20.6.79

NOTE OF A MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND THE RT. HON. PHILIP LYNCH, AUSTRALIAN MINISTER OF COMMERCE AND INDUSTRY AND DEPUTY LEADER OF THE AUSTRALIAN LIBERAL PARTY

Mr. Lynch called on the Chancellor at 9.30 a.m. on Tuesday, 19th June accompanied by the Australian High Commissioner, Mr. Currie, Secretary, Department of Commerce and Industry, and Mr. Hill from the High Commissioner's office. The Chancellor was accompanied by Mr. Turnbull.

2. After the usual exchange of courtesies, Mr. Lynch described the state of the Australian economy. The Liberal Government had halved the rate of inflation, improved the control of the monetary aggregates and reduced the budget deficit to 3.3 per cent of GDP. The Government had also applied a brake to the growth of wages. Nevertheless, wage inflation remained the central problem. Although the Government had continued the formal indexation provisions of its Labour predecessors, some flexibility remained, and it was always open to the Government to argue for a nil norm before the Arbitration Court. Indexation was also subject to a ceiling, above which only flat rate increases in pay were allowed. The Chancellor replied that pay bargaining also remained a problem in the United Kingdom. The Government eschewed direct intervention in pay negotiations: restraint in the private sector depended mainly on "jaw-boning", supported by firm monetary control. In the public sector, the results of comparability studies might help to take the edge off pay demands in the next round.

3. Mr. Lynch asked whether industry would face a crunch at the end of the year. The Chancellor thought that was not the case, at least in terms of business liquidity or prices. But a continuing high exchange rate and firm monetary control could be expected to have its effect on industry.

4. Mr. Lynch then asked whether the announced cuts in public expenditure would have a very significant effect on capital works. The Chancellor said he thought not: the public expenditure cuts had attracted less opposition than might have been expected. The construction industry had been fairly restrained. And the business community had been amongst those urging the Government to take a proper hold of public expenditure.

5. Mr. Lynch commented that the Australian Government had also maintained the support of the business community for their policy of retrenchment, though he sensed growing concern over the composition of the budget deficit as well as its size. There was a fair amount of criticism that cuts had fallen disproportionately on capital expenditure and hence on jobs, and too little on welfare expenditure.

6. The Chancellor asked Mr. Lynch about consultation processes in Australia. How formal were these? Mr. Lynch replied that consultations about economy policy were now part of established machinery. The annual round of consultations had just been completed prior to the Budget in July. The Government reckoned to give each of the main industrial groups e.g. the heavy equipment manufacturers, about an hour of discussion and they could submit papers if they wished. There was also a standing Consultative Group of about 20 members, which included the main representatives of organised labour and business, one of whose purposes was to discuss the state of the economy. Discussions with this group on the whole were pretty satisfactory. There were separate consultative groups of Manufacturers and Economists, the last being the least satisfactory of the three.

The Chancellor likened the standing consultative group to NEDC, and commented that a Council of Economic Advisers was an idea which the Government also had under consideration.

Mr. Lynch said he thought the Liberal Government engaged in a more widespread and effective process of consulttation than the Labour Government had done.

7. Commenting on Mr. Lynch's reference to welfare expenditure, the Chancellor said that social expenditure has also remained relatively free from reductions in this country. His Budget had just announced very large increases in pensions and other benefits. The Chancellor went on to describe how pension uprating had been linked by the Labour Government to prices and earnings, but the Government had now announced a break with the latter. Mr. Lynch commented that since Australian pensions were uprated retrospectively in line with the consumer price index, pensioners had recently faired better than the working population. This fact, coupled with a now ageing population, had produced some pressure to reduce the size of the social budget. But this was not easy politically, especially in a pre-Election year.

8. High Commissioner asked the Chancellor whether he had said anything about benefits for strikers in his Budget Speech. The Chancellor said he had not. But the problem was not simply related to benefits, but also to the availability of tax rebates. Arguably the latter were more important. There was widespread agreement that benefits ought to be taxed, which in turn would reduce the size of rebates, but there was very little agreement on how this could be achieved economically. The High Commissioner commented that the UK tax system was too efficient: in Australia, tax refunds were available only after the end of the income tax year.

9. Mr. Lynch then asked how long the Chancellor thought it would take before his Budget began to have an effect on people's attitudes. The Chancellor said that changing attidues always took longer than expected. But the fiscal changes in the Budget were only part of a strategy which involved progressive deregulation of the economy and removal of a whole range of factors inhibiting enterprise. Mr. Lynch remarked on the similarity with the programme of tax reduction followed by the Liberal Government in Australia. Their programme had additionally included a number of selective tax stimuli. These had taken some time to operate and the economy was only just showing signs of real recovery. Profits were still too low; the public deficit was too high. Next year's Budget would be very important for political reasons, not least because public expectations had been inflated. The trouble was that stringency had a price in political terms. Continuing, Mr. Lynch said that Australia's economic recovery was beginning to have an effect on the consumer price index. The Government were also working on monetary growth and hoped to get it down below 10 per cent. Australia was benefitting from the world shortage of minerals and the demand for agricultural products, but their exports suffered because Australia lacked a rebatable indirect tax like VAT. This was something they would need to look at after the next Election. Meanwhile, they relied on a combination of export and investment incentives. Mr. Lynch said that the system of investment allowances had been very successful.

10. The Chancellor raised the subject of trades union reform. Mr. Lynch mentioned progress on industrial legislation and secret ballots, commenting that labour unrest had been significantly less under the present Government than when the Australian Labour Party had been in power. But good labour relations were about attitudes not about the law.

11. The Chancellor asked about changes in Australian capital taxation. Mr. Lynch confirmed that Australia had no federal capital gains tax, nor any longer any estate duty. At the federal level they had wiped the slate clean. Moreover, even state capital taxes had been largely reduced or abolished, even in Labour-controlled states. There had been no popular opposition to the removal of capital taxes. Opposition to capital taxes had even figured in the Labour programme in some states. The Chancellor said he would like to be better informed about these changes and asked if Mr. Lynch would let him have further details. [Mr. Hill is arranging for this to be done.]

12. Mr. Lynch then asked how the Chancellor had found the mood of the OECD at the Ministerial meeting the previous week. The Chancellor described the meeting as very sombre. There had been a natural concentration on energy, with a wide appreciation of the fact that reliance on the price mechanism would not solve the problem without genuine progress on conservation. Mr. Lynch then asked whether the United States position had shifted at all. The Chancellor said that Mr. Blumenthal had not said anything very new. There had been some criticism by others of the US oil subsidy. He agreed with Mr. Lynch that it would be difficult to persuade OPEC to take a helpful attitude unless they were also persuaded that the oil-consuming countries were taking energy conservation seriously.

13. Mr. Lynch then asked what had been said about positive adjustment measures. The Chancellor said discussion had been overlaid by fears of inflation and the effects of lower growth, including the effects on the LDCs.

14. The meeting concluded with a brief discussion about overseas investment, in which the Chancellor referred to the relaxations on exchange control in his Budget. It was important for the UK to build up its stock of overseas assets, whilst we enjoyed the benefit of North Sea oil. Mr. Lynch expressed

warm approval, saying that Australia was as anxious as ever to attract British capital. There were good investment opportunities, particularly in mineral exploration and development. It was important to Australia to preserve her share of world trade in competition with the rapidly developing countries of South East Asia.

15. Mr. Lynch thanked the Chancellor for receiving him, and the meeting closed at about 10.15 a.m.

(A.M.W. BATTISHILL)
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PS/IR ) see paragraphs 8 and 11
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