



COMMONWEALTH OF AUSTRALIA

SENATE

Official Committee Hansard

ECONOMICS LEGISLATION COMMITTEE

Consideration of Estimates

THURSDAY, 25 JUNE 1998

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SENATE
ECONOMICS LEGISLATION COMMITTEE

Thursday, 25 June 1998

Members: Senator Ferguson (*Chair*), Senator Jacinta Collins (*Deputy Chair*), Senators Bishop, Chapman, Murray and Watson

Substitute member: Senator O'Brien

Senators in attendance: Senators Bishop, George Campbell, Chapman, Jacinta Collins, Cook and Hogg

Committee met at 8.05 p.m.

DEPARTMENT OF THE TREASURY

Proposed expenditure, \$1,953,646,000 (Document A).

Proposed provision, \$189,715,000 (Document B).

Consideration resumed from 5 June.

In Attendance

Senator Kemp, Assistant Treasurer

Department of the Treasury—

Mr Ted Evans, Secretary

Mr Mike Callaghan, First Assistant Secretary, Economic Division

Mr Gary Johnston, Assistant Secretary, International Finance, International and Investment Division

Mr Brian Cassidy, First Assistant Secretary, Structural Policy Division

Mr Jim Livermore, Assistant Secretary, Market Competition Branch, Structural Policy Division

ACTING CHAIR (Senator Chapman)—I declare open this public meeting of the Economics Legislation Committee for the purpose of examining the 1998-99 budget estimates. The committee will examine Department of the Treasury subprograms 1.1—Domestic economy; 1.2—International economy; and 1.3—Structural. I welcome the minister and officers from the department and thank them for their attendance at short notice. Minister, do you wish to make an opening statement?

Senator Kemp—Yes, I will make a brief statement. I want to put on the record that it is well known that this committee has sat for very long hours already. The agreement that the Manager of Government Business had with the Labor Party was that if the government was prepared to allow committees to sit for long hours and government senators were restrained in their questions, there would be little difficulty with the appropriation bills being passed by the House. We kept to our agreement.

It surprises me that we are back here this evening. In fact, I understand that senior members of the Labor Party have confirmed that that was the agreement. Nonetheless, for reasons which are well known to Senator Cook and to me, this committee has now resumed. I regard it as a breach, as does the Manager of Government Business, of the undertakings that were given to us. Nonetheless, as I said, we are here. Officers of the Treasury have been asked to attend at extremely short notice and I am grateful that we have been able to have the Secretary to the Treasury and his other officers with us.

Naturally, we will cooperate, but I do want to put on the record that, if agreements are reached, particularly in relation to estimates, I have always believed they should be kept. In my view, I have kept my side of the bargain. Having got that on the record, I suggest we now proceed.

Senator COOK—Can I make a statement? First of all, it would be wrong to let the statement made by the minister stand without commenting on it. It is a forthright statement and it deserves commentary. My first comment is that I made it clear that I was seeking an extension of time for these estimates hearings at the conclusion of the proceedings when this committee last met. I regret that it has taken so long for the government to make up its mind and, potentially or actually, inconvenienced officers of the Treasury this evening.

That was a clear position flagged by me back then. I understand from those in my party who are responsible for negotiating these things that I was completely within my rights to do so and no agreement that had been entered into prevented me from so doing. I took the matter up, as foreshadowed, with Senator Campbell on the next available occasion. He asked me to wait a little longer; he would look into it. Eventually, I pursued him again in an effort to get an answer to the issue and at that stage he told me that he had conferred with his party leader and it would not be agreed. As a consequence, correspondence was entered into and it now is agreed.

With regard to keeping an undertaking, I have been meticulous to ensure that, in seeking some more time to conclude the estimates, I consulted with the relevant people in my party who are responsible for these things and I was assured at each stage that I was quite within my rights to proceed.

The second point is that I do think there is some justification in what the government has said about the amount of time taken up by this estimates committee. When I look at the content of what this estimates committee deals with, I see that it deals with a huge number of portfolios—a much greater number of portfolios than other estimates committees. To compare the time it takes with the time taken by other estimates committees is, I think, unfair from that perspective.

Additionally, some of those portfolios—particularly the portfolio of Workplace Relations and Small Business, obviously, given events on the waterfront in Australia this year—were going to take a huge amount of time. It is not surprising that quite a bit of time was taken up on those estimates, which meant that the meeting of this committee was extended.

I put those comments on the record as my views. I do not expect the government to accept them. I do not think Senator Kemp will. They are, frankly and straightforwardly, my understanding, and reflect the actions that I took with respect to this matter. I understand that it has inconvenienced officers of the Treasury and they have had to reshuffle their timetable or their program as a consequence. I apologise to them for that.

Senator Kemp—I do not want to prolong this discussion, but my understanding—and I have been advised by senior people who were involved in these negotiations—is that the Labor Party did accept that there were such agreements. Equally, I think you would be aware that, in order to facilitate the Labor Party, we have encouraged our senators—unlike what occurred when we were in opposition—not to absorb significant amounts of time in estimates hearings. I put on the record that, in light of what has happened today, I think it will be difficult to encourage government senators to pull out of asking questions at estimates committees, because obviously it is of no advantage to us to do so. In future, we should get very clear

understandings—preferably, from Senator Cook, written understandings—on the way these committees should proceed.

Senator COOK—I have nothing further to add to what I have said, although I do find the last remark offensive. I do not intend to pursue it.

ACTING CHAIR—I think it is worth putting on the record that, this year, this estimates committee has sat for the longest period ever—something over 38 hours—and, notwithstanding Senator Cook's comment that it does deal with three significant portfolios, during the time that the present government was in opposition, we took less than half that time in terms of estimates hearings. That is recorded in the report of the estimates for this year.

Senator Kemp—Equally, it is important to note that in those days government senators were very active on these estimates committees. I remember, when I was on a run on a series of questions, constantly being interrupted by government senators who wanted to make a point. We have not done that, because we believed we had clear agreements. Apparently, from what Senator Cook has said, at least as far as Senator Cook is concerned, those agreements were not there. Therefore, that matter should be very carefully considered in future estimates.

Senator COOK—I have no further comments on the introductory statements of the minister. I stand by what I have said. I do not need to embroider it any further.

[8.14 p.m.]

Program 1—Treasury

Subprogram 1.1—Domestic economy

Senator COOK—In dealing with the section of estimates on the domestic economy, I particularly draw attention to the opening paragraph of Budget Paper No. 1 for 1998-99 under the section 'Statement 2—Economic and Fiscal Outlook, Part 1: Economic Outlook, Overview' where this section of the budget papers are introduced by the statement:

The Australian economy should continue to record solid economic growth, low inflation and a further reduction in the unemployment rate in 1998-99.

I note that that is what the budget then goes on to justify in terms of not only its outlays but also forecasts of what will occur. In the light of that, can I ask some questions related to the *ACCI & Westpac Banking Corporation Report on the 147th Survey of Industrial Trends, June Quarter 1998*, dated 16 June. In the introductory summary of that survey, ACCI and Westpac Banking Corporation say:

The severity of the economic recession in East Asia appears to be having a noticeably adverse effect on activity and confidence in the manufacturing sector. Business confidence is down to its lowest level since 1991 and contrasts with the positive sentiment and trends evident in 1997.

My first question is: does Treasury agree with that conclusion of this survey?

Mr Callaghan—That is the statement of what is in that survey, Senator, I think that we would agree.

Senator COOK—Have you undertaken any work yourself to test or corroborate that outcome, or to justify that outcome?

Mr Callaghan—That is one of many pieces of data that we can look at, in terms of trying to gauge what is happening in the economy. I think, if you are looking at that particular survey, that there are a range of questions they ask business in terms of coming to the general overview of business confidence. If you look at some of the particular details that were in the question, for example, the measures of current activity such as output growth, new orders

received and capacity utilisation, while they have fallen, they have fallen to levels that prevailed during 1996-97. The rate of economic activity in 1996-97, on the most recent national count, was three per cent. That survey can be interpreted as consistent with an economy where the pace of activity is slowing in line with the budget forecast of three per cent growth.

We do not draw any specific conclusions from that survey. It is one of many. It is very volatile. One of the aspects at the moment is that it is measuring a particular sector of the economy that is particularly affected by the events in East Asia. Of the companies that are surveyed in that particular survey, about 80 per cent of them are exporters and a lot of them have direct exports to Asia. It is to be expected that that is fuelling the effects of the developments in Asia. It is not picking up, for example, what is happening in the rural sector or what is happening in the commodity sector.

Senator COOK—Max Walsh said on 22 June:

Business sentiment is so dismal that you would say, on the evidence of the past 20 years, that there is a 60 per cent chance Australia is heading for a recession.

That does seem to confirm the indications in the ACCI-Westpac survey, doesn't it?

Mr Callaghan—That is just one person's opinion. There are a range of indicators and a range of data that we need to look at in terms of trying to assess where the economy is going. Business expectation surveys are, as I said, particularly volatile and it is very difficult to draw precise conclusions as to where the economy is going. As I said, that survey could be consistent with an economy that is slowing in its pace of activity from very high rates of growth, that were confirmed in the March quarter national accounts, down to a rate of activity that could be consistent with the budget forecasts.

There are other indicators that have come out and would suggest the alternative. For example, yesterday Westpac released its leading indicator for economic activity and it showed a rise. Again, we do not place particular importance on that indicator. It has not proved to be, we believe, a good indicator of where the economy is going. We think the best indicator is looking at all the available evidence and trying to draw conclusions from that.

Senator COOK—Yes. I am talking about business expectations at the present time. On 24 June, the MTI survey of 50 leading manufacturers—I accept this is very likely to measure the same sentiment that the ACCI and Westpac survey of industrial trends measures—concluded that business conditions are the worst for five years, that half of the respondents, that is, the 50 leading manufacturers, are expecting falling sales and orders and that one-third of them are expecting lay-offs in the next 12 months. Again, that seems to corroborate the findings of the Westpac and ACCI survey.

Mr Callaghan—Again, you can be saying that they are consistent with an economy that is slowing in its pace of growth and, as you have already indicated, it is only picking up one sector of the economy. There are other sectors of the economy, as I said, rural and the commodity sectors, that may not be feeling the full effects of Asia as the manufacturing sector is.

Senator COOK—Just coming back to the ACCI and Westpac survey, they cite as one of the problems the issue that you have referred to, which, I think, everyone would expect them to do—that is, the recession in East Asia and its effect on business confidence in the June quarter. The findings of the survey go on to be set out as:

Those firms expecting an improvement in general business conditions in the next six months fell from 16% to 6%, while those predicting a deterioration rose from 35% to 57%. The negative net balance (-51%)

is sharply worse than the March (-19%) and December (+7%) quarters and is the lowest outcome since 1991.

My question is: was this within the field of expectations that Treasury took into account when it framed its own forecast of what the economy would do? Are we seeing here things consistent with what you anticipated when you framed the budget?

Mr Callaghan—When the government framed the budget, the forecasts it released were for an economy that was expected to grow 3¾ per cent in 1997-98 and, as was outlined in the budget papers, because of the impact of Asia, would slow to a forecasted three per cent growth in 1998-99. Incorporated in that is an impact from Asia that would be affecting exports flowing through to reducing the rate of growth of investment and also slowing consumption. So it is consistent with an economy that is slowing in its pace of growth from the current very high levels.

