the balance of payments in 1968-69. There is little difference in estimates of exports. The official figures, of course, are much more reliable on probable differences of spending and purchases of civil aircraft, which it is stated will be less in that year. There is, however, no discussion in the White Paper of the extent to which the high level of activity at home will lead to increased commercial imports. Our high estimates of imports for 1968-69 are based on the experience of previous years in this respect.

The latest figures published are increases in total trading banks advances, new and increased lending committments by trading banks, and a sharp rise in new capital expenditure in manufacturing in the June quarter of 1968. All seem to confirm the impression that demand will be at a high level in 1968-69, as was suggested in the Review.