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1998

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AUSTRALIA

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1997-1998

AUSTRALIA

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

– to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
– to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
– to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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Publié également en français.

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BASIC STATISTICS OF AUSTRALIA

THE LAND

Area (1 000 sq.km)	7 682.3	Population of major cities, 1995 (1 000):	
Agricultural area, 1986-87, per cent of total	61	Sydney	3 770
Urban population, 1991, per cent of total	85	Melbourne	3 217
		Brisbane	1 489
		Perth	1 262
		Adelaide	1 081

THE PEOPLE

Population, June 1996 (1 000)	18 289	Civilian employment, 1996 (1 000)	8 344
Number of inhabitants per sq.km	2.4	*of which:* Agriculture	424
Natural increase, 1996 (1 000)	125	Industry[1]	1 877
Net migration, 1996 (1 000)	111	Other activities	6 043

PARLIAMENT AND GOVERNMENT

Composition of Parliament following latest elections:

Party	Senate	House of Representatives
Australian Democrats	7	–
Australian Labor Party	29	49
Independent	1	5
Greens	2	–
Liberal Party of Australia	31	75
National Party of Australia	5	18
Country Liberal Party	1	1
Total	76	148

Present government: Liberal/National Party coalition

Next general elections for House of Representatives: March 1999

PRODUCTION

Gross domestic product, 1996 (A$ million)	499 548	Gross fixed capital formation, 1996 Percentage of GDP	20.1

GENERAL GOVERNMENT SECTOR, PER CENT OF GDP, 1996

Current disbursement	35.6	Current revenue	35.2
Current transfers	13.5	*of which:* Direct taxes	17.8

FOREIGN TRADE

Main exports, 1996, per cent of total:		Main imports, 1996, per cent of total:	
Food, beverages and tobacco	21.4	Food, beverages and tobacco	4.4
Raw materials	19.7	Raw materials	2.3
Fuels	16.8	Fuels	6.2
Machinery and transport equipment	12.9	Machinery and transport equipment	47.0
Other manufactured products	29.2	Other manufactured products	40.1

THE CURRENCY

Monetary unit: Australian dollar		Currency unit per US dollar, average of daily figures:	
		Year 1996	1.2769
		October 1997	1.3880

1. Including mining, electricity, gas and water, and construction.

Note: An international comparison of certain basic statistics is given in an annex table.

This Survey is based on the Secretariat's study prepared for the annual review of Australia by the Economic and Development Review Committee on 13 November 1997.

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After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 26 November 1997.

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The previous Survey of Australia was issued in December 1996.

Assessment and recommendations

The medium-term growth record is very good but the pace of job creation has slackened since mid-1995

Australia's economic growth record in the 1990s is among the best in the OECD area. Over the six years of the current economic upswing, output growth averaged about $3\frac{1}{2}$ per cent, taking seasonally-adjusted real GDP in mid-1997 to a level some $21\frac{1}{2}$ per cent above its previous cyclical peak. Hourly productivity of the non-farm sector grew by an average annual rate of $1\frac{3}{4}$ per cent, which compares favourably with the average rate of 1 per cent during the first six years of the upswing of the 1980s. Growth slowed down somewhat in the second half of 1996, but picked up in 1997. The mild and brief weakening of economic activity confirms the notion that the current upswing is steadier than the expansion periods in the 1970s and 1980s, which were both interrupted by more severe mid-cycle slowdowns. However, the pace of job creation has slackened since mid-1995. In part this is a result of the surge in wages in 1995 to 1996 and the recent slowing of aggregate demand. Low employment growth has left the rate of unemployment broadly unchanged at around $8\frac{1}{2}$ per cent since the middle of 1995, after the steep decline from its post-war record of over 11 per cent in late 1993.

And the absence of strong inflationary pressures has contributed to the steady recovery

The steadiness of the current recovery owes much to the absence of strong inflationary pressures, achieved mainly through a forward-looking approach to monetary policy. Cash rates were raised substantially in the second half of 1994 to counter anticipated inflationary pressures, even though actual inflation remained low. Stability of costs and prices was further promoted by intensified competition in goods and services markets ensuing from the strength of the Australian dollar exchange rate and the ongoing deregulation of sheltered domestic service sectors. Private sector wage increases have fallen from an annual rate of around 6 per cent during 1995 to 4 per cent in the year to the third quarter of 1997. This, together with the exchange rate appreciation and strong productivity growth, has contributed to a decline in underlying inflation from 3.3 per cent in the year to the first quarter of 1996 to 1.5 per cent in the year to the third quarter of 1997, below the official medium-term target of 2 to 3 per cent. Consumers' inflation expectations have fallen correspondingly, from $4^1/_2$ per cent or higher in 1995 to around the top of the official target band. Long-term inflation expectations in financial markets are now around the middle of the target band. Taken together, this signals an important gain in credibility for the Reserve Bank and hence lower costs of anti-inflationary monetary policy in terms of lost output and employment.

Monetary policy has shifted from a restrictive – to a moderately expansionary stance

By the middle of 1996, the short-term economic outlook had weakened and inflation was falling quickly. In these circumstances, it was possible to ease monetary policy to support economic activity without jeopardising achievement of the inflation target. The Reserve Bank cut the cash rate on five occasions by a cumulative 2.5 percentage points from July 1996 to the end of July 1997, to a level of 5 per cent, and interest rates declined correspondingly across all maturities. Monetary conditions at present can be judged moderately expansionary, and the transmission from easier monetary conditions to stronger growth of credit and loan commitments is becoming more evident. Although some pick-up in price pressures can be expected next year, the rate of underlying inflation is likely to stay within the official medium-term target band of 2 to 3 per cent.

Fiscal consolidation has been maintained

Fiscal policy continues to be set in the context of the medium-term framework established in the Commonwealth Government's FY 1996/97 budget. The medium-term objective is underlying budget balance on average over the course of the economic cycle. The major element of the Government's programme of fiscal consolidation was provided in the FY 1996/97 budget, with a range of measures to be implemented over two years expected to reduce the deficit by 0.8 per cent of GDP in FY 1996/97 and 1.3 per cent of GDP in FY 1997/98. The FY 1997-98 budget, delivered 9 months later, was intended to ensure that the Commonwealth budget remained on a path consistent with the Government's announced medium-term objective and the shorter-term target of an underlying budget surplus by FY 1998/99. To this end, it incorporated an additional package of measures which preserved the fiscal consolidation already in train for FY 1997/98 while adding to the tightening in the out-years.

Despite a lower-than-forecast deficit in FY 1996/97, fiscal repair efforts must be sustained

The Commonwealth underlying budget deficit fell substantially in FY 1996/97, to A$ 4.9 billion (1.0 per cent of GDP). This was 0.4 per cent of GDP less than estimated in the FY 1997/98 budget. On the basis of the estimates in the FY 1997/98 budget, the underlying budget balance is officially projected to reach a small surplus in FY 1998/99, rising to 1.6 per cent of GDP in FY 2000/01. In the period ahead, the Government will need to ensure that fiscal policy remains focused on the medium term. In particular, if the Government is to attain its objective of balance over the cycle, the structural tightening undertaken in recent years will need to be kept fully in place, and significant surpluses will need to be achieved while economic growth prospects remain favourable.

Stronger output growth and lower unemployment are in prospect

On the basis of the setting of macroeconomic policies discussed above, output growth is projected to accelerate steadily to around $3\frac{3}{4}$ per cent in 1999. This mainly reflects a strengthening in consumption expenditure. Employment growth should pick up from around 1 per cent this year to $2\frac{1}{4}$ per cent in 1999, reducing the unemployment rate to $7\frac{1}{2}$ per cent. This reduction in unemployment may contribute to a small increase in the growth in wage rates. This, together with the passing of the effects of exchange rate appreciation and a slowing in productivity growth, underpins a small projected rise in inflation to 2 per cent in 1998 and 1999. The current external deficit is projected to rise to around 4 per cent of GDP in 1998 and 1999, reflecting the lingering problem of insufficient national savings.

But developments in Asia pose a risk.

The major risks surrounding these central projections concern the effects of recent financial market turbulence in Asian countries, which altogether account for almost 60 per cent of Australia's exports. While the projections already embody a more subdued outlook for growth in these countries, there is a significant risk of this outlook deteriorating further, especially in Japan and Korea. There is also considerable uncertainty about the likely severity of the possible drought in eastern Australia. However, there has been good rainfall recently and any effects of a drought would be modest as farm product makes up less than 5 per cent of GDP. Recent developments in global financial markets underline the importance of measures taken to raise national saving, in particular fiscal consolidation.

Further reform was made to industrial relations ...

Strong economic growth alone will prove insufficient to bring unemployment down to socially acceptable levels, if not assisted by policies along the lines of the *OECD Jobs Study* to reduce structural impediments to job creation. The *Workplace Relations Act 1996,* which came into effect at the beginning of 1997 addresses major shortcomings of previous legislation which aimed at a more flexible and adaptable labour market. The *Act* aims at further facilitating the transition to enterprise bargaining, mainly by restricting awards to a safety net of minimum wages and other core conditions of employment, and by providing more effective choice and flexibility for parties in reaching enterprise agreements. The new individual employment agreements (Australian Workplace Agreements), which are made between an employer and an individual employee, and collective non-union certified agreements, should provide a more effective way than hitherto to introduce enterprise bargaining in lightly or non-unionised workplaces. Employees may appoint a bargaining agent (which may be a union) to negotiate on their behalf, but the *Act* rules out uninvited union involvement. More effective limits on industrial action have been introduced. Secondary boycott provisions under trade practices legislation have been restored and while there is a limited right to strike or lock out while negotiating agreements, this does not apply during the period of an agreement's operation. Furthermore, arrangements that had previously sheltered unions from competition, such as 'closed union shops', have been abolished. Notification of proposed industrial action is required and strike pay is prohibited. The more balanced industrial relations framework should contribute to better labour market outcomes and lower structural unemployment. A more flexible labour market will also assist Australia to adjust successfully to sudden changes in its terms of trade or in prospects in major export markets.

... and unfair dismissal legislation

Out of concern that changes made to the unfair dismissal legislation in 1993 may have created severe disincentives to hiring workers, particularly in small firms, the new government simplified the federal unfair dismissal legislation on the basis of a "fair go all round" from the beginning of 1997. Its aim is to minimise legal costs and discourage frivolous and malicious claims. But as compliance with unfair dismissal provisions may have a larger impact on the behaviour of small business, including a negative impact on hiring, legislation has currently been put before Parliament seeking to exempt new employees of small businesses from unfair dismissal legislation.