Senator COOK—I accept that. In fact, your budget anticipated the economy would slow and did refer directly to the impact from Asia. But my question is about this being a sharper slowing than what I thought would have been the case at the time of the budget and what appeared to me at least to be what the budget anticipated. Was I right or was I wrong? Did you anticipate a slowing of this? We are talking here about business confidence, of course, which is not something that the budget measures necessarily. Is this the sort of dent in business confidence that you expected?

Mr Callaghan—It is a very difficult thing. When we are talking about business confidence, particularly at the current time when there is a very discrete external shock occurring and impacting on the Australian economy, that is receiving a great deal of publicity, it is to be expected that sentiment would be affected. In the business surveys we have seen throughout this year, not only the business but also the consumer surveys, we have seen the general question of sentiment falling quite significantly, and I think that is to be expected. But if we look at the other indicators, as I said, if we look at what they have for their output growth, for their new orders, for their capacity utilisation, even in the most recent one, it is slowing down to a pace of activity that was comparable to what was occurring in 1996-97.

Prior to this survey, if we go back to the March survey, we had sentiment and business confidence also falling but the other indicators—trade, new orders and output—were still growing very substantially. So we have seen sentiment affected by the events in Asia. That was to be expected and it was referred to in the budget papers. The difficult thing is trying to draw conclusions about what we are seeing in these sentiment surveys and how they are going to impact on expenditure and activity. That is when we have to look at other indicators.

While this survey is pointing to a decline in sentiment, and certainly that is being affected now, we can see other indicators such as the one I referred to earlier about the Westpac leading indicator. Also, in terms of what we are seeing with business finance, with leasing activity, with imports, with actual expenditure decisions, they are still holding up. We have to keep in perspective any measures of sentiment we have seen in the current environment, which is a rather unique set of circumstances.

Senator COOK—It is true though, as well, that consumer sentiment is below what is expected. Retail sales are basically flat, if not in slight decline. It is not just business sentiment; it is also consumer sentiment.

Mr Callaghan—I am not sure whether we can say that retail sales are in decline. Certainly, we saw a survey of consumer expectations which had fallen, but I think you have to look at the components there. They ask a number of questions when getting these measures of

consumer expectations. A general question, 'What do you think is likely to happen to the economy over the next 12 months?' is the one that recorded most of the fall. Other questions, such as on the state of your personal household finances, did not record much of a fall. There was also a relatively modest fall in a question which we think is perhaps the most important one in terms of trying to assess what is going to happen to consumer spending, and that is, 'Do you believe it is a good time to buy household equipment, a household item?' That fell, but still remains at quite high levels.

You have to have a close look at the nature of the questions and, again, it is consistent with what I was saying previously that general questions about sentiment, general questions about their outlook for the economy—their general feeling for economic activity—are the ones that are recording significant falls. But those affecting their personal finances or their personal decisions—whether it is a good time to buy household equipment—have held up at a relatively high level.

Senator COOK—Turning back to the ACCI-Westpac survey, they also say, in their section overiewing the highlights of the economy:

The outlook for profits has softened further. The net balance predicting higher profits in the next twelve months dipped to 8% from 17% and an average of 33% in 1997.

That is obviously showing a slide in profit expectations. They come to the conclusion in their summary:

Profit expectations have also fallen to their lowest levels since 1991, with sales expected to slow and margins likely to narrow.

Is that expectation shared by Treasury?

Mr Callaghan—I do not think it is a question of whether that expectation is shared by us. What we are looking at is trying to determine where the economy is going to go. Again, we look at a variety of things and this is but one. I would not put the emphasis that you are putting on it to draw precise conclusions as to where you think the economy and business profits are going. You are focusing on this particular survey but, again, if I point to other indicators, they point to a different picture. We can look at the more comprehensive survey of capital expenditure undertaken by the Australian Bureau of Statistics. The final capital expenditure survey—they have a preliminary one, followed by a final one—had an upward revision in terms of business investment plans compared with the preliminary one, so that was moving in a slightly different direction from what is picked up in this survey.

These surveys are not very precise in terms of the way they are compiled. They are working on a net balance. They are not weighted. This one, in particular, is not weighted in terms of the size of firm. All these things are really just to be treated as indicators, not to draw excessively precise conclusions from them as to where the economy is heading.

Senator COOK—To take a wider shot than the area under scrutiny by the survey of industrial trends from ACCI and Westpac: do you agree with a general view though that, in the ensuing period, expectations are that profit margins will narrow?

Mr Callaghan—In the sense that that is what that survey is reporting, I cannot disagree with that. As to what will happen with profit margins, they are at a relatively high level and I believe that they will be staying at a level that is high enough to support the rate of economic activity and business investment that is in the budget forecasts.

Senator COOK—But that would not be at the same level. It would be at a lower level.

Mr Callaghan—There could be some squeeze on profits.

Senator COOK—Thank you. If I can turn for a minute to exports, again I will stick with this survey for starters. It says export deliveries are down more sharply again in the June quarter, representing one of the lowest outcomes in the history of this survey question. We have seen in the last few days—we are talking here, of course, about the industrial trends, but moving to the agricultural or primary industry and minerals and energy sector—the ABARE survey of the 24th of this month also blaming weak economic activity in Japan, which is not surprising. It noted that consumer purchases of wool apparel in Japan declined last year, that demand for beef was weak, that exports of minerals and energy commodities in Japan will also be adversely affected, and that there is a marked decrease in the consumption of aluminium, copper, lead and zinc and some downward pressure likely on Australia's exports of iron ore and metallurgical coal. They also expressed the view that the economic stimulus package, if it is related to the implementation of reform of the financial market, may change that outlook. But that is not a positive outlook in that sector either. Were these your expectations at the time of the budget?

Mr Callaghan—That there would be downward pressure on exports? Most definitely.

Senator COOK—To the extent that is now being forecast?

Mr Callaghan—Within the budget papers?

Senator COOK—Yes.

Mr Callaghan—What we have seen is exports performing in line with what was indicated in the budget papers.

Senator COOK—This is consistent with what you thought would be the case.

Mr Callaghan—The direction and the nature of the influences on exports, as was outlined in the budget papers, I believe is being borne out in the data. For example, the budget papers went into some detail to say that it is not accurate to assess what is happening to Australia's exports by adopting what could be termed a fixed trade share model—to simply say that because a certain amount of our trade goes to some countries and what is happening to the income level in those countries, therefore there will be the same impact on our exports. The budget papers outlined the range of factors that bear on exports and noted that it is supply that is the main determinant on our commodity exports, that we diversify our exports, that we can and have been diversifying our exports to different markets, that income levels in our trading partners are not the major determinant of our exports to them, given the nature of our exports, in that the exchange rate will help in that diversification.

I think the data we have seen up until April, and it is the most recent, confirms that picture. We have seen a diversification in our exports. We have seen a decline in our exports to the troubled Asian economies. But more recently we have seen something of a bounce back of those and we have seen some of our exports to some of the countries in the region not fall anywhere near the full extent of the fall in their imports and their income levels. That picture is the one that was presented in the budget and has been borne out by the data.

Senator COOK—Japan takes about 20 per cent of our trade. Obviously, any reduction in Japan has a disproportionate influence, compared to most other countries, on our trading balance. I suppose it is in the international economy that I should examine the Treasury on what they see is the situation in Japan. But are you saying that you were anticipating in your budget forecasts a reduction of this order for the minerals and energy, agricultural and manufactured exports?

Mr Callaghan—Yes. The budget forecasts incorporate a significant reduction in export volumes. As is indicated in the budget papers, export volumes are forecast to rise by 2½ per cent in 1998-99. That is a very significant reduction because the growth in 1996-97 was 10 per cent, so incorporated within the budget forecast is a very significant reduction in our export volumes. That is across both the rural and non-rural manufactures and services. For example, in the manufactures area, the rate of growth of manufactures incorporated in the budget forecast is well over half what has been the average for the last 10 years.

Senator COOK—The survey goes on to say:

Expectations for the September quarter are also negative, albeit less so than the very low actual outcomes in the June quarter.

This of course is a survey of the June quarter. Obviously that is the impact of the devaluation of the dollar, but that is still quite a negative forecast for the next quarter.

Mr Callaghan—Yes.

Senator COOK—It does not suggest that the rebound we are anticipating that the devaluation of the dollar might bring is coming through very rapidly, does it?

Mr Callaghan—I would go back to look at the actual data we have seen up until April. We have seen a significant diversification in our exports, and part of that is a result of the strong growth in other parts of the world outside of Asia, but it is also the improvement in the competitiveness of Australian exporters because of what has happened to the dollar. For example, to quote some figures, if we look at our merchandise exports for the three months to April 1998 and compare them with the three months to April 1997, while our exports to what we might call 'troubled Asia', which is Korea, Malaysia, Thailand and Indonesia, certainly fell by 23 per cent, our exports to the rest of the world grew by 25 per cent over that period.

Senator COOK—Let me go to the next element that is thrown up by this survey. It says: Overall, both demand and output weakened in the June quarter, reversing the trend improvement evident since mid 1996. Expectations are for further falls in the September quarter.

It then goes on, and I think quite significantly.

Consistent with that, capacity utilisation has fallen sharply. In response, firms have become more cautious about expansion, with declines projected for capital spending on plant and equipment. Reflecting the earlier positive trend in output, labour shedding in the June quarter eased but expectations are for it to resume in the September quarter.

This is obviously pointing to the question of underutilisation of productive capacity in the manufacturing sector. They do give some figures on what they anticipate that would be. They say:

After steady rises in capacity utilisation up to the March quarter, the fall in output in the June quarter led to a fall in capacity utilisation (from—18% to—41%).

Of course they go on to say that, as a consequence, capital spending plans have been cut back for the next 12 months and that the balance in this survey worsened by minus 26 per cent in the June quarter. Is there a significant growth in underutilisation of productive capacity in the manufacturing sector?

Mr Callaghan—As I said, Senator, just drawing from that survey, and I would, we do not use it in any way as the basis for determining our forecast for the economy.

Senator COOK—I am not suggesting you do; I am just asking.

Mr Callaghan—If we look at where their level of capacity utilisation is, it is at the same level as it was in 1996-97. Then we can look at what the rate of growth in the economy was in 1996-97; it was three per cent. It has certainly fallen. It has fallen from a high level but, again, keep it in perspective.

Senator COOK—Are you saying that it has just come back to what it was?

Mr Callaghan—I am saying that the level is consistent with where it was in 1996-97, just looking at that survey.

Senator COOK—We were experiencing a very low level of growth in 1996-97.

Mr Callaghan—In the most recent national accounts, three per cent is the estimate for growth in 1996-97.

Senator COOK—I think what this points to, though, is a considerable growth in overcapacity. The question is: do you expect that trend to ease now and for capacity utilisation to pick up?

Mr Callaghan—We have seen capacity utilisation fall, and that is consistent with the investment forecasts that are underlying the budget forecasts, which have investment falling from the double digit rates of growth we have seen in recent years down to a single digit rate of growth.

Senator COOK—Are you expecting that we have bottomed out in terms of the growth of the underutilisation of capacity and we are now expecting capacity utilisation to pick up?

Mr Callaghan—The capacity utilisation depends on what is the total level of investment. Investment is adding to the capacity. A large surge of investment can add to that and there can be a fall in capacity utilisation. If there is an absence of investment and we see demand picking up, the capacity utilisation will rise, and that will be an indicator for greater investment. I am not sure I follow the conclusions you are trying to draw from where we lie in terms of capacity utilisation.

