Research Department
Federal Reserve
Bank of
San Francisco

December 17, 1976

Ups and Downs, Down Under

So now it's Australia's turn. After several years of weak economic performance, the government devalued the Australian dollar by 17½ percent in late November, and backtracked only slightly with two modest up-valuations during the past week. This situation of a weakening currency—and a weakening economy—contrasts strikingly with the nation's strong growth performance of the several preceding decades.

A formula of moderately expansive fiscal and monetary policies, coupled with an open-door approach toward foreign investment, proved highly successful in the 1950's and 1960's, as the nation's real gross product expanded at close to a 5-percent annual average rate, while the inflation rate averaged just over 3 percent a year. But the internal and external shocks of the 1970's led to entirely different results—slow growth, high unemployment, double-digit inflation, declining foreign investment, and dwindling foreign-exchange reserves.

Curbing government spending

The problem could be traced in part to an upsurge in public-sector spending. Federal (Commonwealth) government spending quadrupled in real terms over the last quarter-century, and its share of gross domestic product increased from 23 to 32 percent over that period. In the 1973-75 period alone, Federal spending rose almost 15 percent annually in real terms, with the largest increases concentrated in education, health, and social welfare. Meanwhile, the government deficit rose from $A0.7 billion in fiscal 1973 to $A3.6 billion in fiscal 1976, and the money supply expanded rapidly.

The Liberal-Country Party coalition government, immediately after taking office in December 1975, attacked the problem by introducing ceilings on government spending and employment. Later, in an August budget presentation, Treasurer Phillip Lynch announced a $A1.0 billion reduction in the Federal deficit for fiscal 1977, along with a slowdown in the target money-supply (M_3) growth to the 10-12 percent range, compared with the 14-15 percent growth of the several preceding years.

To date, no one can tell how well these measures will work. At the end of the third quarter, the consumer price index still stood about 14 percent higher than a year earlier, only slightly behind 1975's inflation rate. In the present quarter, however, the inflation rate is expected to slow to about a 5-6 percent rate.

Curbing protectionism

Part of Australia's problems could also be traced to a long-standing policy of protectionism, followed

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by both the present coalition and the predecessor Labor Party government. Australia traditionally has relied on relatively high tariff barriers to protect domestic industries from foreign competition. Yet no matter how successful the policy has been as a means of nurturing infant industries, it has also tended to weaken the efficiency of the nation's manufacturing sector. During the past two decades, labor productivity in Australian manufacturing has grown at a slower pace than in practically every other major industrial country. In addition, Australian industries have encountered difficulty competing in foreign markets. While manufacturing is Australia's largest sector in output and employment terms, it ranks behind both agriculture and mining in total exports.

Recognizing these problems, the Labor government reduced tariff rates by 25 percent in 1973, but soon thereafter reversed itself and imposed new quotas and tariffs when unemployment rose and the foreign-trade account deteriorated. This turnaround enabled Australia to register trade surpluses in both 1974 and 1975, despite falling world demand and falling prices for its major exports. But the new import restrictions also aggravated long-term structural problems in manufacturing. Most of the restrictions remain in effect today, although the increasing flexibility in exchange-rate policy could ultimately pave the way for trade liberalization.

Reversing investment curbs

In the area of foreign investment, several sharp policy reversals have occurred in recent years. Up until 1965, Australia had pursued a predominantly open-door strategy, with restrictions in certain sectors but with the welcome mat out for investors in manufacturing and mining. Policy began to shift over the next several years, and then a major change occurred in late 1972 when the Labor Party came to power on a platform of "start buying back Australia." Under the new policy, foreign capital was barred from a number of areas (such as banking, domestic airlines, and television) while tight screening procedures and 50-percent domestic-ownership requirements were applied to other areas (such as mineral exploration).

The consequences were dramatic for the capital sector. Foreign direct investment declined nearly two-thirds in 1973 alone, and capital

inflows even today remain well below those of the early 1970's. Finally, responding to the depressed state of domestic capital formation, the Labor government completely revamped its guidelines in September 1975, primarily by easing restrictions for mineral-resource development.

After it took office, the Liberal-Country Party government announced similar liberalized guidelines. Foreign investors are now encouraged to seek Australian participation in those "key areas" where guidelines call for 50-percent Australian equity and control, but projects will be allowed to proceed even in those cases where local participation is not readily available. Although somewhat tattered, the welcome mat is out once again.

Abounding problems
Australia may still have some difficult times ahead. Like most other developed countries, it is faced with the trade-off between severe inflation on the one hand, and slow growth and serious unemployment on the other. Although inflation now appears to be decelerating, the price level in early fall was still 14 percent higher than a year ago. At the same time, the economy is growing at only a 3½-percent rate, while the jobless rate approaches 5 percent—a very high figure for Australia. Also, one-third of the nation's foreign reserves have disappeared within a year's time, setting the stage for the recent devaluation. (Actually, the exchange rate had not been rigid, having been set as a trade-weighted average of the rates of Australia's trading partners.)

Now an export-led recovery can be expected, especially in the important mining and agricultural sectors, provided that Australia keeps inflation under control. In addition, devaluation might spur a resurgence of capital inflows.

Yet structural as well as cyclical problems still abound, as our account suggests. The government to date has relied mainly on fiscal-monetary policies to restore a situation of non-inflationary growth. Should the economy not respond as expected to these macroeconomic policy changes, more effort might be directed at areas of structural weakness in the economy. Further pressures might then arise to liberalize foreign-trade and foreign-investment policies in order to spur economic growth.

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