But concerns remain about the effect of the award system on labour market flexibility

While the *Workplace Relations Act 1996* represents a significant advance in industrial relations arrangements, it retains core elements of the previous industrial relations system: awards continue to play a significant role as a benchmark against which the new global "no-disadvantage test" of workplace agreements is conducted, and there remain arbitral powers of the Industrial Relations Commission, especially the power of compulsory arbitration over award minima. All this entails the risk that awards continue to constrain direct negotiations, dictate many working arrangements, limit wage dispersion and tend to make many registered enterprise agreements *de facto* "add-ons" to existing awards rather than comprehensive agreements reflecting the reality of the workplace. However, as employers become more familiar with the new industrial relations framework and take full advantage of the opportunities created by the new legislation, workplace flexibility should increase. That said, the dual system of federal and state industrial laws and tribunals remains complex and burdensome, in spite of the recent transfer of a large part of the Victorian Government's industrial relations powers to the Commonwealth Government and the adoption of mirror legislation in Queensland. A consequence of the gradual approach to reform is that it may take time for the positive effects of the new *Act* on employment to show up.

Reforms to strengthen apprenticeship training are being made

The *Workplace Relations Act 1996* also made apprenticeships more attractive to employers by enabling them to enter into agreements with apprentices in which they are only paid for time spent on the job in productive work. Wage top-ups are paid by the Government from January 1998 to ensure that full-time trainees and apprentices have an income which does not fall below a minimum amount. Complementing these reforms is the move to allocate all government funding for off-the-job training of apprentices and trainees on the basis of "user choice" from the beginning of 1998. "User choice", which means that employers are able to choose the nature of training, where it should be provided and by whom, should improve the efficiency with which apprenticeship training is provided and, in particular, its relevance to workplace requirements.

Radical change in labour market assistance is being put into place

The new government announced in the FY 1996/97 budget a radical reform to all areas of labour market assistance aimed at increasing its efficiency. The reform involved institutional reorganisation and increased private-sector involvement. The focus on the long-term unemployed and on those most at risk of becoming so is maintained. The Government has deferred the introduction of the competitive employment services market from December 1997 to May 1998 following delays with Parliamentary consideration of the draft legislation. During the transition to the new employment service arrangements, existing labour market programmes will continue though with significant changes and improvements in keeping with the direction of the Government's reforms. The reform looks a promising one, though only experience will reveal to what extent the planned arrangements will produce better outcomes for the unemployed.

Implementation of the Hilmer reforms is progressing well ...

Important progress has been made in 1996 and 1997 in implementing the national competition policy along the lines of the Hilmer Committee's recommendation of 1993 to apply the Trade Practices Act – Australia's main competition policy statute – to all business activities in Australia. A National Competition Council was formed in 1995 to provide independent advice to the Commonwealth, State and Territory governments with respect to the application of structural reform, competitive neutrality, third party access, monopoly pricing oversight and regulatory review principles. The competition policy reform includes sector-specific agreements on electricity, gas, water and road transport and defines a number of reform objectives for the period to the year 2000. As of July 1996, Commonwealth, State and Territory legislation came into effect to apply the competitive conduct rules of the Trade Practices Act to the unincorporated sector and State and local government businesses. The Commonwealth and each of the States had also published their respective 1996/97 policy statements on the application of agreed competitive neutrality principles, the application of national competition policy at the local government level, and the review of legislation to identify and, where appropriate, reform provisions that create anti-competitive effects. Other infrastructure areas have also been deregulated, such as telecommunications, the aviation market and the operation of airports. But major reforms are still needed in the shipping industries and waterfront, the market for postal services, and for railway services, all of which suffer from inefficiencies due to restrictive practices and lack of competition. In this regard, postal services are currently being reviewed and the rail industry restructured and partly privatised.

... but demands for a slowdown in other reforms should be resisted

In June 1997 the Government decided to maintain passenger motor vehicle tariffs at 15 per cent between the years 2000 and 2004, before reducing them to 10 per cent on 1 January 2005. And in September the Government decided on a broadly parallel tariff pause from 2000/04 for the textile, clothing and footwear industries. These decisions maintain Australia’s commitment to its APEC obligations, and should also be assessed in the context of substantial falls in tariffs in these industries over the last decade (which will continue until the year 2000). Nevertheless, efficiency gains could be achieved by accelerating tariff reductions in the post-2000 period. Although the Government insists that this decision is not a departure from its resolve to move Australia towards a freer trading environment, the decision risks encouraging other industries to call for a slowdown of the pace of trade liberalisation or even for increased industry assistance. Such demands must be resisted in the interests of improving Australia's long-term economic performance.

Some progress has also been made in addressing expenditure pressures in health care

As in other OECD countries, there have been persistent pressures in Australia for increased health expenditures. Major causes of these pressures have been fee-for-service payment arrangements for medical services and a lack of incentives for public hospitals to improve the efficiency of service delivery. The spread of casemix funding (*i.e.* payment for a treatment episode on the basis of average expected costs) of public hospitals and of their out-patient departments in recent years addresses both issues, at least in part. Measures have also been taken or are being considered to increase participation in private health insurance. (It serves as a top up to the compulsory public scheme – Medicare – and as such, reduces claims on the public scheme). However, unless community rating is abolished or at least replaced by lifetime community rating, participation in private health insurance is unlikely to rise significantly.

Planned reforms to the financial system should enhance efficiency

Following the recommendations of the Financial System Inquiry, the Government has announced a comprehensive set of financial system reforms. These are aimed at increasing competition and improving efficiency while preserving the integrity, security and fairness of the financial system. The existing institution-based regulators are to be replaced by three agencies whose responsibilities will extend across the financial system. This is a path-breaking response to recent and prospective developments in the financial sector, including the blurring of the boundaries between financial instruments and institutions, especially through activities of conglomerates, increasing competition from non-financial institutions and from abroad and the substitution of financial market transactions for direct financial intermediation.

Tax reform should be pursued

Comprehensive tax reform has returned to the political agenda. The priority in any such reform must be to replace the existing array of indirect taxes with a general sales tax. This would substantially reduce the present high efficiency costs of indirect taxation and protect this base from continued erosion. Arguments that a move to a broad based indirect tax should be made simply because Australia raises an unusually small proportion of tax revenue from indirect taxes are false: this proportion in Australia is about the same as the OECD average. The related issue of Commonwealth/State financial relations has been identified by the Commonwealth as one that must be addressed in the context of tax reform. Efforts should be made to reduce the already large vertical fiscal imbalance so that voters can better assess both the costs and the benefits of State government expenditures. These issues are being considered by a task force and were recently discussed by Australian Heads of Government.

Laws on corporate governance are being re-examined

Corporate governance – the mechanisms by which those who control an enterprise's on-going operations are held accountable – has been an especially important policy issue in Australia since the late 1980s, when a number of spectacular corporate collapses focused attention on the adequacy of regulation. Many of these collapses involved various kinds of fraud, related-party transactions and misleading financial disclosure. There was widespread concern at the time that such practices were undermining investor confidence in Australian companies, raising their cost of capital. The Corporations Law enacted in 1989-90 and subsequently refined included numerous provisions aimed at curtailing such practices. Similarly, developments in common law in recent years have also added to the weight of obligations on those responsible for the governance of enterprises. While there is little doubt that some tightening in regulation was required, there is now a concern that this may have gone too far. The current regulatory framework is being re-examined in the context of the Corporate Law Economic Reform Program (CLERP) with a view to assessing whether it represents a reasonable balance between the costs and benefits of regulation and, if change is needed, to identifying reform priorities. Each of the corporate governance issues discussed below is being examined under the Reform Program which is being advanced by the release of a series of issues papers.

A "business judgement" rule is needed

Given the central role of boards in Australia's system of corporate governance, the legal duties of directors have been an issue of ongoing concern. These duties have become increasingly onerous in recent years, mainly as a result of developments in common law. There is a perception that directors are now substantially more likely to find that conduct entered into in good faith will be regarded as culpable. This trend is costly as it increases the risks associated with being a director and encourages directors to adopt excessively cautious strategies. These problems could be resolved by introducing a "business judgement" rule. Such a rule, which is an accepted part of US corporate law, would explicitly relieve directors of liability for decisions made in good faith and through an orderly and proper deliberative process. This could be complemented by the introduction of a statutory derivative action, which would allow shareholders to sue in the name of the company for corporate misbehaviour, and so provide them with an additional remedy.

Regulatory barriers to institutional shareholder activism should be removed...

The potential for shareholder activism to secure changes which enhance corporate profitability has increased in recent years with the growing importance of institutional shareholders. Their large shareholdings yield economies of scale and scope in such activism. However, the Corporations Law is perceived to impede Australian institutions, which typically hold a substantial proportion of the shares in any major listed company, from co-ordinating their efforts to secure improved corporate performance. The Law should be clarified to remove any inappropriate barriers to shareholder activism.

as should unuseful impediments to take-overs

An active market for corporate control is an important mechanism in Australia, as in other (mainly English-speaking) countries with comparable institutional arrangements, for ensuring that resources are managed by those able to make best use of them. However, take-overs in Australia are limited by a requirement for bidders holding 20 per cent of any class of shares in a company to make an unrestricted bid for all of the remaining shares in that class. This discourages take-overs by forcing bidders to share the “control premium”, which reflects the expected benefits of making the company more profitable, with all shareholders. These provisions were introduced, among other things, to ensure that all shareholders have reasonable and equal opportunities to participate in benefits accruing to shareholders under any proposal enabling a person to acquire a substantial interest in a company. Experience with these provisions over more than fifteen years suggests that their present operation unnecessarily impedes takeovers. It would now be appropriate to conduct a review of their operation to ensure that they best serve the wider economic interests of Australia in having an efficient market for corporate control.

But the case for some other reforms is mixed

Calls are also frequently made for a number of other reforms in corporate governance arrangements. One of these is to regulate for the number of truly independent directors (in the sense of having no substantial link to the company other than through their ownership interest) on a board. While independence enhances directors’ incentives to monitor managers in the interests of shareholders, this may come at the cost of being less well informed about the company from the point of view of an on-going supplier or consumer of its products. In view of this trade-off, the flexibility in current arrangements to adapt the use of independent directors to a company’s individual situation would seem to be appropriate. Reforms in accounting standards are also being considered. These involve moving towards the use of current cost accounting and adopting international accounting standards. In practice, however, Australian accounting standards already make extensive use of current cost concepts and it is not clear that investors would gain valuable additional information from an enforced move to greater reliance on current cost information. Moreover, this goal could well be in conflict with that of adopting international standards as Australia already makes greater use of current cost concepts than most other countries. With respect to adopting international accounting standards, this will only be of value if they are also adopted in major capital markets and are not watered down to the lowest common denominator to achieve international acceptance.