Senator COOK—I am not trying to draw any conclusions; I am just trying to ask a few questions. They are saying here that expectations of investment in adding further capacity to existing capacity are quite low; they have taken a big tumble. What I am asking from a Treasury point of view is: do you expect that underutilisation of capacity now to change so that we start picking up the spare capacity, or do you expect that it will remain constant in the future?

Mr Callaghan—No. I think we expect that there will be ongoing growth in business investment that will be adding to our capacity. We draw that conclusion from what are some of the underlying fundamental influences in the business investment environment that will be supporting that, but also from the other more comprehensive surveys we have seen of what businesses intend to do with their investment plans.

The one I referred to earlier was the ABS survey of capital expenditure. That was the second estimate for investment plans in 1998-99, and this is something we talked about at the previous meeting here. But, since we talked about it, the final of the second estimate has come up, and they have revised up not only what happened to business investment in the March quarter but also the survey for 1998-99. It has gone up by about one percentage point compared with where it was. So the rise from the second estimate this time to the second estimate last year, I think, is about six or seven per cent now. There has been a rise. That survey is consistent with the forecast for business investment that is in the budget papers. That is business investment that will be adding to the productive capacity of the economy.

Senator COOK—When was that survey published?

Mr Callaghan—The preliminary came out on 28 May and the final was within the last week.

Senator COOK—That seems to be conflicting with the report of the Westpac ACCI survey.

Mr Callaghan—As I said, Senator, there is a range of indicators. Even as Westpac just yesterday released their leading indicator, which had a rise and was consistent with strong growth, their release said that this would appear to present a picture that was inconsistent with their survey on industrial trends. I would not draw any conclusion from any particular one. Like all these things, you have to look at the whole range of indicators we have and all the evidence we have to try to draw an assessment.

Senator COOK—Just let me get this right. What I understand to be the case is that the March quarter national account showed investment in plant and equipment falling by 4.1 per cent in the March quarter. Last week's ACCI-Westpac survey showed a 26 per cent fall in respondents' plans for plant and equipment investment in the June quarter. Your point is that the most recent Westpac publication on economic indicators countermands that?

Mr Callaghan—Yes, Senator. The leading indicator suggests that there is strong growth—that there has been a rise in it. You are looking at a net balance, which is the difference between those who expect it is going to rise and those who expect it is going to fall. As I said, trying to draw too precise a conclusion from it is very difficult. It does not give you that strong guide in terms of history. It is very cyclical and it moves. As an example, if you look at the total movement in the confidence in 1994-95, there was a very significant fall. This was a period in 1994 when there were rises in interest rates. That survey suggested a very big fall, but the economy did not perform that way. Business sentiment, in the wake of those rises in interest rates in the second half of 1994, led to a fall in the general confidence measures, but the economy did not perform in the same way that that survey indicated.

Senator COOK—No. I remember that well. I remember the opposition of the day criticising the government on the basis that the Treasury had published unreal expectations about how capital investment would perform. But my recollection is that, at the end of the budgetary year, you had got it right. That was my understanding in 1994.

Mr Callaghan—It exceeded the budget forecast then but, if you drew conclusions from what was happening in the ACCI-Westpac survey, you would have said that they were indicating a significant fall in the general business confidence measure.

Senator COOK—Of course back in 1994 we were coming out of a recession and starting to pile on a bit of growth. I think the economy in 1994 grew by four plus per cent, didn't it?

Mr Callaghan—That is right, but this is basically 1995 following the rise in interest rates in the second half of 1994. I use that as an example that you have to be careful in trying to draw conclusions from what is happening in those surveys in terms of what is happening in the economy and what is going to happen with business investment. Drawing on history, sometimes it is not a good guide.

Senator COOK—I accept that sometimes it is not a good guide, but in the 1994 example the economy grew by about four plus per cent and we are looking at the economy growing in this budget by three per cent—that is the forecast—and capital expenditure growing by eight per cent—I think is the forecast. The ABS capital expenditure survey showed a total capital expenditure falling by 3.5 per cent for the March quarter. National accounts showed investment

in plant and equipment falling by 4.1 per cent in the March quarter and the Westpac survey falling by 26 per cent in terms of respondents' plans for plant and equipment in June.

Back in 1994 we had an economy expanding at a faster rate, and we were coming out of a recession in which there had been low investment in plant and equipment. It was not surprising, therefore, that, as the economy was going to rebound, there was more forward investment. We do not seem to be looking at that situation now though.

Mr Callaghan—No, Senator. We really should be looking at 1995-96. As I said, it was the rise in interest rates in 1994 and, following that, in the calendar year 1995, those surveys showed a big fall in general confidence. That is after a very strong period of growth and after a rise in interest rates in the second half of 1994. Then those surveys that were taken in 1995 indicated a very big fall in business confidence. That was not what we saw in terms of activity; it did not mirror that.

Going back to what you were saying about the March quarter, in the final survey, when they finalised their CAP EX for the March quarter, there was an upward revision to business investment in the March quarter. In that survey it also suggested that business had strong investment plans for the June quarter, and there was an upward revision for their business investment plans for 1998-99.

Senator COOK—You have made that point a couple of times. I guess that it goes to the point about what survey you think more accurately measures the likely outcome—what more accurately reflects the likely outcome.

Mr Callaghan—As I said, we have to look at a whole range of indicators. As we have said many times, when we get just the preliminary national accounts, we do not just take that on face value. We have a look at everything we can to try to get an assessment of what is happening, and I think that applies with any of these surveys. As I said earlier, the element here in looking at that is that it is picking up a very cyclical part of the economy. The movements in that, in terms of those general indicators of business confidence, would be much larger than movements in the economy. This time round it is picking up one sector of the economy that would be feeling the adverse effects from Asia. So these are all elements that have to be taken into account.

The other thing is that the budget forecasts are for an economy that is slowing down, so it is trying to draw conclusions or assessments as to whether these measures are inconsistent with an economy that is slowing down, in line with the budget forecasts, or whether they are suggesting it is slowing down further than the budget forecasts. They are all the assessments that have to be made.

Senator COOK—This is a survey of particular companies and respondents. They say that labour shedding in the June quarter eased but they do expect it to resume in the September quarter. That is to say that we will be facing more unemployment in this sector in the September quarter. Is that your anticipated result as well?

Mr Callaghan—I think those surveys for a long time have been indicating labour shedding in a period when we have had strong growth in employment. Even now, as we look at other indicators of employment growth—the job vacancy surveys—they have been rising or are at levels that are consistent with ongoing employment growth, so it is difficult to draw conclusions from that one survey of where you think employment growth is going, just as it is difficult to draw conclusions on investment or general economic activity.

Senator COOK—What they are saying here is that, while output was down, the net balance, reporting lower employment levels, contracted in the June quarter to minus 12 per cent from minus 22 per cent. That was in line with the less negative expectations reported in the previous survey of the June quarter of minus 12 per cent, but—this is my emphasis—predictions for the next three months have worsened to minus 26 per cent. This is what the companies themselves are saying. That is quite a severe movement, it would seem to me, in terms of labour shedding for this sector, which is a sector of fairly high employment.

What is the point of that? The point of it is that I am trying to get some sort of measure on how industry is reacting since you put down your budget forecasts. I thought the forecasts on employment were somewhat odd, but you have explained them at the previous meeting of this committee. These are the results of what those who run companies in Australia think in the manufacturing sector, and a reduction in labour, an expectation that it will worsen—an expectation to minus 26 per cent—is quite a severe marking down of employment prospects for the sector and seems to run counter to your forecast on employment.

Mr Callaghan—I am afraid that it is the same story, Senator, in the sense of having to look at the other indicators and not drawing too much from that one indicator. If you go back, you will find that, for some time, they have not been having a positive employment picture in that survey, whereas activity or employment growth has been strong.

The other indicators that would look at employment are what is happening to activity, what is happening to real wages; and more specific indicators are what is happening to job vacancies. All those are consistent, I think, with the budget forecasts.

Senator COOK—What is happening to wages? It seems to be that wages growth is moderating. One of the reasons for that could well be the expectations that unemployment is going to get worse or that the ability to negotiate it at plant level—wage increases—is affected by the level of unemployment.

Mr Callaghan—And the level of wages or growth in wages is a determinant on the level of employment and a moderating in real wages is consistent with employment growth.

Senator BISHOP—Mr Callaghan, Budget Paper No. 1 on a number of occasions makes reference to employment growth and that it should remain firm, a fall to around 7¾ per cent, a further reduction in the unemployment rate, further solid employment growth, with falls in the unemployment rate expected. So it is a consistent picture that you painted. When was this being drafted—late April?

Mr Callaghan—It was released with the budget. I think it was 13 May. That is the date it was released, Senator.

Senator BISHOP—Since that time, the unemployment rate has marginally increased from 7.9 to 8.1, or something to that effect. There was significant growth in the last quarter—something in the order of 4.9 or five per cent. In the light of those two figures, there has been significant inventory growth in a range of surveys, some labour shedding and significant reductions in overtime. Do you still believe that constant theme of solid employment growth and gradual reduction of unemployment to be correct, as it was when you drafted this document?

Mr Callaghan—What we have seen in the data to date, Senator, is consistent with the outlook in the budget forecasts. We have seen employment growth growing through the year to May at two per cent. The budget forecast is for the rate of employment growth to slow in

1998-99 in line with the slowing in activity, but still at a level that we would say would be solid employment growth.

As I said, the range of things that are going to determine that employment growth is what is happening to the level of activity, what is happening to the level of real wages. In terms of the unemployment rate, a lot depends on what is happening to the growth in the labour force. An aspect that was discussed at the previous estimates hearings was that there are influences on the participation rate that will suggest that it will stay down at a relatively low level.

The important influence there is what is happening to mortgage interest rates. If I just go back one step, in terms of what is happening to the participation rate, generally we see it rise. When employment growth is rising strongly, it is people coming back into the work force who have been discouraged. The rate of growth of employment is expected to ease from where it is now. So in that sense we could say that we are not expecting the same discouraged worker coming in to the same extent if we had stronger employment growth.

But the other element that is important in the participation rate is what is happening to mortgage interest rates. We have gone through a period of strong employment growth and not the same rise in the participation rate as a lot of people expected. If we go back and have a look at what might be influencing this, it appears that what is a strong determinant is what is happening to mortgage interest rates and the need for the second income worker in a family to go back into the labour force.

When mortgage interest rates stay low, we would expect that the participation rate will not be rising to the same extent. So the outlook for the participation rate and the influences that are affecting that, I think, are consistent with that unemployment forecast of a moderate fall from the budget forecast of eight per cent by the June quarter this year to 7¾ per cent by the June quarter 1999.

Senator JACINTA COLLINS—What other significant influences do you see on the participation rate?

Mr Callaghan—Other influences?

Senator JACINTA COLLINS—Yes.

Mr Callaghan—The most important one is what is happening to the rate of growth of employment. This is the discouraged worker effect, the one that a lot of people look at.

Senator JACINTA COLLINS—No, I am sorry; what you have not just covered. What other—

Mr Callaghan—I think those are the most important ones. There are also demographic factors on it, as we have seen, if we go back. I think those demographic factors take a much longer time to work through than you would expect in a short time horizon of 12 months. In a longer period, we would expect the participation rate to fall. Just as the working through of the postwar baby boom—that age cohort—works through the population, you would expect the participation rate to start to fall. But there is a range of other influences on it—for instance, the level of welfare payments and whether people feel the need to go into the work force. There is a variety of influences on it.

Senator JACINTA COLLINS—I am asking whether those have been identified as well—as significant?

