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Prime Minister

Ruds

Treasury Chambers, Parliament Street, SW1P 3AG
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8 September 1981

M O'D B Alexander Esq.
Private Secretary
10 Downing Street
LONDON
SW1

Dear Michael

In view of the Prime Minister's forthcoming visit to Melbourne, the Chancellor thinks that she may like to see the attached brief extracts from the Budget Speech delivered on 18 August 1981 by Mr Howard, the Commonwealth Treasurer.

As the Prime Minister knows (and the extracts show), the approach to the budget and to inflation of the Australian Government is very close to our own. However their situation is different from ours. The Australian economy has been benefitting from activity created by the first stage of natural resource developments, which are bigger in scale relative to the Australian economy than North Sea oil here and perhaps also more apt to create employment, directly and indirectly, than North Sea oil. These developments are being financed by large inflows of capital. The main impact on activity of a firm exchange rate and recent high interest rates is yet to come. Moreover their wage experience over the 3 years 1978-80 was better than ours. However, they now face accelerating wage increases and other inflationary effects of the inflow of capital. Hence the strict budget.

The 2½ per cent increase in Sales Tax rates and the application of a 2½ per cent rate to goods hitherto exempt like clothing, footwear, books and newspapers in arousing controversy, and indexation of income tax allowances and thresholds for 1981-82 has been confined to 50 per cent. But as our High Commissioner recently noted, this budget will take the Commonwealth out of the market for new borrowing and ease pressure on interest rates, including those for housing. The Government is also trying to pave the way for income tax concessions in future budgets, which may be seen as preparing the way for the election of 1983.

The budget provides for an increase on $100m (£60m) in foreign aid expenditure. This is estimated to raise the ratio of official development assistance to GDP from 0.43 per cent from 1980-81 to 0.45 per cent in 1981-82 but, as a correspondent to "The Times" pointed out, the ratio when Mr Fraser took office in 1975 was 0.59 per cent.

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I am copying this letter and enclosure to the Private Secretary to the Foreign and Commonwealth Secretary.

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

EXTRACTS FROM THE BUDGET SPEECH 1981-2 DELIVERED ON 18 AUGUST 1981 BY THE HONOURABLE JOHN HOWARD MP TREASURER OF THE COMMONWEALTH OF AUSTRALIA

1980-81 in retrospect

A year in which the fight against inflation was seen not as an end in itself, but as a means of achieving greater investment, more jobs and higher living standards for all Australians.

During 1980-81, private business fixed investment grew by more than 20% in real terms - the largest such growth for 30 years.

There was also a strong lift in personal consumption expenditure of about 3¼% in real terms.

Over the year to June 1981, Australia's inflation rate as measured by the consumer price index was 8.8% - almost 2% below the rate a year earlier.

Overall, gross domestic product increased by almost 3% in 1980-81.

Regrettably, the past year - and particularly the past few months - has seen the pressure for higher wages intensify.

If unchecked, this will not only lead to higher inflation but reverse the falling trend in unemployment and put at risk both investment and employment growth.

The Budget Strategy

In putting together this year's Budget the Government had to ensure that it would meet a possible resurgence of inflation head on.

The uncertainty and loss of international competitiveness that would result from a new inflationary spiral would deter the production and investment essential to the creation of additional jobs and higher real incomes.

We have therefore opted for a Budget which gives priority to containing and reducing inflation and sustaining private sector growth.

The overall Budget deficit on present estimates expressed as a proportion of GDP will be a mere 0.1% in 1981-82, compared with a peak of 4.9% in 1975-76.

Economic outlook

The Budget will significantly reduce the total public sector requirement for loanable funds in 1981-82 at a time when the corporate sector is likely to be seeking substantially larger borrowings to help finance its investment programme.

This will help to ease the pressures which, otherwise, that increase in private borrowings would produce.

For a variety of reasons monetary conditions last year were more accommodating than had been intended: one illustration of this is that M3 increased by 12.7% during the course of 1980-81 compared with the Budget projection of about 9-11%.

While there are many unpredictable influences on the money supply - including external developments in particular - it is fundamental to winding back inflation that growth in the monetary aggregates also be wound back.

In particular, we are determined not to allow the money supply to expand so as to accommodate a new round of excessive wage increases.

The Government will therefore be seeking to restrain growth in the monetary aggregates to a degree consistent with growth in M3 of 10-11% over the course of 1981-82. The sharply reduced Commonwealth Budget deficit will facilitate this task but an appropriate balance of other domestic and external policies will also be required.

The forecast rise in the consumer price index in 1981-82 as a whole is about $10\frac{3}{4}$%.

Leaving aside the effects of the revenue measures mentioned in the Budget and the previously announced changes in health care arrangements, the rise would be a little under 9½% - an underlying rate of inflation much the same as that recorded in 1980-81.

Gross domestic product could rise by more than 3½% this year, compared with about 3% last year.

This outlook is considered to be consistent with employment growth of about 2% in 1981-82.

The current account deficit may widen further in 1981-82 to around 4½% of GDP.

Conclusion

It is vital to the nation's interests that there be no acceleration in the rate of inflation in 1981-82.

This is especially so given that most of the major industrialised countries, led by the United States, are now bent on firm anti-inflation policies.

Australia has been doing better than many of these countries in containing inflationary pressures in recent years. Our aim is to keep it that way.

This Budget is an essential part of the Government's strategy for containing wage and price inflation. It will also help in a major way to ease pressures on interest rates.

Such action is necessary if we are not only to preserve the hard won gains of the past but also if we are to exploit the potential for even greater gains in the years ahead.