Continued market oriented reform will enhance entrepreneurship

The proposed changes in the corporate law go in the direction of encouraging the managers and directors of larger companies to become more entrepreneurial. Enhanced entrepreneurial spirit will assist Australia to flourish as a dynamic, wealthy nation. The market-oriented reforms of the last decade have no doubt animated entrepreneurial spirit, and this policy direction should be maintained. Among the few specific areas where improvement will be of particular help to company creation and growth are a reduction in compliance costs as regards taxation and regulation and increased intermediation of risk capital. In both areas the initiatives already taken as well as proposed by the Government are welcome. As well, there is a need to streamline the existing business support programmes into a selected number of areas where market failure is detectable, as pointed out by the recently released Mortimer Report. However, some of the specific recommendations of the Report, notably an investment fund to provide higher subsidies to attract foreign companies, run counter to the general thrust of structural reforms to increase the efficiency of the Australian economy.

A wrap-up

Australia's economic performance in the 1990s has far surpassed that of most other OECD countries. There have been six years of solid growth, unemployment has fallen, inflation has remained low and productivity growth has picked up markedly from the rates recorded during the last economic expansion. In addition, significant progress is now being made in fiscal consolidation by means of expenditure restraint. While unemployment has fallen, it remains high for this stage of the cycle and compared with countries with more flexible labour markets. The labour-market reforms introduced by the Government a year ago should help to reduce structural unemployment in time but further reforms are likely to be required to achieve the best results. There is also a number of other structural reforms which could be made to stimulate dynamism in the Australian economy. Provided that these opportunities are embraced, Australia can look forward to on-going solid growth in living standards and lower structural unemployment.

I. Recent trends and short-term prospects

Re-accelerating output growth

Growth of real GDP[1] slowed from 3.8 per cent in fiscal year[2] (FY) 1995/96 to 2.5 per cent in FY 1996/97 with the slackening concentrated in the first half of the fiscal year (Table 1). Such mid-cycle slowdowns have also been observed in the preceding two economic upswings of the 1970s and 1980s, though they were more pronounced in both cases than this time. With activity in the first half of 1996 buoyant enough to compensate for the moderation in the second half, the growth slowdown does not show up in calendar-year statistics for GDP(A). Output growth re-accelerated in the first half of 1997, to a seasonally adjusted annual rate (s.a.a.r. hereafter) of 3 per cent[3]. Over the six years of the current economic upswing, real GDP grew at an annual rate of $3\frac{1}{2}$ per cent, with its level by mid-1997 21.5 per cent above the last cyclical peak in the second quarter of 1990. With the outlook for growth favourable (see below), the current expansion period is likely to match the duration of previous economic upswings. So far, the cumulated growth of the current expansion period exceeds that of the 1970s, but is surpassed by the strong recovery of the 1980s (Figure 1), when annual growth averaged $4\frac{1}{2}$ per cent, stimulated by population growth much stronger than in the 1990s.

The growth slowdown in FY 1996/97 was essentially accounted for by the negative swing in the real foreign balance (Figure 2) as the effective appreciation of the Australian dollar in 1996 resulted in accelerating imports and slowing exports. The weakening of exports was most pronounced in the second half of 1996 and has been offset by the re-acceleration in the first half of 1997 as shown by standard expenditure accounts. However, this gives a misleading impression of export strength as a substantial part of the increase in exports in the first half of 1997 was due to special factors and was entirely offset in its net effect on GDP by a simultaneous rundown in stocks[4].

Table 1. **Demand and output**
Percentage changes, FY 1989/90 prices

	From previous period				From previous period, seasonally adjusted annual rate		
	Calendar years		Fiscal years[1]		1996		1997
	1995	1996	1995/96	1996/97	I	II	I
Consumption							
Private	4.6	3.0	3.9	2.3	3.2	1.8	2.9
Public	2.8	2.5	3.0	1.4	6.1	–1.6	3.4
Gross fixed investment	1.6	5.1	0.2	7.6	7.7	4.7	13.1
of which:							
Government	–2.5	–0.2	–3.0	8.2	–2.4	4.1	25.9
Private	1.6	5.7	0.6	7.6	8.8	4.7	11.9
Dwellings[2]	–9.2	–7.3	–12.2	1.1	–8.6	–0.9	16.5
Other construction	20.3	17.1	23.4	16.9	0.1	36.8	0.4
Equipment	5.3	15.6	6.2	15.5	32.7	3.7	24.1
Public enterprises	4.9	–6.4	–6.5	–15.8	–3.2	–18.3	–23.9
Final domestic demand	3.6	3.4	2.9	3.3	4.7	1.8	5.2
Change in stockbuilding[3]	0.4	–0.1	0.0	–1.1	–0.7	0.3	–4.1
Total domestic demand	4.0	3.2	2.9	2.2	3.9	2.1	1.0
Exports of goods and services	4.4	10.2	10.2	9.5	12.6	3.4	19.3
Imports of goods and services	9.6	8.6	5.4	10.3	13.9	6.9	12.5
Change in foreign balance[3]	–1.0	0.4	1.0	–0.1	–0.2	–0.7	1.5
GDP (expenditure–based)	3.0	3.6	4.0	2.1	3.7	1.4	2.5
Statistical discrepancy[3]	1.0	–0.2	–0.3	0.7	–0.7	1.6	0.0
GDP (income–based)	3.9	3.4	3.6	2.8	3.0	2.9	2.5
of which:							
Farm	2.2	23.1	25.2	14.4	5.7	22.4	7.9
Non–farm	4.0	2.8	3.0	2.4	2.9	2.3	2.3
GDP (average measures)[4]	3.5	3.4	3.8	2.5	3.2	2.1	3.0

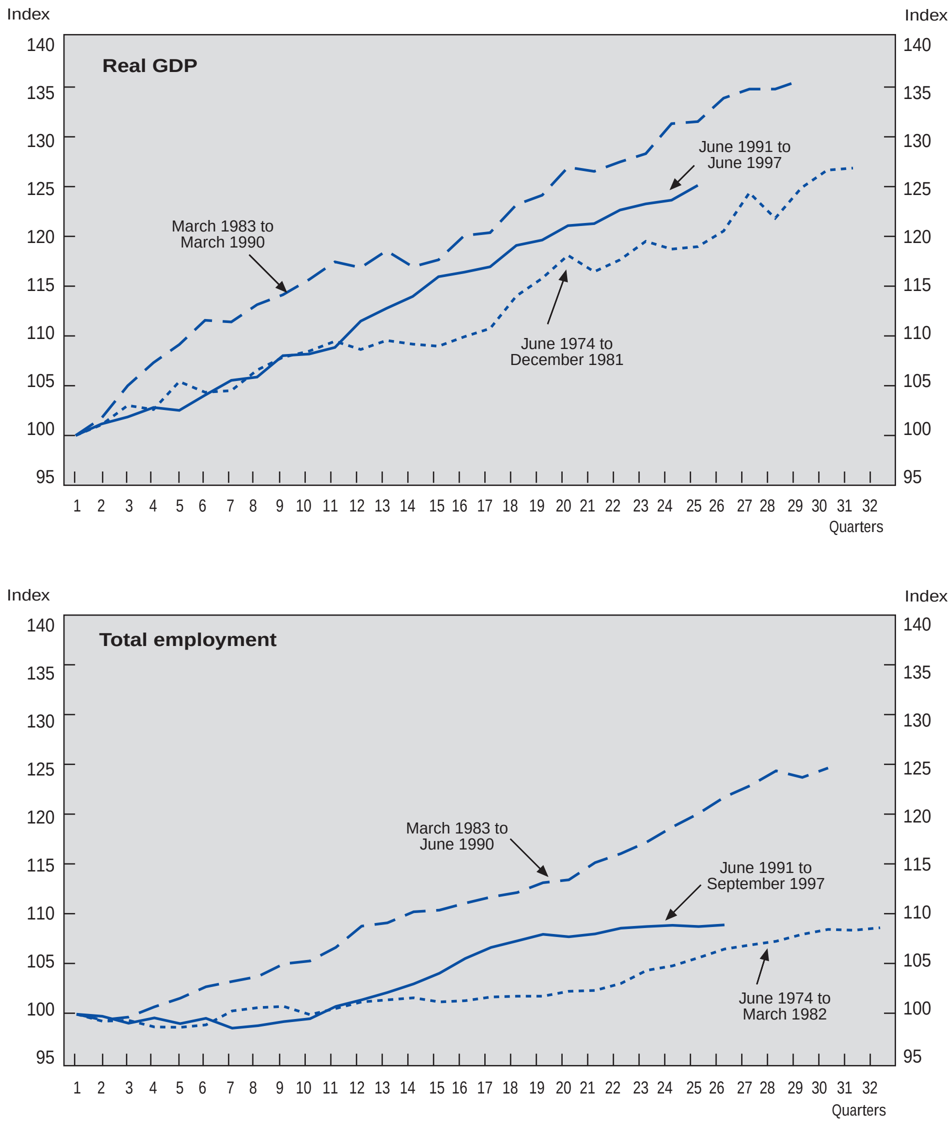
1. Fiscal years begin 1st July.
2. Including real estate transfer expenses.
3. As per cent of GDP in the previous period.
4. Average of the expenditures, production and income measures of GDP.

Source: Australian Bureau of Statistics and OECD estimates.

Domestic demand growth was well maintained, largely because of a surge in business fixed investment, which was assisted by strong profitability in many non-manufacturing industries. The share of the gross operating surplus of the private corporate sector in GDP rose from the recession level of 14.2 per cent to 14.9 per cent of GDP in FY 1996/97, which equals the average over the past decade.