Mr Callaghan—We look to try to estimate what is happening to the participation rate. We look at all the indicators that are likely to affect it in the short term, and all of those that we have factored in are consistent with that budget forecast.

Senator BISHOP—What figure do you expect the participation rate to go to over the next 12 months?

Mr Callaghan—I think we have mentioned it in the budget papers—staying at 63¼, a flat participation rate.

Senator BISHOP—A flat participation rate—no decline?

Mr Callaghan—That is over the course a flat participation rate. It bounces around, as we see, with the volatility in the monthly labour force numbers, but over that 12 months we expect it to be flat.

Senator BISHOP—I am sorry; I thought you said that you expected the participation rate to decline because of continuing low interest rates and hence no need for—

Mr Callaghan—Flat, sorry—why we were expecting it to stay flat. In a period of employment growth, you could say, ‘Why shouldn’t the participation rate rise?’ because if there is employment growth, the discouraged worker should be coming back. There is an incentive to get a job. But we have gone through a period of very strong growth in employment and we have not seen a rise in the participation rate. I was just explaining that one of the influences on that is what is happening to such things as mortgage interest rates. Over the period of 1998-99, there was solid employment growth but, with the mortgage interest rates still at historically low levels, that would be an influence working towards keeping it at that flat level. We think it is a consistent story and a consistent picture.

Senator BISHOP—You think it is a consistent story. Do you have any reason to depart from your forecast, in terms of employment growth, with respect to the different sectors in the economy—services, mining, construction, manufacturing?

Mr Callaghan—In terms of preparing the budget forecast, we do it at an aggregate level. We do not try to break it down into particular sectors.

Senator BISHOP—To get an aggregate figure, you have to have composite parts.

Mr Callaghan—No, we do not look at the parts; we look at the whole. We look at those broad determinants on it—what is happening to activity, what is happening to real wages.

Senator BISHOP—When you forecast a figure of 7¾ per cent unemployment in 12 months time, that is an aggregate figure.

Mr Callaghan—That is an aggregate figure.

Senator BISHOP—How do you arrive at that?

Mr Callaghan—At the aggregate level—looking at what is happening to the growth in the economy, what is happening to real wages. We do not do sectoral forecasts. We do not break it down to look at what might be the employment growth in manufacturing, in services or in agriculture. We look at the economy as a whole. We look at the overall growth in activity and the overall growth in wages and we forecast it on that basis.

Senator BISHOP—Do other departments provide you with that?

Mr Callaghan—No, we do it.

ACTING CHAIR—For the benefit of committee members, I indicate that we do have three subprograms that we are considering this evening. We have three hours and we have just ticked over one hour.

Senator COOK—I am aware of that. According to your employment forecasts, the employment will go to eight per cent and will then decline over the budgetary year to 7¾ per cent. When do you expect the decline to start?

Mr Callaghan—I would not put it down; we do not do quarterly forecasts, we only present it in terms of the year average and the through the year on that. I would just say that it is not a significant movement over that, so it could be a gradual decline over that period. There will be volatility, as we have just seen between the April and May numbers, from 7.9 to 8.1 per cent. There will be continuing volatility, but over the course of the year we would expect it to fall to 7¾ per cent.

Senator COOK—I hate to do this to you, Mr Callaghan, but I come back to the ACCI-Westpac survey—I am sure you thought I would—and one of the other significant points that they make here is that inventory accumulation was much stronger than expected in the June quarter and a sharp contraction in inventories is now planned for September. So the picture here is one of expanding overcapacity, large accumulation of inventories and, in the September quarter, downsizing. This is the manufacturing sector. Where do you expect the employment growth to occur? Where do you expect the economy to be able to be pulled past a decline in what is obviously an important sector, the manufacturing sector, which is not the only one but quite an important sector in its own right?

Mr Callaghan—I am afraid the answers get boring in the sense that, as I said, that is focusing on one sector that in these circumstances is probably getting the largest effect from what is happening in Asia. Other sectors in terms of rural and services—agricultural, domestic services—will not be affected as much. As I said, 80 per cent of the respondents to that survey are exporters so they are very exposed to the events in Asia.

In terms of where the growth is coming in employment, again, we do not forecast particular sectors. But if we look back at where the employment growth has occurred in the past, we have seen strong growth in the services sector and we have seen employment growth in the manufacturing sector.

Senator COOK—This is the manufacturing sector speaking for itself. I accept all the qualifications you put on that, about this being one survey to be seen among others, but this is a reputable survey and one can take these figures as a reasonable indication, I think. Inventory accumulation is strong and expected to get stronger, lack of forward investment and overcapacity, downsizing of employment—that is what this says for this sector.

ABARE, in their media release, talked yesterday about the reductions in exports—this was to Japan—of agricultural and mineral commodities and energy products. One can almost project that across to Korea as well. I do not have a recent figure for Korea, but the figures given to me by the Department of Foreign Affairs and Trade during their estimates pointed to similar reductions in beef and other agricultural exports to Korea—an economy that is contracting by about 4¼ per cent—and lower demand for a range of other standard exports in the commodities field.

When you go to services, the intake of tourism is an active question amongst the tourist industry. And God knows, after the performance of the One Nation party in Queensland, what that might do to the image of Australia in some of our premium tourist markets as well. But the clear fact is that tourist figures are lower than anticipated. While one always hopes that

they can grow by emphasising new and different markets and that Americans might wake up to the exchange rate advantage of visiting Australia and so forth, the outlook for tourism is not very positive—and that makes up a large part of the services sector figures.

Senator Collins mentioned education. I have just been talking to the universities about projections for the future intake of foreign students, and the English language sector. Education exports are our fifth largest export overall and I think second in the services area after tourism. They are expecting a decline. I am not making this up—that is what the indicators are. I think it is a reasonable question to ask: where do you think the growth will be? What in that picture misrepresents the—

Mr Callaghan—In that picture, you have picked up some of the things in terms of the diversification that is occurring. You have mentioned tourism in particular. Again, if I can just quote some numbers on it—

Senator COOK—And in reference to services.

Mr Callaghan—And the services. If I can just quote some numbers on the arrivals, we are seeing some of that diversification occur. If we just look at short-term arrivals in May 1998 over May 1997, yes, there has been a 19 per cent fall from South-East Asia, an 11 per cent fall from north-east Asia, but there has been an 18 per cent rise from North America and a 7.5 per cent rise from Europe. Overall, they are down in May 1998 compared to May 1997, but we have been seeing that diversification.

If we look at services in the March quarter, services rose 0.8 per cent in volume terms in the March quarter. Travel was down, but it was more than offset by others, including education and business services. So we are seeing this diversification and we are seeing a picture that is consistent with the budget forecasts. As I said, the budget forecasts incorporated a significant reduction in exports and a significant reduction in services, in manufactures, and in rural and non-rural commodities. The picture we have seen is consistent with that.

Senator COOK—I know those figures that you have quoted about percentage increases in various tourist markets, but it is a bit like my argument with the Minister for Trade when he says we are doing well in third markets because, for example, exports to Pakistan have increased by 74 per cent. With due respect to the Minister for Trade, you can yawn about that figure because it just means we sold another shipment of wheat; it is coming off an extremely low base.

The American and European tourist sectors are important—I do not diminish their significance—but the biggest source of our tourism is not from those sectors. Percentage growth in those sectors does not give you a good impression of the overall. Overall, I think the point is that it is down. That is my only point: it is down. I am asking: where is the growth coming from?

On the figures you have given me about education, the English language sector of the education field has declined by some 42 per cent in the last year; there has been a massive cut there. With universities it takes longer for the cut to come through, but they are all budgeting for a massive reduction next year, and the figures this year are also down. My question is: in terms of your forecast of getting unemployment down, where is it coming from?

Mr Callaghan—Where is what coming—the employment growth?

Senator COOK—Where is the growth coming from?

Mr Callaghan—Overall growth coming from?

Senator COOK—Yes.

Mr Callaghan—We are focusing and all your comments are focusing on areas that are taking the largest impact from the events in Asia. As I said, and I am repeating myself, Senator, the budget forecasts did incorporate a significant reduction in exports, in export volumes. Asia came at a time when the domestic economy was growing very strongly. There are indicators or there are the fundamental driving factors that will continue solid growth in the domestic economy, but it will be slowing, and the budget forecasts have been based on that premise.

We have been focusing on these particular services sectors, and I think the question of diversification is important. Yes, it is taking a significant fall, but we are seeing that diversification. As we have said before, what we have seen with the movements in the exchange rate has improved the competitiveness of the Australian exporters and is allowing them to make that diversification. All up, what is happening in the domestic economy and what is happening on the external side are still consistent with the budget forecasts. The data we have seen to date is consistent with that picture.

Senator COOK—We are just bouncing our same questions back. You are right to say—

Senator Kemp—I'll say—that is true.

Senator COOK—Mr Callaghan is right to say I am focusing on where the downturns are. My question is where the upturns are coming from. The answer seems to be that, because of the exchange rate, there will be upturns in the mature markets.

I do not want to be contentious about this just on the sheer empirical facts, but last Friday I talked to a range of manufacturers in the automotive sector supplying component parts to the Australian automotive industry. All have an export market. With the exchange rate at the level it is, why are they not winning contracts in North America and in Europe and, to a lesser extent, due to low domestic demand, in Japan? We have still gone down against the yen. They are not winning through with their general message to me. Why aren't they? On price competition you would think it was a monte that they would do so.

With that in mind, I look at this survey of the manufacturing sector itself. It talks about higher accumulation of inventories, overcapacity, downsizing of staff and lack of further investment. This is one of the indicators. There are others. What do I point to about this forecast uptake in employment prospects and a lowering of unemployment? Where can you reassure me?

Mr Callaghan—What is happening to employment is going to depend, importantly, on what is happening to the economy as a whole, what is happening to activity. If we look at the budget forecasts, consumption is expected to continue strong growth. About 60 per cent of the economy is consumption. The factors driving consumption are what is happening to household income. That is going to depend on what is happening to employment, what is happening to wages and then there is going to be the question of confidence and whether people are willing to spend. While consumption is expected to slow, it is still expected to grow strongly and there are those fundamental influences there that would suggest that it would support solid growth and consumption.

We have seen the housing cycle still in an upswing and all the indicators there are consistent with continued growth in the housing cycle. Mortgage interest rates are at historically low levels. We have seen that a lot of the building approvals are consistent with a lot of work in the pipeline. We have gone through business investment. We believe that the indicators there are consistent with growth in business investment, which is certainly slowing from where it was in the past. We have talked a bit about exports. The external side is expected to be

detracting from growth and strong growth in imports will result in this continuing solid growth in the domestic spending and a reduction in the rate of growth of exports. But with the transmission mechanism of what is happening in exports, it is important to look at all these factors and not simply focus on what is happening in Asia and say that, therefore, we are going to have the same rate of fall in our exports. We have to look at these questions of diversification. As we have just been saying, we are seeing the data on this and this diversification occur. In terms of diversifying exports, it is easier if you have an homogeneous export like commodities than it is for manufactures.

ACTING CHAIR—Just following on from that answer, can I ask what today's job vacancy figures reveal?

Mr Callaghan—They are consistent with strong growth in employment and, as a number of private sector commentators have said, pose a question in terms of such things as these business conference surveys. Business is still putting out advertisements for jobs, still expecting to be employing people. They are continuing with strong growth in their vacancies. That then seems to run counter to some of the more negative surveys that we have seen. It is just another indicator why it is important to not focus on one indicator in isolation and look at the range of indicators such as the employment vacancy numbers today.

