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TELNO 694

OF 260347Z AUGUST 88

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DTI FOR (OT4/2).

(CULL)

AUSTRALIAN FEDERAL BUDGET 1988/89

SUMMARY

1. BUDGET MAINTAINS GOVERNMENT'S EFFORTS TO ENCOURAGE ECONOMY TO RESTRUCTURE AND BECOME MORE PRODUCTIVE AND INTERNATIONALLY COMPETITIVE. CONTINUED FISCAL RESTRAIN WITH LARGE SURPLUS, ZERO PSBR AND FURTHER DECLINE IN FEDERAL GOVERNMENT SPENDING. RENEWED ATTACK ON INFLATION. MODEST REDUCTIONS IN INDIRECT TAXATION. PERSONAL TAX CUTS PROMISED NEXT YEAR BUT SIZE TO BE LINKED TO LEVEL OF NEXT YEAR'S NEGOTIATED NATIONAL WAGE INCREASE. EXTRA EXPENDITURE ON EDUCATION AND WELFARE PROGRAMMES FOR THE POOREST. A TAX ON GRADUATES. FURTHER BANKING DEREGULATION. OVERSEAS INVESTMENT STRONGLY ENCOURAGED. 3.5 PER CENT GDP GROWTH FORECAST. PACKAGE GENERALLY WELCOMED.

DETAIL

2. PRESENTING HIS SIXTH BUDGET TO PARLIAMENT THIS WEEK MR KEATING PAINTED AN ENCOURAGING PICTURE OF AN ECONOMY NOW EMERGING FROM SEVERE ECONOMIC CRISIS AND ON AN IMPROVING TREND WITH INFLATION, THE CURRENT ACCOUNT DEFICIT AND UNEMPLOYMENT FALLING, RESTRUCTURING IN PROGRESS AND GROWING INTERNATIONAL COMPETITIVENESS. TO ENSURE THAT THE GAINS WERE CONSOLIDATED IT WAS ESSENTIAL TO STICK TO THE GOVERNMENT'S TOUGH POLICY MIX.

MAIN FORECASTS

3. THE BUDGET FORECASTS GDP GROWTH AT 3.5 PER CENT FOR 1988/89, ABOUT THE SAME AS LAST YEAR. THE WHOLE OF THIS WILL COME FROM DOMESTIC DEMAND, THE LARGEST COMPONENT BEING INVESTMENT IN PLANT AND EQUIPMENT FORECAST TO RISE 12 PER CENT IN REAL TERMS. INFLATION IS FORECAST TO FALL TO 4.5 PER CENT BY MID 1989 FROM ITS CURRENT

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ANNUALIZED RATE OF JUST UNDER 7 PER CENT. THE CURRENT ACCOUNT DEFICIT IS FORECAST TO FALL FROM DOLLAR 11.9 BILLION LAST FY TO DOLLAR 9.5 BILLION (3 PER CENT OF GDP), MAINLY BECAUSE OF PREDICTED CONTINUED BUOYANCY IN COMMODITY PRICES.

EXPENDITURE

4. PUBLIC EXPENDITURE IS TO FALL BY A FURTHER 1.8 PER CENT IN REAL TERMS, MAINLY AS A RESULT OF PREVIOUS SPENDING CUTS. MR KEATING CLAIMED THAT NO MAJOR OECD COUNTRY HAS REDUCED THE SIZE OF THE GOVERNMENT SECTOR ON THE 'VAST SCALE' ACHIEVED IN AUSTRALIA SINCE 1984/85. (HE ALSO CLAIMED THAT AUSTRALIA'S RATE OF JOB GROWTH WAS 'UNMATCHED IN THE WESTERN WORLD'.)

5. SOME MODEST INCREASES IN SOCIAL WELFARE PROGRAMMES WERE ANNOUNCED AIMED AT HELPING PARTICULARLY DISADVANTAGED GROUPS INCLUDING LOW INCOME AND SINGLE PARENT FAMILIES AND ABORIGINALS, TOGETHER WITH NEW SCHEMES TO ENCOURAGE THE LONG TERM UNEMPLOYED TO RETRAIN AND SINGLE PARENTS TO RE-ENTER THE WORK FORCE, AND INCREASED SPENDING ON HOSPITALS. 40,000 NEW TERTIARY EDUCATION PLACES ARE TO BE CREATED OVER NEXT THREE YEARS.