Figure 1. **THE CURRENT EXPANSION COMPARED**

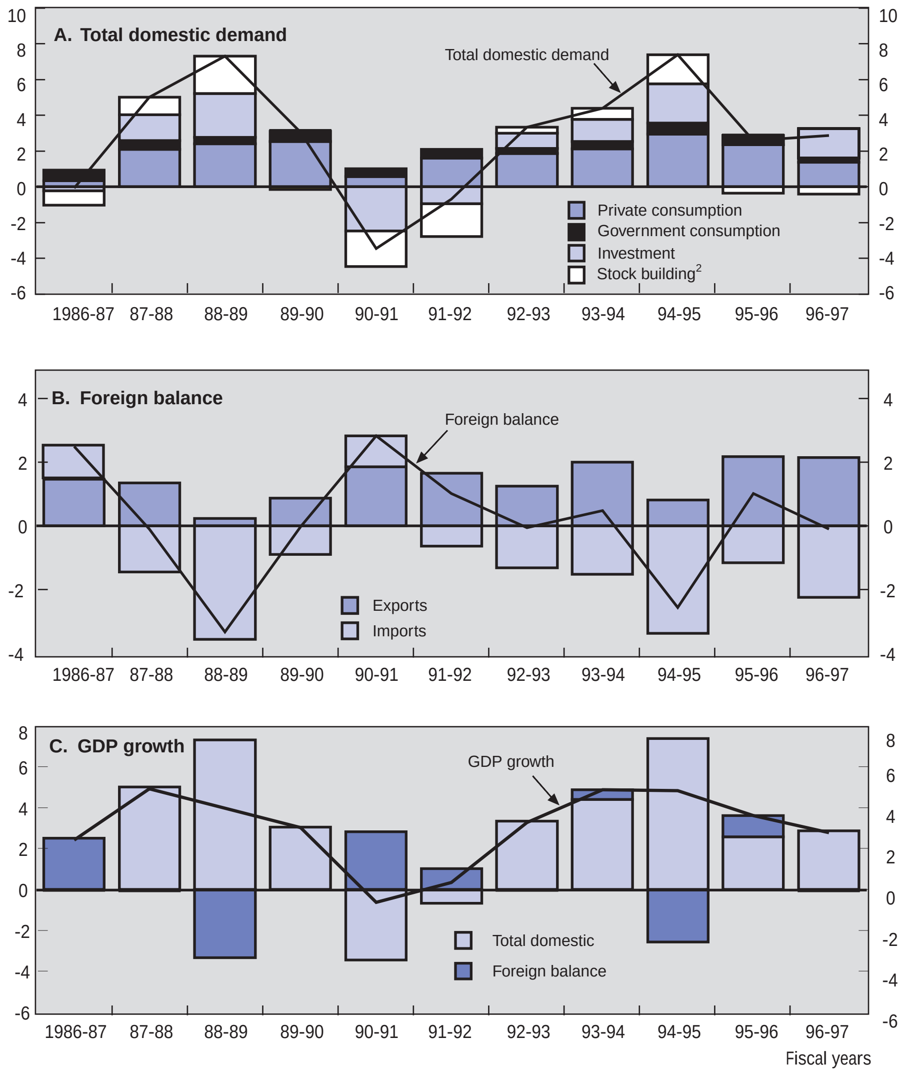
Cumulative growth



Source: OECD, *National Accounts.*

Figure 2. **CONTRIBUTION TO GDP GROWTH**[1]

As a percentage change of GDP in previous fiscal year



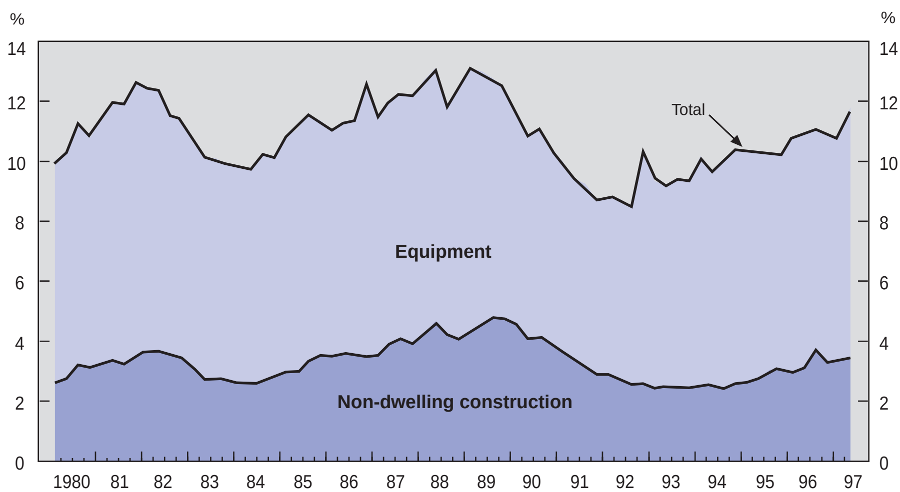
1. Income measure of GDP.
2. Including statistical discrepancy.

Source: Australian Bureau of Statistics, *National Accounts.*

Profits after interest payments have improved by more, as a result of the recent rate cuts by the Reserve Bank of Australia (see Chapter II). The ongoing recovery in business investment raised its share (excluding public enterprises) in GDP to about 1 percentage point above its long-term average by mid-1997, although it is still more than 1 percentage point below its previous peak of early 1989 (Figure 3). Some of this increase, however, reflects asset sales by public enterprises to the private sector, so that there was an offsetting drop in public investment. Non-residential construction was boosted by a number of large private-sector infrastructure works[5] – some of them associated with the Olympic Games in Sydney in the year 2000 – and mining and resource-related developments, all of which are only loosely linked to expected movements in the domestic business cycle. Non-residential building activity was broadly spread across office, hotel, retailing and other business premises. Some further strengthening of demand for office space may be expected in view of declining office vacancy rates, albeit from high levels in most cities. By contrast, the recent weakening of profits in manufacturing and the accompanying subdued investment activity reflect depressed prices of manufactures due to intensified international competition, high wage settlements in many parts of the sector, and low capacity utilisation after several years of strong investment growth.

Figure 3. **BUSINESS FIXED INVESTMENT**[1]

As a share of GDP



1. Excluding investment of public enterprises.
Source: Australian Bureau of Statistics.

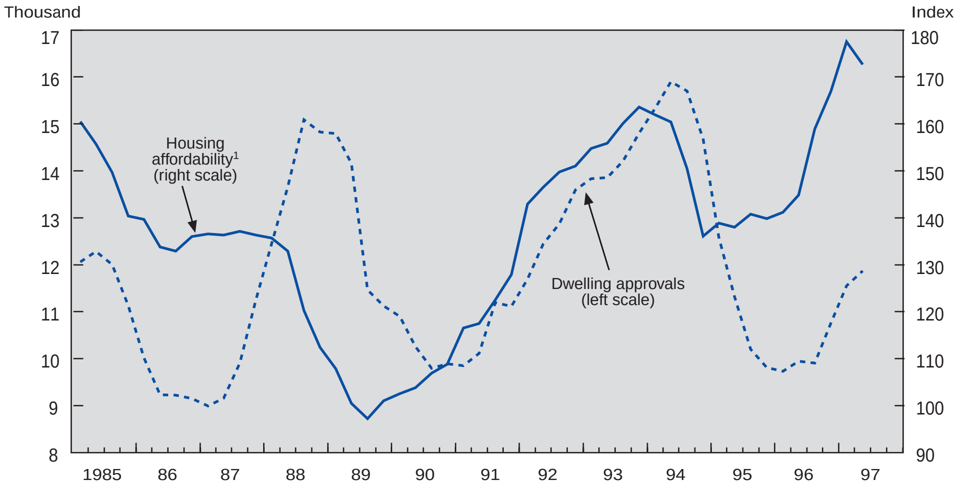
Household consumption growth slackened in FY 1996/97 after several years of rapid expansion. This mainly reflected the fall in real household spending (on a s.a. basis) in the September quarter of 1996, when farm and other incomes fell sharply.[6] But it was also likely to be related to growing concerns about job security, a view which is supported by the Westpac-Melbourne Institute's Survey of Consumer Sentiment as well as a 0.6 point quarterly jump in the (s.a.) household saving ratio to 5.3 per cent in the third quarter. But in spite of the persisting high unemployment and the continuing pessimistic labour market outlook, household consumption spending picked up in the following three quarters, helped by solid growth in real household disposable incomes, rapid improvement in household net financial assets and a declining interest servicing burden. By the second quarter of 1997, the household saving ratio returned to its lower level of a year ago. Reductions of staff in Commonwealth and state administrations also led to a slowdown in government consumption in FY 1996/97.

The inevitable correction of the excess supply of dwellings built up during the 1992-94 housing investment boom continued to act as a drag on economic activity in FY 1996/97. It was accentuated by higher mortgage interest rates ensuing from the monetary policy tightening in the second half of 1994. Although the "housing affordability index"[7] improved sharply from the second quarter of 1996 onward (Figure 4) as mortgage interest rates began to decrease, dwelling construction broadly stagnated in the second half of 1996. In part, this reflected continuing excess housing stock in a number of areas, in particular outside the major capital cities. Dwelling investment, however, picked up vigorously in the first half of 1997, although it was insufficient to lend major support to economic activity in FY 1996/97. It may, however, become a mainstay of economic growth over the next two years or so as the housing affordability index now has reached its highest level in more than a decade and building approvals for dwellings are on a rising trend.

Sluggish employment and persistent high unemployment

Total employment lagged behind the recovery of output during the first two and a half years of the current economic upswing, but picked up forcefully in 1994 and 1995 (see the lower panel of Figure 1 above). Thereafter total employment weakened substantially: it little more than stagnated in the first half of 1996, hence before the slowdown in output growth. It improved temporarily during the remainder of the

Figure 4. **HOUSING AFFORDABILITY**



1. Commonwealth Bank-Housing Industry Association index.
Source: Australian Bureau of Statistics.

year,[8] but slowed down again in the first three-quarters of 1997 (Table 2). Altogether, employment has increased by about 9½ per cent during the six years since the trough in activity in June 1991, while it rose by more than double that rate during the first six years of the upswing in the 1980s. Companies' reluctance in hiring in 1996 may have been related to the substantial rise in nominal wages in 1995 and into 1996 when output price increases in many industries were low and declining. In spite of substantial productivity gains, total-economy unit labour costs increased by around 3 per cent in both 1995 and 1996, following flat and negative growth in 1993 and 1994, respectively. Hence, rather than recruiting new personnel, it appears that companies preferred to generate output growth through the substitution of capital for labour. The renewed slowing of employment during the earlier part of 1997 seems to be the usual lagged response to moderating activity in the second half of 1996 (Figure 5). With unit labour costs moderating and activity picking up in the first half of 1997, total employment is set to improve in FY 1997/98.