Senator BISHOP—Mr Callaghan, in response to the point that Senator Cook was driving at on two or three occasions you said that the answer lay in diversification. Presumably you meant continuing diversification in the economy.

Mr Callaghan—We were talking about exports and diversifying export markets. It is not that the answer lies in it. It is just one factor that needs to be taken into account.

Senator BISHOP—Okay, it is one factor. How significant a factor is it? You have raised it on a number of occasions.

Mr Callaghan—It is significant in the sense that we cannot apply a static trade share model to say that our trade shares are fixed. We see them change. If you look at a chart on page 2.11 of the budget papers, it has contributions to our merchandise export growth by destination. In there you see the segments or regions which have contributed to our strong growth in exports. In the period from 1985-86 to 1990-91, the large segment there is East Asia. It contributed strongly to our export growth; the black section at the bottom is OECD. If in 1990, for example, we knew that Japan, our largest trading market, for the next seven years was going to have a flat economy on average, it is likely that we would have made quite dour projections as to the likely performance of Australia's exports over the next period. If we look at what happened in 1991-92 to 1996-97, we see that while our total export volume growth fell, it still remained at a very impressive level of about seven per cent growth.

In that top section, the other increased its contribution in terms of our total export growth. For just the last two-year period, that top section was considerably larger. These other markets of the Middle East, Oceania, Pakistan, India and South Africa have been very important in contributing to our export growth. One of the reasons for this is that we have seen a slowing in exports to Asia over this period. Part of that is because Asian exports have been slowing, with overvalued exchange rates. To increase their exports and their performance, Australian exporters have had to look elsewhere and they have been looking for areas outside East Asia. That is why, if we look at that, we can see that these other markets have contributed significantly to our export growth. That is an indication that diversification does occur.

As I say, the data that we have seen lately in terms of what has happened with the events in Asia and what has happened in the exchange rate, do bear out that we have to take into

account diversification. I will just go over those figures again, Senator. In the three months to April 1998 compared to the three months to April 1997, our merchandise exports to Japan grew by 9.6 per cent, notwithstanding what was happening in Japan. What do I conclude from that? That is that income growth in the trading partner is not the best indicator of what is likely to happen to our exports. Was there a troubled Asia? It fell certainly—a 23 per cent fall—but not as large as the total fall in the imports of these economies. Our market share increased in many of these economies because the nature of exports there is not responsive to income as much as other factors. The classic there is food. Food is not as responsive to income as things like manufactures or even services. Our exports to the rest of the world grew by 25 per cent, an indication of the diversification. We are just indicating that you have to look at all these factors in trying to work out what is going to be the impact of events in Asia on our export performance.

Senator BISHOP—Following that line, our exports are about \$A100 billion a year, aren't they?

Mr Callaghan—I would have to check the exact amount. I will take your word for it.

Senator COOK—It is a bit more than that.

Senator BISHOP—Do you have an exact figure?

Senator COOK—It is about \$120 billion, I think.

Senator BISHOP—Senator Cook says it is about \$120 billion.

Senator COOK—It is about 23 per cent of GDP, isn't it?

Senator Kemp—We will get the precise figures.

Senator BISHOP—It does not matter, \$100 billion or \$120 billion, that diversification—

Mr Callaghan—I think it was about \$105 billion.

Senator BISHOP—Okay, we will take the figure of \$100 billion for simplicity. What part of that \$100 billion can you attribute to diversification in the last two or three years?

Mr Callaghan—I would be going back to this chart, Senator. A breakdown is in front of you on page 2.11. You have to look at performance previously relative to performance now. There on the top of the chart are the other markets and you can see what they contributed to our export growth over that period.

Senator BISHOP—The other in the right-hand column appears to be about four or five times bigger than the other in the left-hand column.

Mr Callaghan—That is about right.

Senator COOK—I am not particularly interested to pursue this much longer. I think it is worthwhile making an observation though that for our commodity exports of mineral commodities, our major markets are North Asia—Japan, Korea, China.

The third markets that we are seeing evolve in South Africa and Pakistan are not markets which will take the shortfall in mineral commodity exports because of the downturn in North Asia. That is not an area of growth for them. The amount of extra exports they take from us is not sufficient to compensate for the loss of those volumes in some of our key exports.

Mr Callaghan—Would you like some numbers?

Senator COOK—Yes, I would like some numbers.

Mr Callaghan—Again, I go back to commodities over a three-month period. If we take the percentages first, for the three months to April 1998 compared to the three months to April

1997: Japan, a 9.5 per cent rise; troubled Asia, an 18 per cent fall; the rest of Asia, excluding Japan, a 3.5 per cent fall; the rest of the world, a 32.5 per cent rise. If you want to put them into some perspective regarding levels, in dollars million, the figure for Japan was \$3,871 million; troubled Asia, \$2,302 million; the rest of Asia, \$3,208 million; the rest of the world, \$7,049 million. The figure for the rest of the world is considerably smaller than the figure for Japan, troubled Asia and the rest of Asia, but it is still significant, and if it continues to grow at something like 32 per cent, it will help to offset a lot of that fall. But we are not talking about a total offset. As I say, go back to those budget forecasts and you will see that they incorporate a very significant fall in our total exports.

In terms of our non-rural commodities, what is behind that budget forecast is two per cent growth in 1998-99. That compares with about seven per cent growth, on average, for the last 10 years. So there will be a significant fall in our exports, and that is incorporated in the budget numbers. This diversification is going to help to offset it, but not offset it totally at all.

Senator COOK—I was going to quote back to you what ABARE said yesterday about a marked decrease in Japan's consumption of aluminium, copper, lead, zinc and some downward pressure also likely on Australia's exports of iron ore and metallurgical coal. They hope it comes up, because of the reforms in Japan cutting through, but that is another story. That is yet to be seen. Does Treasury agree with what the Prime Minister said when he said that we need about four per cent or more growth to reduce unemployment?

Mr Callaghan—I do not know if the Prime Minister has said that.

Senator COOK—Let us remove the Prime Minister from it. At what level of economic growth do we start to make serious inroads into unemployment? Is it four per cent or more than four per cent?

Mr Callaghan—We have just had a discussion about a lot depending on what happens to the participation rate. We are talking about an economy that is growing at budget forecasts of three per cent in 1998-99 and a modest reduction in the unemployment rate. By definition, stronger employment growth would lead to faster reductions in the unemployment rate, but a lot depends on what happens to that participation rate. As I said, it usually responds to the rate of growth in employment, that is, the encouraged worker effect takes over. So if we saw very strong growth in the economy, strong employment growth, we might see the encouraged worker effect, and that will all be important in determining what happens to your unemployment rate.

Senator COOK—The participation rate is forecast to be static, isn't it?

Mr Callaghan—For the next 12 months.

Senator COOK—Am I right in thinking that in the 1996-97 budget—I am not so sure about last year's budget—the forecast levels of unemployment were in fact not achieved?

Mr Callaghan—For the June quarter 1998, the forecast was eight per cent unemployment.

Senator COOK—No, in the 1996-97 budget. The employment outcomes you forecast for that budget were not achieved.

Mr Callaghan—I would have to check what was the forecast for June 1997, in the 1996-97 budget.

Senator COOK—I do not have the figures to hand—I have got them in my office—but I think the performance of the economy was under the forecast in the budget for that year.

Mr Callaghan—The forecast for the economy in 1996 was for 3½ per cent growth in GDP. As of the March quarter accounts, the estimate then was for three per cent growth in 1996-97.

Senator COOK—Three per cent growth in employment?

Mr Callaghan—No, GDP. I am not sure what the forecast for employment growth was or what the actual outcome was.

Senator COOK—I do not have the figures in my mind, but my recollection of the outcome is clear—that unemployment got worse than what you anticipated in that budget. I think the same is true of last year.

Mr Callaghan—As I recall—I would have to check—I think last year the forecast for the unemployment rate in the June quarter was eight per cent, and that is still the forecast for the June quarter this year.

Senator COOK—Can I put it to you that these are forecast figures and they may not be accurate?

Mr Callaghan—I would not disagree with you on that one.

Senator Kemp—I think it is probably true that from time to time you made some forecasts in the Senate which have not turned out to be accurate.

Senator COOK—That is absolutely right.

Senator Kemp—I am glad you have conceded that.

Senator COOK—Thanks for highlighting the fickle nature of forecasts, Minister. When we were last here considering the estimates, we had a brief discussion with you about the devaluation of the Australian currency. I am not going to get into predictions about where it might go, by how much and how soon, but as I recall, there was a comment made by Mr Evans. I was asking whether Treasury was surprised at the level to which the dollar had slipped against the US dollar. I want affirmation that this is a correct understanding, in the first place: the response was no, it depends on how long it stays down. If it stayed down for a long time, yes. But at the present time there is no indication of how long the dollar would stay down. Am I right in trying to paraphrase you, Mr Evans?

Mr Evans—I have not checked the records, but that sounds reasonable.

Senator COOK—For what length of time would it need to stay down for you to become alarmed or concerned?

Mr Evans—The concern would be purely in terms of the inflation outlook. There would not be a concern otherwise. If you recall, I would have said on that occasion that the decline in the dollar was a necessary part of the adjustment process to what is happening in the rest of the world. So on that score, one is not concerned about the dollar. The concern comes from the implications it might have for inflation, and that would depend, as I said, on how long it stayed down.

Senator COOK—For how long would it need to stay down before you started to furrow your brow in concern about the impact on inflation?

Mr Evans—That is difficult to say, frankly. When we next do forecasts, we will base those forecasts on what has happened to the dollar since we last did them. If we were to do that now, for example, we would have a lower assumption on the dollar, we would feed that through and come up with a higher inflation figure than we did last time, but we are not doing forecasts again at the moment. When we next do it, we will see then.

Senator COOK—I think it is about a fortnight or so since we last talked in this forum. Are you worried that it has been at about the level at which it has been for that length of time?

Mr Evans—No, I am not worried.

Senator COOK—Are you saying there is no cause to be concerned about the impact on inflation, given the level to which the dollar went and the length of time it has been down?

Mr Evans—No, not to be concerned. It would produce a different forecast for inflation but that is not the only thing one is concerned about. I think you have spent most of this evening being concerned about the growth outlook and the unemployment outlook. Those are also concerns.

Senator COOK—Sure. If it were to stay at about its current level for another month or two, would that be a cause for concern?

Mr Evans—Senator, I do not think it helps for me to be expressing concern about where the exchange rate is, frankly.

Senator Kemp—I think that is true, Senator. When you were in government, I remember you saying in the Senate that you would never speculate on the exchange rate—and urged others, I think, not to do so.

Senator COOK—Yes, well, I do not speculate on the exchange rate out loud; I speculate on the exchange rate privately, to myself.

Senator Kemp—I am not sure this is an entirely private hearing, Senator.

Senator COOK—No, it is not entirely private. I think we are on *Hansard*, and you will notice I have not speculated.

Senator Kemp—I think you have sought that from others, though.

Senator COOK—I was not sure whether Mr Evans would, I must say. The home mortgage rates have gone up in recent weeks, haven't they?

Senator Kemp—Sorry, Senator—what was the comment you made?

Senator COOK—I asked is it true that home mortgage rates have gone up in the recent period.

Mr Callaghan—I think it is just that for some banks, their fixed mortgage rates have gone up—not the variable rate, and not all banks have put up their fixed rate.

Senator COOK—By what amount did those who put it up go up—was it about 0.4 per cent?

Mr Callaghan—I would have to check, Senator.