REVENUE

6. A 2.1 PER CENT INCREASE IN REAL TERMS IS FORECAST MAINLY OWING TO BUOYANT INCOME TAX RECEIPTS.

7. CUTS IN INDIRECT TAX COSTING DOLLAR 400 MILLION IN 1988/89 ARE TO BE INTRODUCED, MAINLY INVOLVING REDUCED SALES TAX ON BEER, COSMETICS, PHOTOGRAPHIC MATERIALS AND COMPUTER SOFTWARE. THE TAX TREATMENT OF BEER IS RADICALLY ALTERED WITH IMMEDIATE EFFECT BY INTRODUCING A SALES TAX OF 20 PER CENT WHILE DRASTICALLY CUTTING EXCISE DUTY WITH MORE FAVOURABLE TREATMENT FOR LOW ALCOHOL BEER DESIGNED TO ENCOURAGE ITS CONSUMPTION. AS A RESULT THE PRICE OF BEER WILL FALL SIGNIFICANTLY.

8. A 'HIGHER EDUCATION CONTRIBUTION SCHEME' IS TO BE INTRODUCED UNDER WHICH GRADUATES WILL BE REQUIRED TO REPAY ABOUT ONE FIFTH OF THE COST OF THEIR COURSES BY AN ADDITION TO INCOME TAX OF 1 PER CENT WHEN THEIR INCOME REACHES AVERAGE EARNINGS, WITH PROGRESSIVE INCREASES APPLYING AT HIGHER INCOME LEVELS UP TO A MAXIMUM TAX OF 3 PER CENT.

BUDGET SURPLUS AND PUBLIC SECTOR BORROWING REQUIREMENT

9. THE PROJECTED BUDGET SURPLUS IS DOLLAR 5.5 BILLION. THE SURPLUS WILL EXCEED THE FORECAST COMBINED BORROWING OF ALL STATE AND LOCAL GOVERNMENT AUTHORITIES AND PUBLIC ENTERPRISES THUS REDUCING NET PSBR TO ZERO, 'AN ACHIEVEMENT WITHOUT PRECEDENT IN OUR HISTORY'.

ANTI-INFLATION STRATEGY

10. MR KEATING DESCRIBED INFLATION AS AUSTRALIA'S NUMBER ONE ECONOMIC DISEASE. ITS ERADICATION WAS A FUNDAMENTAL OBJECTIVE. THE INDIRECT TAX CUTS WOULD HELP BRING IT DOWN (BY ABOUT ONE HALF PER CENT), AS WOULD THE WAGE/TAX TRADE-OFF TO BE NEGOTIATED WITH THE UNIONS. IN RETURN FOR CONTINUED WAGE RESTRAINT THERE WILL BE CUTS IN PERSONAL TAX TO BE INTRODUCED FROM 1 JULY 1989, THE SIZE OF THE CUTS TO BE RELATED TO WAGES GROWTH DURING 1988/89 AND THE QUALITY OF THE TRADE-OFF. (THE APPRECIATION OF THE DOLLAR THIS YEAR IS ALSO EXERTING DOWNWARD PRESSURE ON THE INFLATION RATE: THE TRADE WEIGHTED INDEX HAS RISEN 20 PER CENT SINCE JANUARY AND THIS IS FORECAST TO TAKE ABOUT 1.5 PER CENT OFF THE INFLATION RATE.)

AUSTRALIAN INVESTMENT ABROAD

11. MR KEATING REFERRED WITH WARM APPROVAL TO THE RAPID GROWTH OF OVERSEAS INVESTMENT, WHICH HAD RISEN FIVE TIMES IN VALUE SINCE THE DOLLAR WAS FLOATED AND EXCHANGE CONTROLS REMOVED IN 1983. AND NOW TOTALLED 34 BILLION DOLLARS. THIS INVESTMENT ACTED AS A COUNTER-WEIGHT TO THE DEBT BURDEN AND WOULD CONTRIBUTE TO HIGHER LIVING STANDARDS. IT WAS EVIDENCE THAT THE ECONOMY HAD ENTERED A 'NEW AGE OF AUSTRALIAN INTERNATIONALISM'.