Table 2. **The labour market**

Seasonally adjusted

	1993	1994	1995	1996	1996 I	1996 II	1997 I	1997 Q3
Civilian labour force[1]	0.7	1.8	2.6	1.4	0.9	1.8	0.8	0.7
of which:								
Males	0.4	1.1	1.9	1.2	1.0	1.3	0.3	1.1
Females	1.0	2.8	3.5	1.7	0.7	2.5	1.4	0.1
Employed persons[1]	0.6	3.1	4.0	1.3	0.7	1.5	0.7	0.7
of which:								
Full-time	0.8	2.3	3.3	1.1	0.3	1.0	–1.0	1.7
Part-time	–0.2	5.9	6.0	2.1	1.8	3.1	5.9	–2.1
Unemployment rate[2]	10.9	9.8	8.5	8.6	8.5	8.7	8.7	8.7
of which:								
Males	11.5	10.0	8.8	8.8	8.7	8.9	8.8	8.9
Females	10.1	9.4	8.1	8.3	8.2	8.4	8.5	8.2
Juniors looking for full-time work	31.7	30.2	27.8	28.0	27.5	28.5	28.1	27.3
Participation rate[2]	62.6	63.0	63.7	63.6	63.6	63.6	63.4	63.1
of which:								
Males	73.7	73.6	73.9	73.7	73.8	73.6	73.2	73.0
Females	51.8	52.6	53.8	53.8	53.7	53.9	53.9	53.5
Overtime (hours)[2, 3]	1.2	1.3	1.2	1.1	1.1	1.1	1.1	1.0
Average weekly hours worked [2, 4]								
Total	34.5	34.7	34.6	34.0	33.0	35.1	34.0	34.8
Full-time	40.4	40.9	40.9	40.3	39.0	41.6	40.4	41.4
Part-time	15.0	15.1	15.3	15.2	14.8	15.5	15.3	15.5
Job vacancies (thousand)[5]	34.2	57.3	57.3	60.8	61.0	60.5	63.0	63.7

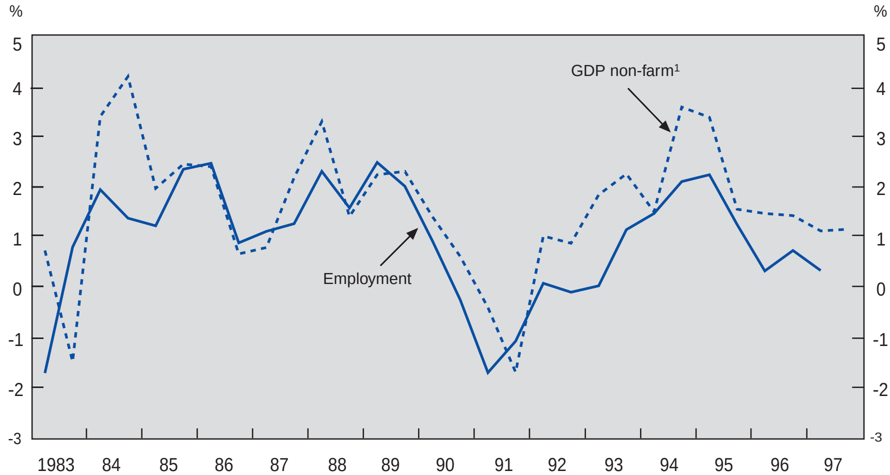
1. Percentage change from previous period at annual rates.
2. Levels.
3. All industries, per employee.
4. Not seasonally adjusted; average of July and August for Q3 1997.
5. Quarterly data based on mid-month of quarter.

Source: Australian Bureau of Statistics.

As regards sectoral distribution employment was flat or even fell during FY 1996/97 in some cyclically sensitive industries such as construction and retailing and in a number of industries associated with the public sector. Manufacturing employment was also flat in 1995 and the first half of 1996 but accelerated in the second half of 1996, raising its growth to 1¾ per cent for FY 1996/97. By contrast, many private-sector service industries reported solid employment growth. Because the proportion of part-time employees in services industries is typically higher than in

Figure 5. **OUTPUT AND EMPLOYMENT**

Seasonally adjusted rates from previous half-year



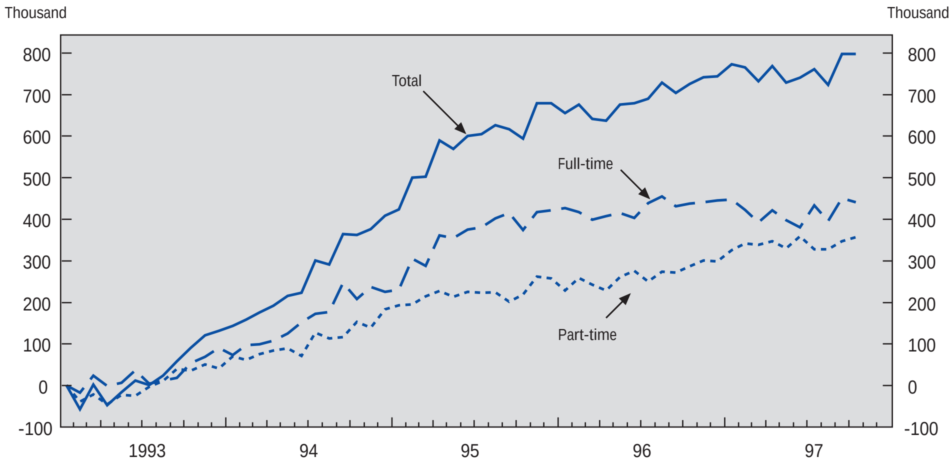
1. Brought forward by one semester.
Source: Australian Bureau of Statistics, *National Accounts*, and OECD.

manufacturing, this shift largely explains the much faster growth of part-time employment from 1994 to mid-1997 compared with full-time employment (Figure 6). Strong growth in part-time work is possibly also a result of changing household preferences, along with the increased incidence of two-income households. However, a good quarter of all part-time workers – and about 40 per cent of male part-time workers – are reported to be involuntarily so in the sense that they would prefer to work longer hours. While the number of part-time jobs continued to expand at an annual rate of close to 6 per cent, full-time employment even fell in the first half of 1997. However, the data for the third quarter of 1997 suggest a partial reversal of this striking divergence.

Weak employment growth in spite of generally buoyant output growth implied an improvement in economy-wide labour productivity (per employed person) from a small decline in 1995 to an increase of around 2 per cent in 1996 and in the first half of 1997. This productivity growth, which probably is partly the result of strong

Figure 6. **PATTERNS OF EMPLOYMENT**

Changes since January 1993



Source: Australian Bureau of Statistics.

investment and enhanced workplace flexibility, significantly exceeded the average yearly rate of productivity growth of around $1^1/_4$ per cent during the 1980s. Hourly labour productivity of the non-farm sector has so far grown by an average annual rate of $1^3/_4$ per cent over the current recovery period, also comparing favourably with the average rate of 1 per cent *per annum* during the first six years of the upswing of the 1980s. It is, however, below the annual $2^1/_4$ per cent growth in hourly productivity recorded over the first six years of the recovery of the 1970s, when a very slow expansion of hours worked combined with strong investment. Part of the differences in labour productivity growth between business cycles reflects differences in the rate of capital accumulation. Measures of total factor productivity allow for changes in both labour and capital inputs in the production process. Latest estimates by the Industry Commission[9] arrive at annual growth of total factor productivity of $2^1/_4$ per cent or even higher over the past two years, compared with an estimated average of $1^1/_2$ per cent from 1970 to 1994.

With employment growth decelerating, the rate of unemployment has remained in the vicinity of $8^1/_2$ per cent since mid-1995, after it had come down rapidly from its post-war yearly record of over 11 per cent in 1992. The stability of recorded unemployment occurred against the background of declining labour participation since 1995. The share of long-term unemployed (one year and over) in the total number of job seekers had declined from around 30 per cent at the beginning of 1996 to a (s.a.) low of $26^1/_2$ per cent in May 1996 but has increased since to $31^3/_4$ per cent in the third quarter of 1997.

Low inflation

Private sector wages – as measured by average weekly ordinary-time earnings of adults working full-time (AWOTE[10]) – grew at an annualised rate of around 6 per cent in the second half of 1995, seemingly unaffected by the Reserve Bank's (RBA) monetary tightening during the second half of 1994. Although there is a small upward bias[11] in the AWOTE rates of growth, wage increases of this magnitude were out of line with the RBA's medium term target of a rate of 2 to 3 per cent for the Treasury measure of underlying inflation,[12] even allowing for private sector labour productivity gains of the order of 2 per cent. But growth of the private sector AWOTE measure slowed down to 3.9 per cent in 1996 and to 2.5 per cent in the first half of 1997, probably reflecting weaker labour market conditions and declining inflation expectations. Broader measures of wage growth, such as the average weekly earnings of all employees,[13] which was up 2.3 per cent during the twelve months to the second quarter of 1997, confirm the notion of recent wage moderation.

Quarterly wage movements have proved very volatile in recent periods, particularly so with the public sector AWOTE measure, which rose at an annual rate of around 6 per cent by the middle of 1996 and accelerated to 9 per cent in the remainder of the year (Table 3). A substantial deceleration occurred, however, during the first half of 1997. With enterprise bargains in the public sector generally delivering annual pay increases of around $4^1/_2$ per cent, the recent extraordinary growth shown by statistics of public sector wages seems to result from distortions in the series originating in compositional change within the public sector. It appears that the recent cuts in public-sector employment have been concentrated among employees with below-average earnings, which would have inflated AWOTE levels.

Table 3. **Costs and prices**

Percentage change from corresponding period of previous year

	1993	1994	1995	1996	1996 Q3	1996 Q4	1997 Q1	1997 Q2
					From same period of previous year			
National accounts deflators[1]								
Private consumption	2.0	0.9	2.3	2.0	1.6	1.6	1.5	1.4
Total domestic demand	2.2	0.5	1.8	1.4	1.2	0.7	0.6	0.2
GDP	1.4	0.9	2.6	2.2	1.5	2.0	1.8	1.9
Exports of goods and services	1.6	–3.8	6.6	–2.5	–4.5	–2.7	–2.9	–0.7
Imports of goods and services	4.9	–5.4	1.9	–6.7	–8.1	–7.8	–6.5	–4.8
Non-farm GDP	1.5	0.5	2.3	2.6	2.1	2.8	2.4	2.3
Consumer price index	1.8	1.9	4.6	2.6	2.1	1.5	1.3	0.3
Underlying inflation	2.0	2.0	2.7	2.7	2.4	2.1	2.1	1.7
					From previous period, annualised			
Average weekly earnings								
All employees	2.8	3.0	2.7	3.0	2.9	1.6	5.2	–0.2
Ordinary time, full-time work (AWOTE)	2.1	3.4	4.8	3.9	4.2	4.6	4.0	1.3
Private sector	1.9	3.5	5.9	3.9	2.3	2.9	5.2	–0.2
Public sector	2.7	3.8	3.2	4.9	10.4	9.2	3.0	6.5
Nominal non-farm unit labour costs[1]	0.8	–0.9	3.3	3.4	8.8	5.8	–0.7	–3.1
Award rates of pay, full-time adults (hours)	1.0	1.4	1.7	1.8	1.4	1.3	1.1	1.9

1. Seasonally adjusted series derived by Treasury.

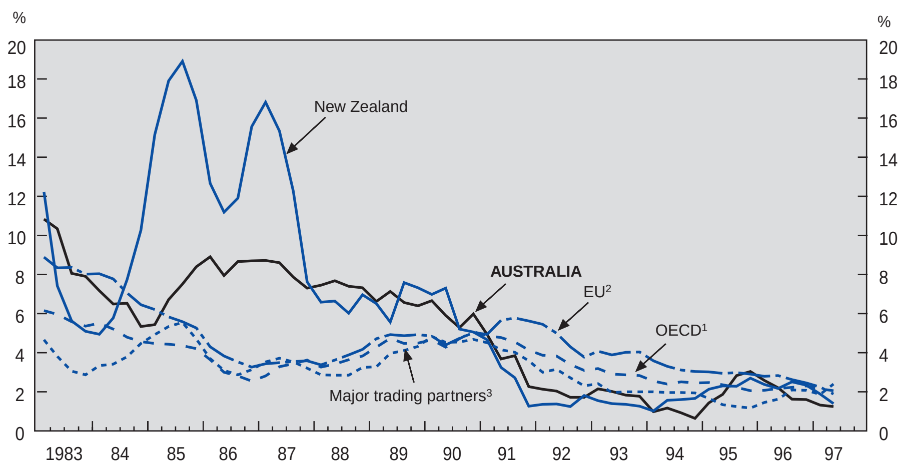
Source: Australian Bureau of Statistics, Reserve Bank of Australia and OECD.