Senator COOK—When you were framing your budget forecast did you anticipate that that event might occur?

Mr Callaghan—No, Senator. We do not speculate on future movements in interest rates at all, in forming the budget forecasts. For example, over the period we see significant movements in market rates all the time, we have seen a fall and a slight up tick in the long bond rate, we have seen different movements across the yield curve, so we have seen a variety of movements in interest rates occurring. I do not think we can focus on just one of them.

Senator COOK—Thank you. I have got one more question for you but I am damned if I can find it.

Senator Kemp—Senator, would it be a question on the Westpac survey by any chance?

Senator COOK—Thank you for the assistance you are providing me, Minister. Not specifically on the Westpac survey, no. It is to do with the forecast of a possible recession that was made by the officer of the IMF in his recent address to the Australian summit. My question is: does Treasury share the view expressed in that speech?

Mr Evans—Was it the IMF or the World Bank?

Senator COOK—Sorry, the World Bank vice-president who was here. I am trying to do him the honour of remembering his name, but that is in my notes which I cannot find.

Mr Evans—His name was Jean-Michel Severino.

Senator COOK—That is right.

Mr Evans—I spoke with him the following day and told him I did not share the sentiment he had expressed.

Senator COOK—Why not?

Mr Evans—He spoke about a depression in Asia. I do not think it was a particularly wise expression to use frankly. The problems in Asia have a lot to do with confidence, particularly in Japan, but more generally. Confidence is not helped when people of some assumed standing make comments to that effect. As it happens, it is not the job of the World Bank to make forecasts of the world economy—that happens to be the role of the International Monetary Fund—which is why I think the distinction there is rather important. I have no doubt it was a genuine concern that he was expressing, but I think he was using the expression ‘depression’ to draw the attention of the rest of the world to what he saw as a policy requirement of assistance to the countries of Asia. Unfortunately, while it may aid that objective, it certainly does not help in an objective assessment of what is happening in Asia and it certainly does not help confidence.

Senator COOK—If I may say so, that answer goes to whether it was prudent or wise for Mr Severino to actually say what he said, not so much to the accuracy of what he said. It may be imprudent for him to say it, but are you saying he got it wrong as well?

Mr Evans—Your question was: did I agree with his assessment? My answer was no, and that I had told him so.

Senator COOK—Right. Has he changed his mind, Mr Evans, since you spoke to him?

Mr Evans—Have I?

Senator COOK—No, has he?

Mr Evans—I do not know.

Senator COOK—He did not indicate whether he agreed with the point of view you were putting?

Mr Evans—I would not expect him to change his mind on the basis of my opinion.

Senator COOK—I might change my mind on the basis of your opinion, Mr Evans. It is quite an important opinion to have. You do not agree with his assessment of the likely future of the Asian economic crisis then? However, whether or not one agrees, whether or not one thinks that what he said is taking the matter just a bit too far, do you have any reason to regard that the budget estimates on the current account ought to be reviewed in the light of the events in Asia?

Mr Evans—The answer to that is no, because the events in Asia were forecast in the budget and that really goes to a lot of the earlier questioning. There is a suggestion in the questioning

that the information that has become available since the budget adds to what is in the budget. That ignores the basic point that the budget was forecasting this period and the period beyond.

What we have seen come out of the data—and from a lot of information that is not data, such as surveys—is a confirmation of the forecast. Is it a precise confirmation? That is a difficult question; it is what you have been discussing with Mr Callaghan for some time. The thrust of his responses would be a confirmation that we do not see enough, in the balance of the information that has become available since, to change our forecast. What is clear is that people who are responding to surveys are becoming more aware of what is happening in Asia. That does not mean that what is happening is new: it is just that more people are becoming aware of it—as it affects them directly, perhaps.

Senator COOK—In a way, though, you are in the same business as we are. For politicians, perception is often more important than reality: although one should never lose sight of reality, what people believe can be more important than what is true. What people believe is not always true; otherwise you would not have got the high vote that the One Nation Party got in Queensland on the belief that you can have a two per cent interest rate loan or that you can print money. It is clear that a lot of people believe that.

The fact that responsible business people are turning on to the problems in Asia and coming up with dour, if not worried and concerned, opinions goes to the level of business confidence and the types of investment provisions they would make. I do not know where this is taking us, other than for me to make the observation that what people believe can be self-fulfilling, in terms of business confidence, and the fact that they are now expressing a more gloomy attitude is a concern, a worry.

Mr Evans—Yes, and I think it can become more self-fulfilling if people start talking about a depression. That is the point I was making about the wisdom of using such expressions.

Senator COOK—I accept that. I am happy, Mr Chairman, to turn now to the international economy.

[9.47 p.m.]

Subprogram 1.2—International economy

Senator COOK—We might start with my making a quick observation as a prelude to a question. At the January-February estimates this year, Mr Borthwick of the Department of Treasury readjusted Treasury's expectations of growth in Japan, in evidence that he gave here. The Japanese economy is forecast this year to grow in the budget by 0.25 per cent. Is that still Treasury's forecast of Japanese economic growth for the financial year?

Mr Evans—We have not redone the forecast. If we were to redo it, it might be a little below that at the moment. The latest IMF forecasts are just on the negative side, I think. Looking at the figures here, in fact the latest forecast for Japan is flat for this year, with no growth, followed by a pick-up in 1999 of 1.3 per cent. That is probably a reasonable assessment, I would think.

Senator COOK—You had it at 0.25 per cent this year and 1.25 per cent next year.

Mr Evans—There is not much in that, frankly.

Senator COOK—Is that forecast about next year predicated on the assumption that the much touted stimulus package will bite? Or is it predicated on that assumption as well as that the Japanese government will continue to pursue financial reform in the Japanese economy?

Mr Evans—It would have to be predicated on both. Both have been announced, of course.

Senator COOK—Both have been announced. Reform in the Japanese economy has been announced before, but not delivered on. However, I am not asking you to read the political will in the Japanese government to proceed, although this may become clearer after the July upper house elections in Japan. The United States has made suggestions—‘lectured’ is too heavy a word—to the Japanese government about pursuing financial sector reform. Do we share their views?

Mr Evans—Yes, we do, Senator. We participated in a meeting in Tokyo last weekend of a sizeable group of countries, who all shared that view and expressed it in quite clear terms.

Senator COOK—Are you satisfied that the Japanese have taken note of that view and are likely to proceed with it?

Mr Evans—At the meeting, they made it very clear that they had taken note and they agreed to a joint statement, emerging from the meeting, that said precisely that.

Senator COOK—Yes.

Senator BISHOP—What did that joint statement say? What were its key points, Mr Evans? It was only earlier this week at the APEC meeting that Japan refused to commit its markets to deregulation—

Senator COOK—The early sector liberalisation.

Senator BISHOP—in sectors of its economy. So they appeared to be saying one thing last week in Japan, but with a different action to give effect to it, a couple of days ago at the APEC meeting.

Mr Evans—I can provide you with a copy of the statement Senator; I do not have it in front of me or else I could read it. The meeting was looking at Asia in general, but with a very heavy concentration on Japan. In respect of Japan, it said that the Japanese government acknowledged the need to address fiscal stimulus, market opening and, in particular, banking sector reform, ‘as a matter of the highest urgency.’ Those were the precise words. That was an acknowledgment from the Japanese government, reflecting the concern expressed in that meeting about the importance of that, both for Japan and for the Asian region—a point that Australia, along with others, made.

Senator BISHOP—How does having the Japanese officials you dealt with being committed to market opening, as one of the three key points, run with the apparent refusal—if the press reports are correct—to give effect to that, within the past two days at the APEC meeting?

Mr Evans—The statement at the meeting at the weekend was a general one on market opening. The subsequent one was in the specific context of the APEC program, and I am afraid I am not across the detail of that. I noted the statement, as you did, and one could see a seeming conflict there; but one really has to be across the specific language that the experts in the trade area use, in order to be sure there is in fact a conflict.

Senator BISHOP—Yes. I acknowledge that point, Mr Evans. The press reports indicated that all of the countries, bar one, had agreed to give effect to liberalisation measures, and that particular sectors of the economies had been targeted and agreed. The fact that the one country that appeared not to be playing the same game, if you like, was Japan does not bode well in the context of ongoing reform in their economy: that is the only point I am making.

Senator COOK—I think it is a reasonable point that you raise but the situation, as I understand it, was that at the Vancouver meeting of APEC, APEC countries agreed on a series of sectors to fast-track under what was called early sector liberalisation and signed off on it as a commitment. This was the trade ministers review meeting halfway through the year as

a prelude to this end of year leaders meeting, in which the full review will be undertaken. At a review meeting, clearly, one tries to audit the progress being made.

What was surprising at this Malaysian meeting was that the meeting started out, not just with Japan but with a number of other APEC countries wanting to backtrack on their commitments in Vancouver on early sector liberalisation. Some in some of the sectors committed to and others in all of the sectors committed to, but the stand-out in this was Japan, given its other international commitments. I know Australia tried to hold their feet to the fire and oblige them to continue with their commitments, but that was not the final outcome.

Looking at it from a trade point of view, I am not expecting you to be across the detail of all of the intricacies of trade diplomacy, but I do express the view that this is a worrying sign in Japan. Coming off the back of a number of efforts to get the Japanese economy up and running, this last stimulus package is not the first time they have tried to do it in recent memory. Many of those efforts have not succeeded until this point. We can speculate, but I must say I do not feel as confident as I would like to feel about the situation in Japan.

Can I come to a question though. We were talking earlier about the budget forecast for economic growth in Japan, which was 0.25 per cent. You quoted some more recent figures, which had zero growth this year, but a slightly higher growth next year—1.3 per cent as compared to 1.25 per cent. Just so I understand this: are you now saying that Treasury goes to the zero growth option and that you do not think it will be 0.25 per cent? You think it will be just the zero this year?

Mr Evans—The latest IMF figure is a zero for the year. I do not think we, at this stage, would second guess that. We would take that as being a reasonable forecast.

Senator COOK—We could substitute that for your 0.25 per cent?

Mr Evans—Yes, but I would just make the point, as I think I did, that there is very little in that.

Senator COOK—Only in an economy the size of Japan; that would be quite a bit of difference to a smaller economy like Australia.

Mr Evans—I would have to look behind the figures before I agreed with that because, as I think Mr Callaghan may have said earlier, Japanese exports are more important for Australia than Japanese GDP.

Senator COOK—I accept that point too. What is the expectation of recovery in the Republic of Korea? I think their economy is forecast to contract by about 4¼ per cent this year. Is that a figure that Treasury supports?

Mr Evans—Again, calling on the IMF, their current forecasts are for Korea to decline by about two per cent this year and to grow by four per cent next year.

Senator COOK—Are there any particular reforms, apart from what the IMF package is doing to reform the Korean economy, that you think ought to be made there?

Mr Evans—The reforms in Korea have really been very impressive. One might say more so than in most cases that one sees like this. The new government there has been extraordinarily determined to come to grips with the problems. That is what would give you some confidence in that forecast.

Senator COOK—Would you make the same comment about Korea as you have just made about Japan in the sense that one ought to look at export growth out of Korea as being more significant to Australia than growth in the domestic economy?

Mr Evans—Yes, I think that does go again for Korea.

Senator COOK—The strength of the Chinese economy is one of the pillars holding up, I think, the economy of this whole region, yet there are still forecasts of a devaluation in the renminbi. What does Treasury see as the prospects for China?