BANKING DEREGULATION

12. THE DISTINCTION BETWEEN TRADING AND SAVINGS BANKS IS TO BE ABOLISHED AND THE STATUTORY RESERVE DEPOSIT ARRANGEMENTS UNDER WHICH TRADING BANKS ARE REQUIRED TO MAINTAIN DEPOSITS EQUIVALENT TO 7 PER CENT OF THEIR DOLLAR DEPOSITS AT AN ARTIFICIALLY LOW RATE OF INTEREST IS TO BE REPLACED OVER THREE YEARS BY A MUCH LESS ONEROUS SYSTEM UNDER WHICH ALL LICENSED BANKS WILL HAVE TO HOLD DEPOSITS EQUIVALENT TO 1 PER CENT OF TOTAL LIABILITIES. THESE MOVES WILL REMOVE DISTORTIONS IN THE BANKING SYSTEM AND EXERT DOWNWARD PRESSURE ON INTEREST RATES.

OPPOSITION REACTION

13. THE BUDGET HAS BEEN GENERALLY APPROVED BY MOST MAJOR INTEREST GROUPS AND OPPOSITION ATTACKS HAVE RUNG HOLLOW. THEY HAVE CONCENTRATED ON CRITICISING THE SURPLUS AS BASED MORE ON HIGH TAXATION THAN REDUCED EXPENDITURE, CHALLENGING SOME OF THE FORECASTS AS UNDULY OPTIMISTIC, ATTACKING THE PACE OF STRUCTURAL REFORM AS TOO SLOW AND CLAIMING THAT THE CUTS IN PERSONAL TAXATION SHOULD HAVE BEEN MADE NOW AND THAT THE DELAY UNTIL NEXT YEAR IS MOTIVATED BY CYNICAL ELECTORAL CALCULATIONS.

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COMMENT

14. ANOTHER EFFECTIVE AND POLITICALLY ADROIT PERFORMANCE BY MR KEATING. THE GOVERNMENT CAN JUSTIFIABLY CLAIM MUCH OF THE CREDIT FOR THE CURRENT IMPROVEMENT IN THE ECONOMY, THOUGH THEY HAVE BEEN GREATLY HELPED BY THE RECENT RISE IN COMMODITY PRICES WHICH HAS NOW RESTORED AUSTRALIA'S TERMS OF TRADE TO 1984/85 LEVELS. ESSENTIALLY THE BUDGET IS A HOLDING OPERATION DESIGNED TO KEEP THE ECONOMY ON COURSE WHILE PREPARING FOR THE WAGE/TAX TRADE-OFF NEXT YEAR WHICH THE GOVERNMENT CLEARLY ENVISAGES AS BOTH ECONOMICALLY IMPORTANT AND A POTENTIAL ELECTION WINNER. MR KEATING INDICATED THIS WEEK THAT HE REGARDS A CUT IN THE TOP RATE OF INCOME TAX FROM ITS PRESENT LEVEL OF 49 PER CENT TO 39 PER CENT AS A REALISTIC TARGET.

15. THE ECONOMY REMAINS FRAGILE. THE PACE OF STRUCTURAL CHANGE IS SLOW, WITH THE SHARE OF MANUFACTURED GOODS IN TOTAL EXPORTS STILL VERY SMALL AND MANY RIGIDITIES IN THE WAGE SYSTEM AND OTHER AREAS. MR KEATING REFERRED IN HIS BUDGET SPEECH TO THE "DEEPLY ENTRENCHED INEFFICIENCIES" IN TRANSPORT AND COMMUNICATIONS, PORTS AND COASTAL SHIPPING WHICH THE GOVERNMENT HAD STARTED TO TACKLE, AS WELL AS EXAMINING "ECONOMIC BOTTLENECKS" IN THE TOURISM AND SERVICES INDUSTRIES AND THE IMPACT OF GOVERNMENT CHARGES ON BUSINESS THE IMPROVING TREND IN THE CURRENT ACCOUNT DEFICIT IS ENTIRELY ATTRIBUTABLE TO THE RISE IN COMMODITY PRICES, AND THE BUDGET PAPERS FORECAST THAT IN VOLUME TERMS IMPORTS WILL CONTINUE TO GROW FASTER THAN EXPORTS.

16. MR KEATING'S STATEMENT HAS BEEN FAXED TO SPD, FCO AND OT4/2, DTI. SETS OF BUDGET DOCUMENTS DESPATCHED IN THIS WEEK'S BAG TO FCO ECONOMISTS DEPARTMENT, DTI, TREASURY AND BANK OF ENGLAND.

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