There is also substantial variation between the centrally determined award pay rates and wages determined by enterprise agreements. For example, yearly pay rises negotiated in enterprise agreements averaged around 4¾ per cent in the first quarter of 1997, with growth in executive salaries reported[14] to have grown by 5.8 per cent during the year ending in June 1997. In contrast, award wage rates have continued to grow only modestly in 1996 and particularly in the first half of 1997, entailing a continuing decrease in inflation-adjusted terms. Taking all these elements into account, the RBA estimates an average increase in hourly wage rates of 3¾ per cent in FY 1996/97. Wage growth of this magnitude is consistent with the underlying inflation target.

The combination of decelerating wages and faster productivity growth had a moderating impact on unit labour costs in 1996 and into 1997; non-farm unit labour costs even fell in the first half of 1997. Together with falling import prices, induced by the sizeable effective appreciation of the Australian dollar in 1996, this helped to bring the twelve-monthly rate of underlying inflation of 3.3 per cent in the first quarter of 1996 down to 1.5 per cent in the third quarter of 1997, hence below the RBA's medium-term inflation target. Headline CPI inflation fell rapidly from early 1996 onward, after it had risen to twelve-monthly rates of above 5 per cent in the second half of 1995, in part as a result of the increase in mortgage interest rates in the wake of monetary tightening in 1994. Initially, the decrease in headline inflation was amplified by the effect of a halt to the rise in interest charges. But since the middle of 1996, CPI inflation was further dampened by the effect of declining mortgage interest rates in response to the RBA's cuts in cash rates, and the twelve-monthly rate fell by 0.3 per cent in the third quarter of 1997. The prevailing low level of inflation pressures is also shown in national accounts deflators (see Table 3 above). Altogether, Australia's inflation performance compares favourably with that of other OECD countries (Figure 7).

Figure 7. **INTERNATIONAL COMPARISON OF CONSUMER PRICES**

Change of the private consumption deflator over four quarters



1. Total OECD which excludes the Czech Republic, Hungary, Mexico, Poland and Turkey is based on GDP weights.
2. Using GDP weights.
3. Japan, USA, New Zealand, Korea and United Kingdom; calculated using trade weights.

Source: OECD.

A narrowing current external deficit

The current external account has improved substantially in 1996 and in the first half of 1997, after its deficit had peaked at about 6 per cent of GDP in the first half of 1995 (Table 4), a level which could potentially raise concerns in financial markets about the sustainability of Australia's external position. In part, the improvement reflected the breaking of the drought, which brought about a sharp recovery of rural exports in 1996 and in the first half of 1997, from the steep fall in 1995. In addition, growth of exports of manufactures and – to a somewhat lesser extent – of services remained rather strong,[15] in spite of the deteriorating price and cost competitiveness, induced by the sizeable effective appreciation of the Australian dollar in 1996 (Figure 8). The deceleration in the volume growth of imports of capital goods and intermediate products, albeit from a high level, also contributed to the shrinking current external deficit. Another major deficit-reducing factor was the substantial terms-of-trade gain in 1996 and into 1997, in line with the currency appreciation. As a result of these influences the trade deficit narrowed from 1¼ per cent in 1995 to ¼ per cent of GDP in 1996. The trade account even turned into surplus in the first half of 1997, but would have been in broad balance if adjusted for the special factor referred to above.

Table 4. **Current account trends**[1]

A$ billion

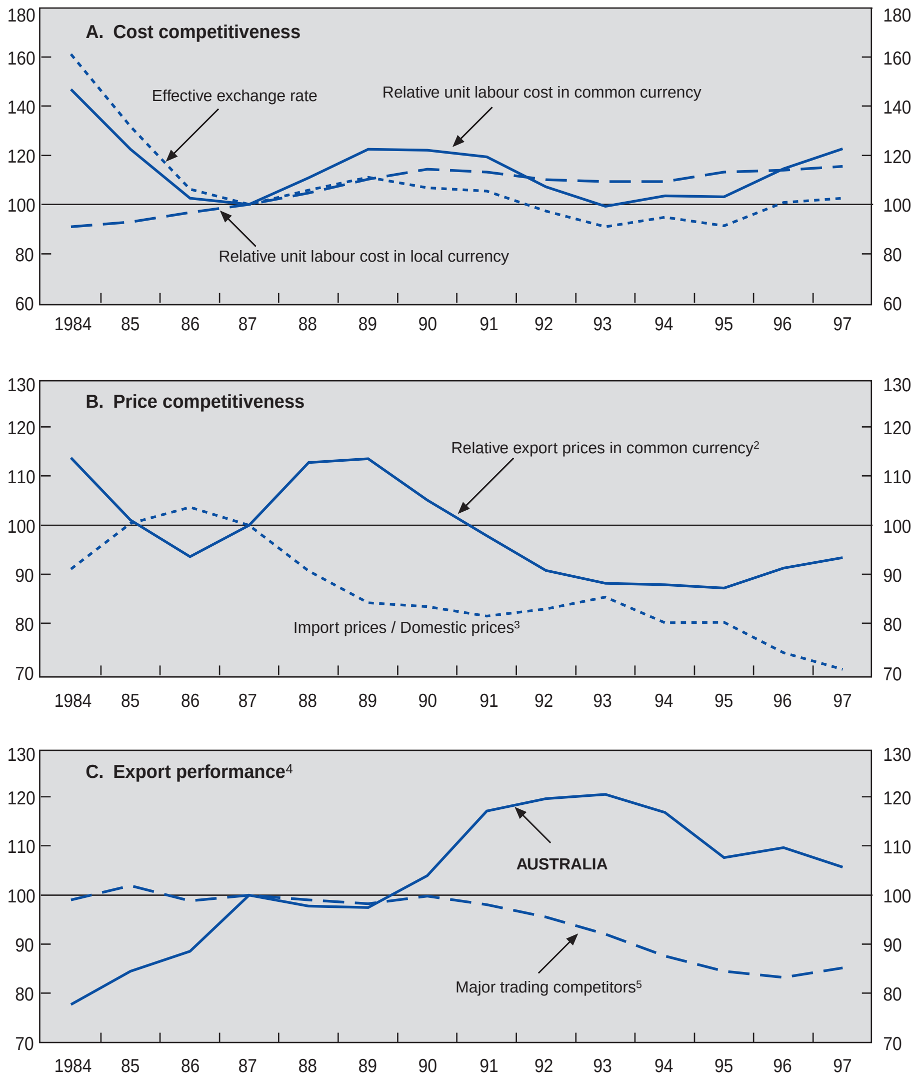
	1993	1994	1995	1996	1995		1996		1997
					I	II	I	II	I
Exports	62.1	64.1	71.1	76.1	34.5	36.6	38.3	37.8	42.2
Imports	62.3	68.6	76.8	77.3	38.6	38.2	38.9	38.4	40.0
Trade balance	–0.2	–4.5	–5.7	–1.2	–4.1	–1.5	–0.6	–0.7	2.2
Investment income, net	–13.4	–17.6	–20.1	–20.6	–9.4	–10.7	–9.9	–10.7	–9.8
Non-factor services, net	–0.6	–0.1	0.1	1.4	–0.3	0.5	0.6	0.8	0.7
Services, net	–14.0	–17.8	–20.0	–19.3	–9.7	–10.3	–9.3	–9.9	–9.1
Transfers	0.3	0.1	0.6	1.3	0.2	0.4	0.6	0.6	0.6
Current balance	–14.0	–22.1	–25.1	–19.2	–13.6	–11.5	–9.2	–9.9	–6.4
As per cent of GDP	–3.4	–4.9	–5.3	–3.8	–5.8	–4.7	–3.7	–3.9	–2.5

1. OECD definitions.

Source: Australian Bureau of Statistics.

Figure 8. **COMPETITIVENESS AND TRADE**[1]

Index 1987=100



1. 1997 figures are Secretariat estimates.
2. Manufactures.
3. Import prices of total goods and services divided by deflator of total domestic demand.
4. Ratio between export volumes of manufactures and export markets for manufactures.
5. Japan, United States, United Kingdom and New Zealand.

Source: OECD.

Although its recent decline brought the current external deficit nearer to a level which is sustainable in the long run – reckoned by some as being in the vicinity of 3 per cent of GDP – corresponding capital inflows raised the stock of net external liabilities from 58.6 per cent to 60.2 per cent of GDP over the year to the middle of 1997. This was 24½ percentage points higher than in 1985. The rise in the net external liability ratio over 1996-97 was made up of increases in both the net foreign debt and net foreign equity ratios, with the latter growing more strongly in line with recent trends. Nevertheless, the ratio of net foreign debt to GDP, at 39.6 per cent in mid-1997, remains significantly below its peak of 42.7 per cent in the third quarter of 1993. In addition to the relative strength of equity flows, the fall in the net-debt-to-GDP ratio reflects valuation gains from the appreciation of the Australian dollar and relatively strong growth of GDP.

The outlook to 1999

Current economic indicators and policy assumptions

Current economic indicators generally suggest a continued strengthening in growth and a shift in demand towards consumption and dwelling construction in coming months. Retail sales have continued to pick up in recent months, and are growing at a trend annual rate of 6.8 per cent. Private building approvals for dwellings rose strongly in the first few months of 1997, and after a slowing in the middle of the year, have picked-up in the last few months, to be around 20 per cent higher than in September a year earlier. Investment indicators, however, are mixed. The June quarter capital expenditure (CAPEX) survey shows that expectations for FY 1997/98 have weakened in recent months. Adjusting these expectations by the five-year average realisation ratio[16] suggests that growth in business fixed investment will fall to 1 per cent in current price terms in the current fiscal year and only a little more in real terms. This decline in expectations reflects downward revisions to building investment expectations. But these results conflict with the strong outlook for non-dwelling construction suggested by other indicators, including building approvals, finance commitments and work yet to be done. Expectations for equipment investment, on the other hand, have strengthened and are now consistent with continued moderate growth, following several years of high growth.