Mr Evans—The growth figures are quite high and that is one stand-out country in Asia. The forecast for this year is about seven per cent growth. You referred to forecasts of a depreciation or devaluation of the Chinese currency. Let me just say that, at the meeting I referred to earlier in Tokyo on the weekend, the Chinese authorities were very firm in their commitment that that would not occur. The meeting indeed welcomed that and endorsed that as being a policy that would be good both for China and for the Asian region. That was probably the other most significant element of that meeting.

Senator COOK—That is a welcome thing. Do you make the same comment about the Chinese economy as about the other two economies in Korea and Japan—that their export market is more important than their domestic one?

Mr Evans—I am not sure about that.

Mr Johnston—It would be. It is more important for Australia, as it is with the other economies.

Senator COOK—That is because most of what we sell to China goes to make up their export output rather than be consumed domestically. Is that the reason?

Mr Johnston—Yes.

Senator COOK—Does Treasury anticipate that these high export based economies like Japan, Korea and China are going to come up against resistance from their main export markets like the United States and Europe if they keep selling basically cheaper goods into those markets and competing with local manufacturers or local suppliers of those services or goods?

Mr Evans—The rest of the world outside of China is actually performing reasonably well. I should qualify that because there clearly are parts that are not, like Russia, for example, and some of eastern Europe. The United States, in particular, is confounding, indeed, most forecasters by continuing to grow very strongly, and most of western Europe is growing very strongly. That is what is sustaining a lot of the export markets from Japan, in particular, and hence demand for a lot of Australian exports. On your question about prices, I do not really have a strong feel for that. I do not know whether Mr Callaghan may want to comment, but I would not chance a comment on it.

Mr Callaghan—Not really.

Senator COOK—You do not have a comment?

Mr Callaghan—Nothing more than what the secretary has said.

Senator COOK—Then it comes down to the continuing strength of the American and European economies as major export destinations for those North Asian economies of which we have spoken. What is Treasury's view of the future prospects of the American economy? Is it a view that growth will continue or that they will see what some have forecast as a correction in the near future?

Mr Evans—Our forecast on the US economy, which would be no different from anyone else's, or at least the mainstream forecasts, is that it will continue to grow at around its capacity rate. I said a moment ago that it has been confounding forecasters for at least a couple

of years by growing more strongly than capacity. Because of that, they have managed to get unemployment down to levels they have not seen since the 1960s. But, like others, we are quite impressed at the way that economy has been managed and see no reason to doubt those mainstream forecasts.

Senator COOK—Thank you. If I can just turn to South-East Asian economies, does Treasury have a view on how the IMF bailout of Thailand and Indonesia is progressing?

Mr Evans—The program in Thailand is going quite well. I mentioned Korea earlier; that is the third of the countries that actually have programs and it is doing exceptionally well. Thailand is also doing quite well. Indonesia is another matter. We all know that that has been primarily due to the unusual political situation in that country, unusual in the sense that there has been a change from a regime that had been in place for 30 years. Thirty years is a long time; hence political changes do not occur as smoothly as they do in a country such as ours. That makes that situation quite uncertain. Since the change of President, the IMF has been back there to negotiate again on a program, and they are very close to reaching agreement. One could not say anything much more certain about that situation other than that it will be the most difficult of all the countries to deal with, and it will take time.

Senator COOK—What do you see as the immediate return to positive growth prospects for Thailand?

Mr Johnston—This year we are expecting negative growth in Thailand for the calendar year 1998.

Senator COOK—And the out years?

Mr Johnston—A return to modest positive growth in calendar year 1999.

Senator COOK—To what extent are you expecting contraction of the Thai economy this year?

Mr Johnston—There are estimates around of minus three to minus five per cent. There is a range of estimates.

Senator COOK—So it is in that field; you cannot get any more specific than that?

Mr Johnston—There is a range of views out there. For example, the latest IMF forecast for Thailand for 1998 is minus 5.5 per cent.

Senator COOK—I think I share the secretary's—if I can use this word—confusion over what the likely events in Indonesia might be. Do you have a figure for Indonesia?

Mr Johnston—There are estimates in the range of minus 10 to minus 15 per cent for Indonesia. It is a dramatic contraction in calendar year 1998.

Senator COOK—One of the countries that was suffering difficulties but undertook its own reform process was Malaysia. Do you have a figure for this year's economic growth forecast for Malaysia?

Mr Johnston—For Malaysia, the IMF is still forecasting positive growth of 2.5 per cent in calendar year 1998. We have had a disappointing first quarter.

Senator COOK—It is not on track to fulfil that forecast?

Mr Johnston—It could struggle.

Mr Evans—I think the expectation is that the second quarter, that is the current quarter, might also be a negative figure, which would make the 2½ per cent look a bit optimistic.

Senator COOK—The Philippines also undertook some internal reform. What is your forecast for the Philippines?

Mr Johnston—The IMF has forecast the Philippines at 2.5 per cent. It is probably doing better than some of the other economies in the region.

Mr Evans—You could almost say that the Philippines is a success story to the extent to which it has held up during this period, of all the ASEAN countries, given that only a few years ago it was clearly the weakest of those countries. At the moment, it is doing very well, which I think reflects the fact that it has undertaken a rather long period of reform.

Senator COOK—One hopes the new administration will continue the pressure for meeting those demands. One of the other economies I am interested in is Hong Kong, which is in recession at the moment, I think. What is the forecast for Hong Kong?

Mr Johnston—The latest IMF forecast for Hong Kong is for three per cent growth in calendar year 1998.

Senator COOK—Three per cent?

Mr Johnston—Positive three per cent. Clearly, they are taking a very big hit at the moment.

Senator COOK—The economy of Taiwan is the stand-out; it has almost emerged through it all unscathed. What is its forecast for the year?

Mr Johnston—Five per cent is the latest IMF forecast.

Senator COOK—I neglected Singapore.

Mr Johnston—For Singapore, the latest IMF forecast is 3.5 per cent.

Senator COOK—These are figures that are a fair bit down on what would have been the case two years ago, but they reflect the general reduction in economic activity in the region. For ASEAN, do you take the view that their export economy is more important to Australia in terms of our exports than their domestic economy?

Mr Callaghan—I do not think it is to the same extent as the North-East Asian economies, in that the commodities are more important to North-East Asia, and a lot of those are inputs to their export sectors. But the export sector in ASEAN is also important; we do provide inputs into their exports.

Senator COOK—The Japanese economic growth rate to March was negative 0.5 per cent.

Mr Johnston—That is on an annualised basis.

Senator COOK—I think the Japanese expectation for the next 12 months is negative 0.75 per cent, yet we are seeing just a flat zero. We are not seeing any negative; we do not think it is going to dip into recession? Does that mean we differ with the Japanese view of what their likely future growth rate will be?

Mr Johnston—The outlook for Japanese growth in this calendar year has clearly deteriorated. But the fiscal package that they have announced is very substantial—it amounts to over three percentage points of GDP—and we should see quite a strong contribution in the second half of the year from that fiscal package. It could get us back to within striking distance of a flat year, zero growth.

Senator COOK—So do you rule out deflation in Japan as being a serious problem?

Mr Johnston—Deflation?

Senator COOK—Yes.

Mr Johnston—I do not know that—

Mr Evans—That is difficult to say for Japan. Confidence is a very big issue there. It is, on our reading, closely related to the problems in the banking sector, so it depends upon the action that is taken there, which is the reason, of course, why we, along with others, have been concerned that action is taken in the banking sector. If it is not—

Senator COOK—If it is not, that economy is in strife and so are we.

Mr Evans—If it is not, one could not rule out that growth will be even weaker than is currently being forecast.

Senator COOK—That is one part of it. The other part is the stimulus package. Why do you think the stimulus package might work this time when it has not worked in the past?

Mr Johnston—I think the past experience is that these packages have had some impact, and this is a very substantial package so I think the sheer size of this package suggests that we should get quite a strong contribution of growth in this calendar year, in the second half of the year.

Senator COOK—Does Treasury support the Japanese government's proposal to establish a new bank to take over all the bad loan problems within the Japanese banking system? Is that part of a process of getting to reform this system, or not?

Mr Evans—I do not think it is appropriate for me to comment on the details of what is right and what is wrong there. It is a very complex situation. I think the Japanese authorities understand what is needed. Beyond general comments about dealing with their non-performing loans, about ensuring that they are removed from the books of banks that are otherwise sound so that they can resume lending, which is a big part of the problem, and that the assets that lie behind them as collateral are got back onto the market at realistic prices, I would not go into details. That is the basic economics of it, but the mechanisms that might be used to achieve those outcomes are best decided by the experts on the spot, I think.

Senator COOK—How much time do you think is a reasonable time to see whether the reforms are beginning to bite and the changes are beginning to be made?

Mr Evans—I mentioned earlier that in the meeting that took place last weekend the view was expressed there that these matters needed to be dealt with with the highest urgency. That was as specific as the Japanese were prepared to commit themselves. But that is pretty specific, I would say.

Senator COOK—Would you agree that if it is perceived that there is any slowness or dilatoriness or lack of resolve to press through with these reforms, there will be another attack on the yen?

Mr Evans—I do not want to speculate on the currency. I just would repeat that it does need to be dealt with as a matter of urgency.

Senator COOK—Many commentators recently have been saying that the Australian dollar tracks the yen in terms of currency movements. I do not know whether a question to you about whether you agree with that intrudes on your refusal to comment on or speculate about exchange rates, but I will ask it anyway: do you think that is right, that it largely tracks the performance of the yen?

Mr Evans—It is a matter of fact that, for the last 12 months, Australia has followed the yen more closely than it has previously, to the best of my knowledge. That is an unusual development. Interestingly, since the yen began to weaken again in recent days, that has not

been the case. We have actually strengthened against the yen. Those are very short-term movements, of course, but it does show that there are questions in the markets' minds about the two currencies, whereas over a period of 12 months, we have been dragged down with the yen and that has not been the case in the most recent period.

Senator BISHOP—You said that in the last 12 months the Australian dollar had closely tracked the Japanese yen. Prior to that, there had been a rough correlation with the US dollar for many years. Why has there been that apparently radical change in that 12 month period?

Mr Evans—No more than the very significance of what is happening in Asia, and Australia being seen—perhaps more so than it ought—to be closely linked to Asia. With the yen in particular being the major currency in Asia, the markets have put us more in that camp than in the US dollar camp. It is not completely unexpected. Most things in exchange markets are unexpected. They are never forecast. Looking at it in retrospect, one can rationalise it.

Senator BISHOP—In light of that earlier discussion we had concerning the diversification of our exports, Mr Callaghan explained it in some detail. With regard to that attachment of our dollar to the yen correlation, do you think that is a correct reading by the markets or do you think that that is open to further review?

Mr Evans—Australia has a very different economy from that of Japan. Japan has some specific structural problems of long standing. The Japanese economy has scarcely grown during this decade, apart from one year—I think it was 1995—when there was a sizeable fiscal stimulus which lifted growth to around four per cent, from memory. That year apart, there has been virtually no growth in that economy. That is very different from Australia. We do not have the banking system problems. So to align those two currencies makes very little sense at all. But markets, as I say, look at Asia in toto.

Senator COOK—Is there any explanation, do you think, for why the Australian dollar is no longer tracking the yen—why that change has occurred?

Mr Evans—I do not have one.

Senator COOK—I understand that the Japanese forecast for their own economy for the next 12 months is negative 0.17 per cent. The IMF thinks it is going to be zero. For an economy the size of Japan's, that is quite a big difference, in Australian terms. Is there any explanation as to why there is such a wide difference of opinion on this?