Short-term official interest rates are assumed to rise by 0.5 percentage point to 5½ per cent in late 1999. Fiscal policy settings are based on those outlined in the

FY 1997/98 Commonwealth budget and, for the State/local government sector, the 1997 National Fiscal Outlook (Commonwealth of Australia, 1997). The general government underlying balance is projected by the OECD Secretariat to move from a deficit of $1\frac{1}{4}$ per cent of GDP in 1996 to balance in 1998, rising to a surplus of $\frac{3}{4}$ per cent of GDP in the following year (Chapter II). The other main assumptions underlying the projections are that:

- prices (expressed in SDRs) for Australia's non-oil commodity exports rise more slowly over the next two years, contributing to smaller increases in the terms of trade than in 1996 and 1997;
- notwithstanding financial market turbulence in Asia, growth in Australia's export markets picks up slightly to around $7\frac{1}{2}$ per cent in each of the next two years;
- nominal exchange rates remain unchanged from their levels of 3 November 1997, implying that, on average, the effective exchange appreciates by 1.3 per cent this year but depreciates by 1.4 per cent in 1998;
- the average price of internationally traded oil is US$ 18.50 in the second half of 1997 and remains around this level over the next two years.

The projections embody information available at 7 November 1997.

Prospects

The strengthening in output growth during the first half of this year is projected to continue, with growth rising gradually to $3\frac{3}{4}$ per cent by 1999 (Table 5). This pick up mainly reflects a rise in consumption expenditures. Following a marked pick up in the first half of 1997, private consumption is projected to strengthen further on the back of rising household disposable incomes. Dwelling investment is also projected to contribute to the strengthening in growth as the recovery phase of the housing cycle progresses and housing affordability remains high. Although growth in business investment seems set to weaken in the short-term, solid growth is nevertheless projected in 1998 and 1999 in response to low interest rates and diminishing spare capacity.

With output growing at these rates, growth in employment is projected to pick up steadily, from 1 per cent this year to $2\frac{1}{4}$ per cent in 1999. This should reduce unemployment to $7\frac{1}{2}$ per cent in 1999. The decline in unemployment to near the OECD Secretariat's estimate of the non-accelerating wage rate of unemployment

Table 5. **Short-term prospects**

Percentage changes

	Percentage share of GDP in 1994 at current prices	Calendar year			
		1996	1997	1998	1999
A. Demand and output at constant 1989/90 prices					
Consumption					
Private	61.9	3.0	2.8	3.1	3.7
Public	17.7	2.5	2.0	1.5	2.0
Gross fixed investment	21.3	5.1	8.8	6.5	6.5
of which:					
Government	2.0	–0.2	7.6	5.0	2.1
Private	19.3	5.7	8.9	6.7	6.9
Dwellings[1]	6.9	–7.3	9.3	10.0	9.0
Other construction	2.5	17.1	4.7	3.7	6.0
Equipment	7.5	15.6	11.5	3.5	6.5
Public enterprises	2.3	–6.4	5.0	15.3	4.2
Final domestic demand	100.8	3.4	4.0	3.6	4.1
Change in stockbuilding[2]	0.6	–0.1	–1.2	1.3	0.1
Total domestic demand	101.5	3.2	2.8	4.9	4.2
Exports of goods and services	18.8	10.2	9.1	2.7	6.8
Imports of goods and services	19.8	8.6	9.9	8.0	8.5
Change in foreign balance[2]	–1.0	0.4	–0.1	–1.3	–0.5
Statistical discrepancy[2]	–0.4	–0.2	0.3	0.0	0.0
GDP(I) at constant prices[3]	100.0	3.4	2.9	3.6	3.7
GDP(A) at constant prices[4]		3.4	2.9	3.6	3.7
B. Other items					
Private consumption deflator		2.0	1.5	2.0	2.1
Employment		1.3	0.9	2.0	2.3
Unemployment rate (per cent)		8.5	8.7	8.2	7.5
General government financial balance[5]		–1.2	–0.6	0.1	0.6
Current balance (A$ billion)		–19.2	–18.5	–21.5	–23.0
Current balance[5]		–3.8	–3.5	–3.9	–3.9

1. Including real estate transfer expenses.
2. Contributions to growth.
3. Income measures. Includes statistical discrepancy.
4. Average of the expenditure, production and income measures of GDP.
5. Per cent of GDP.

Source: OECD.

(NAWRU) is expected to contribute to a small rise in wage pressures owing to speed limit effects. This, together with the passing of the effects of exchange rate appreciation and a slowing in productivity growth from the very high rates recorded in 1996 and so far in 1997 underlies the projected rise in inflation[17] from 1½ per cent this year to around 2 per cent in 1998 and 1999.

Growth in export volumes is estimated to fall back from the high levels in 1996 with the passing of the effect of the return to normal production conditions in the agricultural sector following the drought and also reflecting the loss of price competitiveness in 1996. The decline in underlying growth in exports in 1997 is considerably greater than might be indicated by total exports which are boosted by “one-off” transactions. Growth in export volumes is projected to decline next year, but to pick up to around 7 per cent in 1999. Import growth is projected to remain strong, reflecting the buoyant outlook for domestic demand. After falling this year on the back of the above mentioned “one-off” transactions, the current account deficit is projected to rise to around 4 per cent of GDP in 1998 and to remain around this level in the following year.

The major risks surrounding these central projections concern the effects of recent financial market turbulence in Asian countries, which account altogether for almost 60 per cent of Australia’s exports. While the projections already embody a more subdued outlook for growth in these countries, there is a significant risk of this outlook deteriorating further, especially in Japan and Korea. In addition, the development of the “El Nino” climatic effect suggests that another drought is possible in eastern Australia. At this stage, there is considerable uncertainty about the likely severity of the drought, although there has been good rainfall recently. In any event, the macroeconomic effects of a drought would be modest as agriculture accounts for less than 5 per cent of GDP. Finally, the outlook for modest wage increases could be upset by renewed pressure for substantial increases in award rates of pay.

II. Macroeconomic policies

With inflation well under control but unemployment stubbornly high and signs of cyclical slack in the economy, monetary policy is now aiming at preserving the achieved low inflation environment while keeping monetary conditions conducive to stronger economic growth. Fiscal policy continues to be targeted at a medium term objective of underlying balance on average over the course of the economic cycle, in order to contribute to higher national savings and break the trend growth of government debt. Consistent with its medium-term objective, the Government has also set itself the short term goal of achieving an underlying government budget surplus in fiscal year 1998/99.

Monetary policy

The setting of monetary policy

The operational objective of the Reserve Bank of Australia (RBA) is to foster sustainable growth in output and employment and to keep the underlying rate of inflation[18] on average at around 2 to 3 per cent over the course of the business cycle.[19] To pursue this objective, and in order to lock in the low inflation achieved at the end of a long period of disinflation, which began in the mid-1970s, the RBA adopted an explicit inflation targeting approach in 1993. The new approach implies that – as in a number of other OECD countries[20] – the Bank's conditional inflation forecast for a chosen time horizon is an intermediate target of monetary policy. Hence, monetary policy decisions depend on the comparison of the current inflation forecast with the specified inflation objective.

The RBA's new policy approach was put to a first test, when in response to the sharp acceleration of economic growth in the first half of 1994, most projections saw underlying inflation exceeding 3 per cent over the course of 1995. In consequence, and in spite of the prevailing high unemployment as well as underlying inflation still at the lower end of the target zone, the RBA decided to tighten monetary policy as from mid-1994. The target cash rate – the key policy interest rate[21] – was raised in three steps during the second half of 1994 by a cumulative $2^3/_4$ percentage points to $7^1/_2$ per cent. Only in the second quarter of 1995 did the year-on-year rate of underlying inflation begin to rise, exceeding the 3 per cent mark in the third quarter of 1995. It peaked at 3.3 per cent in the first quarter of 1996. From then on the lagged effects of tightened monetary policy began to show, and underlying inflation fell back within the target band in the September quarter of 1996 (Figure 9). Equally important, indicators of expected inflation declined from the second half of 1995 on, after a twelve-month period during which both financial markets and the general public had expected year-ahead inflation rates of the order of $4^1/_2$ per cent or above.

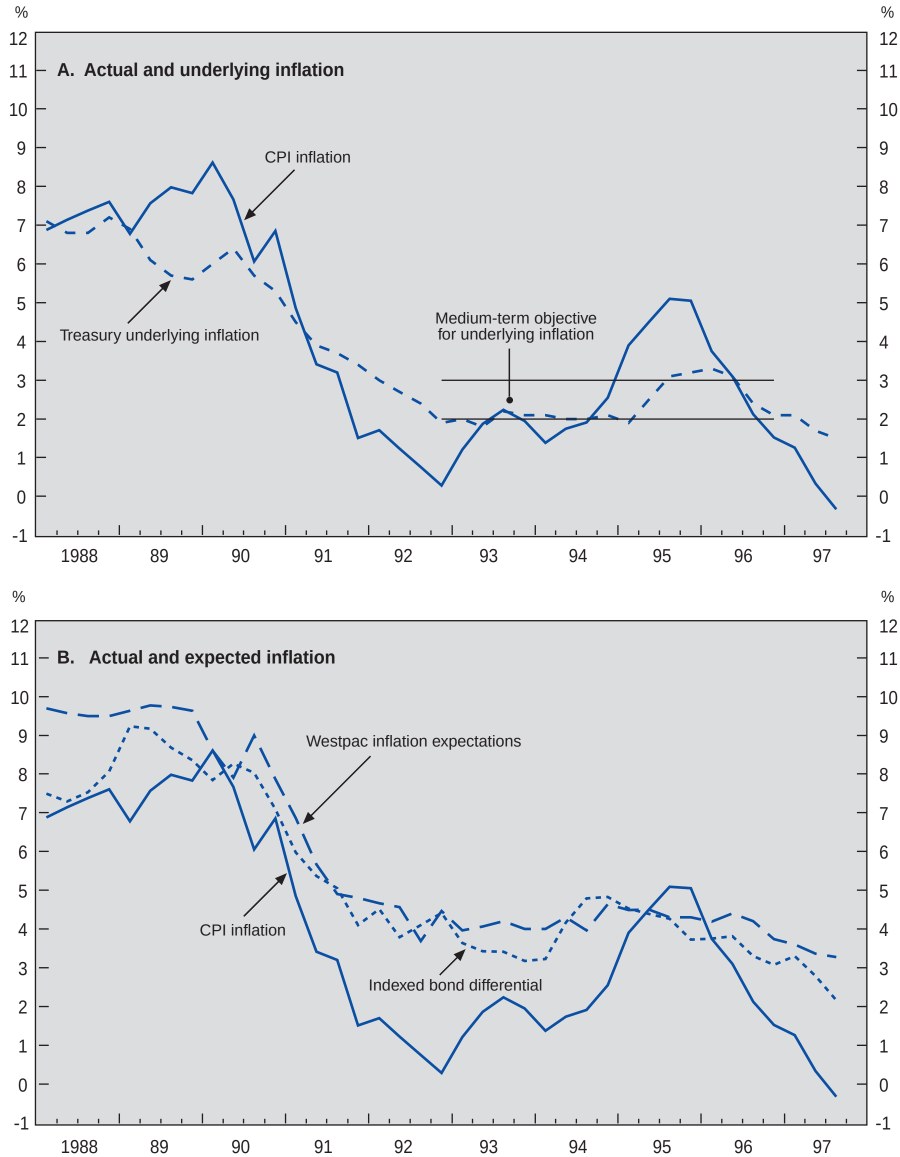
By the middle of 1996, RBA projections pointed to an imminent return of the underlying rate of inflation to within the medium term target band and to a continuing favourable inflation outlook for the foreseeable future, but with some slowing in economic growth. In response, the RBA cut the target cash rate on five occasions by a cumulative 2.5 percentage points to 5 per cent from late July 1996 to the end of July 1997 (Table 6). The cash rate was accordingly brought close to its level of $4^3/_4$ per cent just before the earlier monetary tightening that had begun in August 1994. In spite of an expected small pick-up in inflation over the course of 1998, the RBA forecasts underlying inflation to remain within the 2 to 3 per cent range in 1998. This is broadly consistent with latest data of the Melbourne Institute measure of expected consumer inflation of some 2.9 per cent during the twelve months ahead, expected average inflation of $2^1/_2$ per cent over the next ten years in Consensus Economics and the non-indexed/indexed bond differential of about 2 per cent. The latter two measures suggest that financial market participants expect the rate of inflation to stay inside the RBA's 2 to 3 per cent target in the medium term. This signals an important gain in credibility of the Reserve Bank and hence lower costs of anti-inflationary monetary policy in terms of lost output and employment.