Mr Johnston—It is not a wide difference of opinion. We are talking about a quarter of a percentage point.

Senator COOK—It is 0.7 of one per cent; I would have thought that is a fairly wide difference. I have just been told it is 0.95 per cent. Do you have a figure there of what the Japanese themselves have forecast?

Mr Johnston—No, I do not have the latest figure with me.

Senator COOK—Could you obtain that for the committee?

Mr Johnston—Certainly.

Senator COOK—Thank you very much. I wonder if the department could comment on the European Monetary Union and how that is progressing in Europe—in particular, what does it mean to Australia?

Mr Johnston—We can just offer a few broad comments. Firstly, it is obviously on track. Secondly, we have seen very rapid progress in terms of fiscal consolidation among countries that will join the union. Most importantly for Australia, this offers us a layer of comfort in

the sense that the fiscal repair that we have seen in Europe adds to the strength of their economic fundamentals. We are now seeing growth in Europe gather momentum—broadly based, strong, private consumption expenditure and the signs of a consolidation of investment expenditure as well.

Senator COOK—You were commenting on what importance this has to Australia.

Mr Johnston—It is important for Australia in the sense that it is an anchor of strength in a troubled global economy and it has helped underpin a good outlook for Europe over the next couple of years.

Senator COOK—Just turning to New Zealand, I understand New Zealand has forecast a current account deficit of about eight per cent of GDP this year, which is, of course, higher than many of the Asian countries faced before the current currency crisis. What do we have to say about the outlook for the New Zealand economy?

Mr Johnston—The forecast for the current account deficit has been around for some time and there are some one-off peculiarities that New Zealand are struggling with related to interest income flows into New Zealand and servicing of their debt and dividend outflows. New Zealand has been struggling with a domestic economy that is weakening a little, at the same as they are also seeing some impact from the regional crisis.

Senator COOK—Do you see that current steps in place in New Zealand are going to reduce that eight per cent current account deficit?

Mr Johnston—Well, it is the government's forecast that they will have a current account deficit of around eight per cent with the current policy settings.

Senator COOK—You do not see any immediate possibility of that coming down, though, is my question?

Mr Evans—I think their latest quarterly figure was released only within the last day or so and it actually came in noticeably below expectations. The figure was about seven—

Mr Johnston—I think it was 7.2.

Senator BISHOP—I thought they said last night that the current account in New Zealand was worse than they expected—it blew out to 8.2. Are you saying 7.2?

Mr Johnston—Yes, 7.2. I can check on that figure for you.

Senator COOK—Some have forecast that the New Zealand economy and the Vietnamese economy might be the next to succumb in Asia. Do you have any comment on that?

Mr Johnston—No, I do not; I do not think I want to comment on that. I do not think it would be helpful.

Senator Kemp—I think the officer has quoted some figures for those economies and I certainly endorse his view. That is probably sufficient.

Senator COOK—Have there been any more recent appointments to international bodies such as the European Bank of Reconstruction or the Asian Development Bank since we last met as a full-blown estimates committee?

Mr Evans—No, Senator.

ACTING CHAIR—There are talented people there already.

Senator COOK—At the last estimates round, we asked some questions about Mr Baker's appointment to the Asian Development Bank and his salary was then given as \$US126,190 tax free plus other benefits. Can you tell us what the other benefits are?

Mr Evans—We would have to take that on notice, Senator. We would not have that information with us.

Senator BISHOP—I have one or two questions arising out of chart 9, 3-17, the trend total factor productivity growth in the non-farm market sector. We had a discussion in this year's budget paper—and in last year's budget paper there is also a lengthy discussion—on the significance of those charts: is that trend line continuing in terms of growth?

Mr Callaghan—We are still seeing very strong productivity improvement, Senator. That trend line is over a long period and, of course, it would be updated as we see more data but we are certainly seeing continued strong productivity growth.

Senator BISHOP—There is no suggestion at this stage of it stabilising or reverting?

Mr Callaghan—Still strong productivity growth, Senator.

ACTING CHAIR—That completes section 1.2, International economy. We now move to subprogram 1.3, Structural policy.

[10.32 p.m.]

Subprogram 1.3—Structural policy

Senator COOK—Let me start with a free kick. Lately, I have heard a lot of commentary in the media about national competition policy being the cause of dissatisfaction and dislocation in the Australian economy: is that the view of Treasury? What is the definitive reply to these critics?

Mr Cassidy—In a sense, the national competition policy is responding to a whole host of forces which are now upon the Australian economy. My answer to that question would be that the ultimate cause of dissatisfaction is, in fact, those forces that are upon us rather than the policies that are trying to deal with them.

Senator COOK—So what do I say, Mr Cassidy? I was in a televised debate on SBS this afternoon with a number of people, including Mr Anderson, the Minister for Primary Industries and Energy; Mr Philip Cleary, who is an independent Senate candidate, I understand, from Victoria; and a gentleman who was announced as the One Nation spokesman on agriculture. The subject was free trade versus protection, I might say. I found myself on the same side, interestingly enough, as the government minister.

Senator Kemp—A sensible position to be in, Senator.

Senator COOK—I should put it the other way around. He was on the same side as me, because in this debate, he did laud a number of things that we did when we were in government.

Senator Kemp—It is true, Senator, that I do not think I have always been your greatest fan, but I am much consoled by the comments you have just made.

Senator COOK—In this debate, he was on the same side as I was. That is the way I should have put it. However, irrespective of the niceties of it, what was said in that debate by the One Nation spokesman—this is a popular sentiment and I just wonder whether Treasury has a comment to make about it—was that the real evil in Australia is national competition policy, that it is what has to be stopped. Do you have anything to say to those sorts of critics?

Mr Evans—Senator, I could just make a general comment. This is basically a policy issue. If you will interpret a comment from me as a technical comment, I think in straight economic terms that is just a nonsense statement. The competition policy, as Mr Cassidy said a moment ago, is directed at ensuring that Australia is competitive so that it can cope with what is

happening in the world that we live in and that we cannot isolate ourselves from and, indeed, would not want to isolate ourselves from. It may be less than perfect in terms of doing that and of coping with those changes, so some of those changes will still have their effects upon various industries in Australia. But the direction of the policy and its effects in terms of lowering costs for Australian businesses and helping them compete is beyond dispute.

Senator COOK—Do you have anything to add, since there is a policy dimension to this, Minister? How would you answer this critic?

Senator Kemp—Senator, as you know, the previous government initiated some major initiatives in competition policy and signed agreements with the states. Undoubtedly, you supported that position. Clearly, as the secretary said, if we want Australia to be a productive economy and to be able to compete, we have to make sure that we have an economy which can achieve those goals. That is one of the arguments of competition policy. The aim is, of course, to assist growth in the economy and to assist prosperity for our people. It is something that the previous government supported and it is something this government supports.

Senator COOK—What do you say to those people who claim to have been injured by national competition policy—by the loss of their jobs or—

Senator Kemp—You would have to look at each particular case. You would have to look at the particular claims that those individuals have made. I do not wish to make a general comment on it but clearly, if people feel they have particular concerns, there are mechanisms within competition policy to deal with those.

Senator COOK—Do you think the pace of the implementation of national competition policy is too swift?

Senator Kemp—I think the truth of the matter is that, in the agreements that were signed with the states, there were various agreed steps that would be undertaken. We supported competition policy, as you supported competition policy, because we believed that the policy would be to the overall benefit of our people. But if there are particular groups that feel they have been injured, one would always need to look at those particular claims. I think we are seeing some pluses in the productivity performance of the Australian economy. I think we are seeing now that the Australian economy, from a structural point of view, has made some very important gains.

Senator COOK—Do you think that more should be done to explain what the purpose of the national competition policy is?

Senator Kemp—I think all of us have probably got an onus on us to make that clear. It is one of the dilemmas of politics to make sure that people do understand what you are trying to achieve. I think you and I and others in our profession do have an obligation to do that. If you ask me whether we have in all cases succeeded, I think the answer is that we have not succeeded in all cases. Therefore, where people have particular concerns, I think it is important that what we are trying to do is explained to them.

Senator COOK—Does that mean, Minister, we can expect in the next couple of weeks you will be taking up the cudgels to the now articulated opposition to national competition policy and, if you like, engaging in the debate and explaining the merits of it?

Senator Kemp—Senator, because you and I obviously have a shared position on some of these matters, I look forward to getting some questions in the Senate from you on that matter. I think you will be well pleased with the responses I give—as you always are.

Senator COOK—I have to say I will disappoint you in that sense because my questions are not about things that we might agree on. My questions are generally about things we do not agree on.

Senator Kemp—This is a chance to deal with something where there seems to be a more bipartisan approach.

Senator COOK—But the Senate is one arena. What I am asking is: in terms of the public out there that do not listen to Senate broadcasts and do not wait for question time every day for their news feed or for their enlightenment, can we expect you to take this message to the wider community?

Senator Kemp—Of course I have quite a number of messages, in my role as Assistant Treasurer, to take to the wider community, but where the opportunity presents itself, Senator, of course I will.

Senator COOK—Good, I look forward to it. A couple of state premiers recently have announced their intention to do things such as sourcing government purchasing from within their own state and not from within the nation. Is that consistent with national competition policy?

Senator Kemp—I would have to look closely to what they have in fact said. I would not want to make statements that may be misinterpreted. So the first thing I would do if you said that some premiers are making those statements would be to look closely at what precisely was said.

Senator COOK—The Treasury, I think, advises the government on NCC recommendations on national competition policy payments to the states. Are the states satisfied that they are receiving sufficient remuneration as a counterweight to the cost of implementing national competition policy reforms?

Mr Cassidy—I am not aware of any complaint from the states that the amount of money they are receiving from the Commonwealth is inadequate. The money was agreed at the COAG meeting in April 1995 between the Commonwealth and the states and is set out in one of the competition agreements. The money encompasses both the competition payments themselves and also the per capita element of the real per capita guarantee of the financial assistance grants, because the per capita component of that was extended at the same time. When you take those two together, it is a considerable amount of money that the states and territories are getting on condition that they implement the agreed elements of a national competition policy. I am not aware of any suggestions that that money is inadequate for what they are doing.

Senator COOK—Okay. Is the Commonwealth happy about the way in which the states are going about implementing national competition policy reforms? Are they doing the job they committed themselves to do, in the Commonwealth's view?

Mr Cassidy—We basically rely on the NCC to make that assessment. The NCC was basically happy with the states' performance as at the end of 1996-97 and the Commonwealth Treasurer agreed with the recommendations that were put to him by the NCC at that stage in terms of the payments to the states. The NCC is due to make another set of recommendations to the Treasurer within the next few days on the states' performance during the financial year 1997-98 and whether they should get their competition payments in respect of 1998-99. So it will really be, in the first instance, a matter of seeing what the NCC's assessment is of the performance of the states and territories.

Senator COOK—When will you have that?

Mr Cassidy—As I say, it is due to be provided to the Treasurer by the end of this financial year.

Senator COOK—Thank you. I have no further questions.

ACTING CHAIR—As there are no further questions, that completes subprogram 1.3 and also completes the consideration of the Treasury estimates. Thank you, Minister, and thank you Mr Evans and your officers.

Senator COOK—I would just like to thank the Treasury officers and apologise for any inconvenience that may have been caused. We have not gone on to complete all of the estimates, but this is consistent with the arrangement I did enter into with the government.

Senator Kemp—That comment is certainly appreciated. I think my own particular concerns were made well known at the start of this evening.

Committee adjourned at 10.46 p.m.