The response of financial markets

The monetary policy easing induced interest rates of all maturities to decline. The interest rate on three-month bank bills moved closely in line with the cash rate, on several occasions leading rather than following the decreases in the latter, reflect-

Figure 9. **THE PERFORMANCE OF MONETARY POLICY**

Percentage change over four quarters



Source: Reserve Bank of Australia; University of Melbourne, Institute of applied economic and social Research; OECD, *Main Economic Indicators.*

Table 6. **Changes in official interest rates 1994-97**

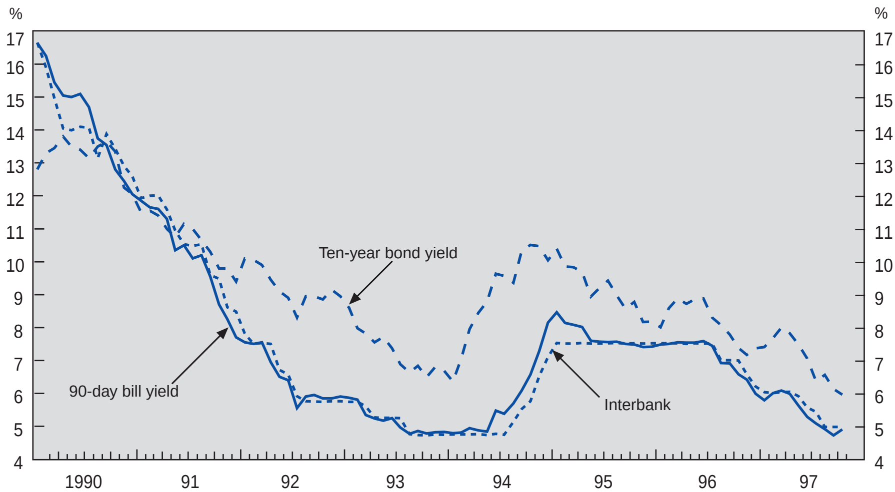
	Change	New cash rate target
	Percentage points	Per cent
A. Tightening		
17 August 1994	+ 0.75	5.5
24 October 1994	+ 1.00	6.5
14 December 1994	+ 1.00	7.5
B. Easing		
31 July 1996	– 0.50	7.0
6 November 1996	– 0.50	6.5
11 December 1996	– 0.50	6.0
23 May 1997	– 0.50	5.5
30 July 1997	– 0.50	5.0

Source: Reserve Bank of Australia, *Report and Financial Statements*, 1996 and 1997.

ing the money market's anticipation of changes in the cash rate target by the Reserve Bank. Altogether, the yield on three-month bank bills fell from 7½ per cent in mid-1996 to 4.9 per cent in October 1997 (Figure 10). During the same period, business lending rates of banks also fell by around 2½ percentage points – to 8¾ per cent for small business loans and to about 8½ per cent for large business loans in October 1997. In the home-loan market, however, banks rapidly and fully passed on lower costs of refinancing to borrowers, whose credit costs fell by 3¾ percentage points to 6¾ per cent from mid-1996 to October 1997, reflecting the intensified competition between financial institutions – mainly banks, building societies and mortgage managers – in the 1990s. This brought the previously high bank margins in this market segment broadly into line with those in other OECD countries. Altogether, in October 1997 business and mortgage interest rates are at their lowest level in around 25 years.

Responding to lower cost of financing the growth in credit provided by financial intermediaries accelerated somewhat during the first three quarters of 1997. In the six months to September, annualised growth of total credit was 12 per cent, compared with growth of 9 per cent over the previous six-month period. These rates of growth have remained well above the rate of increase in nominal GDP, although less buoyant than in the early part of 1996. Of the components of credit to the private sector,

Figure 10. **NOMINAL INTEREST RATES**



Source: Reserve Bank of Australia; University of Melbourne, Institute of applied economic and social Research; OECD, *Main Economic Indicators.*

business credit growth picked up to an annualised rate of 13 per cent in the six months to September, compared with 7 per cent in the previous six months. Housing credit outstanding grew by 10 per cent in that period. Housing credit has shown less evidence of acceleration, partly reflecting increased loan repayments when interest rates fell, but there have been strong increases in housing loan approvals. These have flowed through into increased activity in the housing sector.

Long-term bond yields also declined from their high levels of the first half of 1996 – when ten-year bond yields averaged $8^3/_4$ per cent – to a temporary low in November 1996. This probably reflected the improving inflation outlook for Australia, as during most of this period US capital market interest rates were on a rising trend. As a result, the Australia-US ten-year bond rate differential fell from $2^3/_4$ percentage points in early 1996 to below 1 percentage point later in the year. Bond rates edged up again between late 1996 and March 1997, broadly mirroring developments in US capital markets, before declining steeply to 6 per cent by November 1997. With the fall in US rates less pronounced, the Australia-US bond

Figure 11. **CREDIT TO THE PRIVATE SECTOR**

Seasonally adjusted annuel rates from previous period

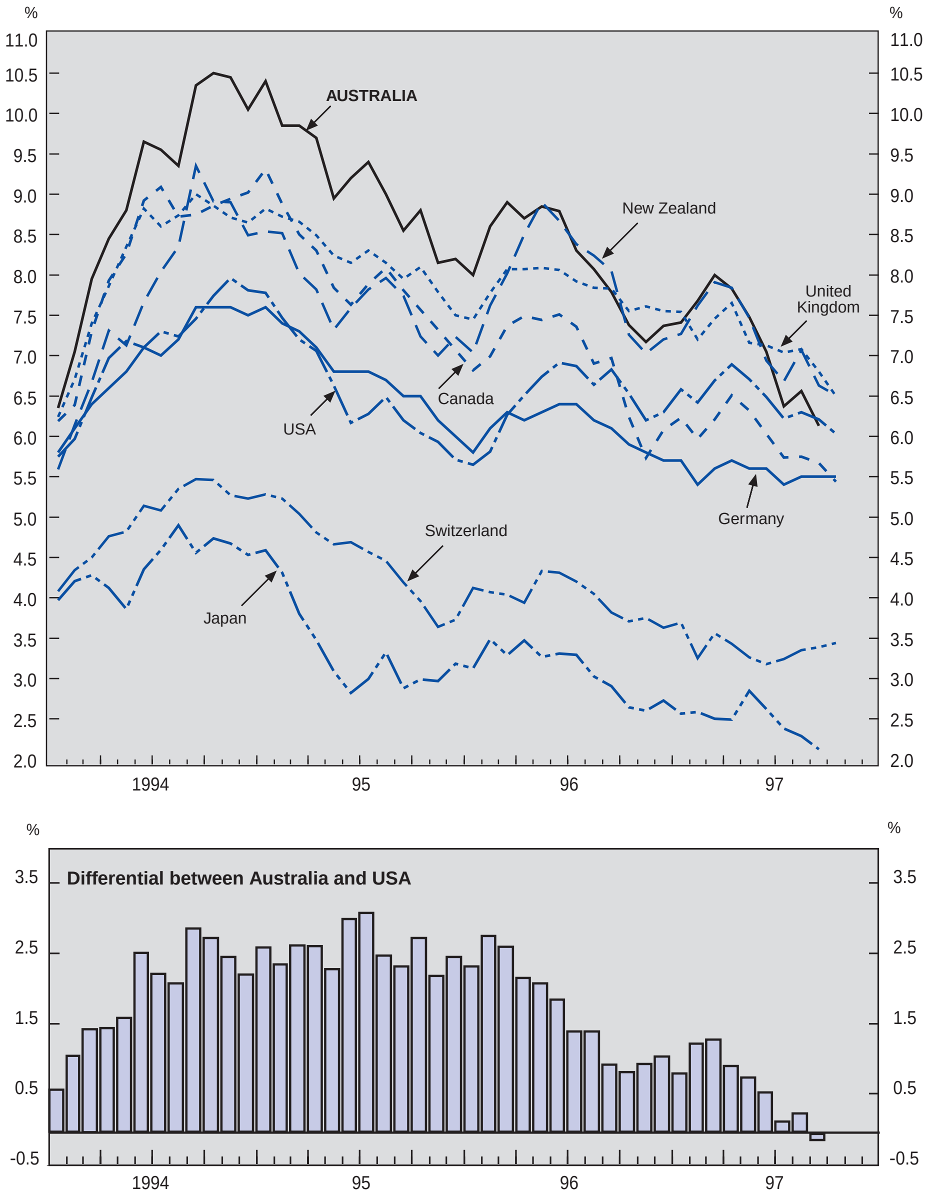
Source: Reserve Bank of Australia.

rate differential virtually disappeared in the second half of 1997, two years after it had peaked at 3 percentage points (Figure 12). In part, this is likely to have been the consequence of the better than projected performance of general government finances in fiscal year 1996/97 and the credible fiscal consolidation plan for the years ahead (see below). It also appears to indicate that international financial markets have built up a high measure of confidence in the Reserve Bank's resolve to keep inflation under control.

The recent easing of monetary policy has contributed to a substantial decline in measures of real financial asset yields from their high levels of the beginning of 1995 in spite of the simultaneous fall in indicators of expected inflation. Estimates of real interest rates vary with the deflation method applied in their calculation. When the Treasury underlying rate of inflation was used as deflator,[22] the ex-post real three-month bill yield fell by a marked $2^1/_4$ percentage points from early 1995 to mid-1997. During the same period, the decline in the ex-post real long-term bond yield was even more pronounced (Figure 13). But the decline in yields on ten-year indexed bonds[23] is smaller: the fall since early 1995 was around $1^1/_4$ percentage points, to around

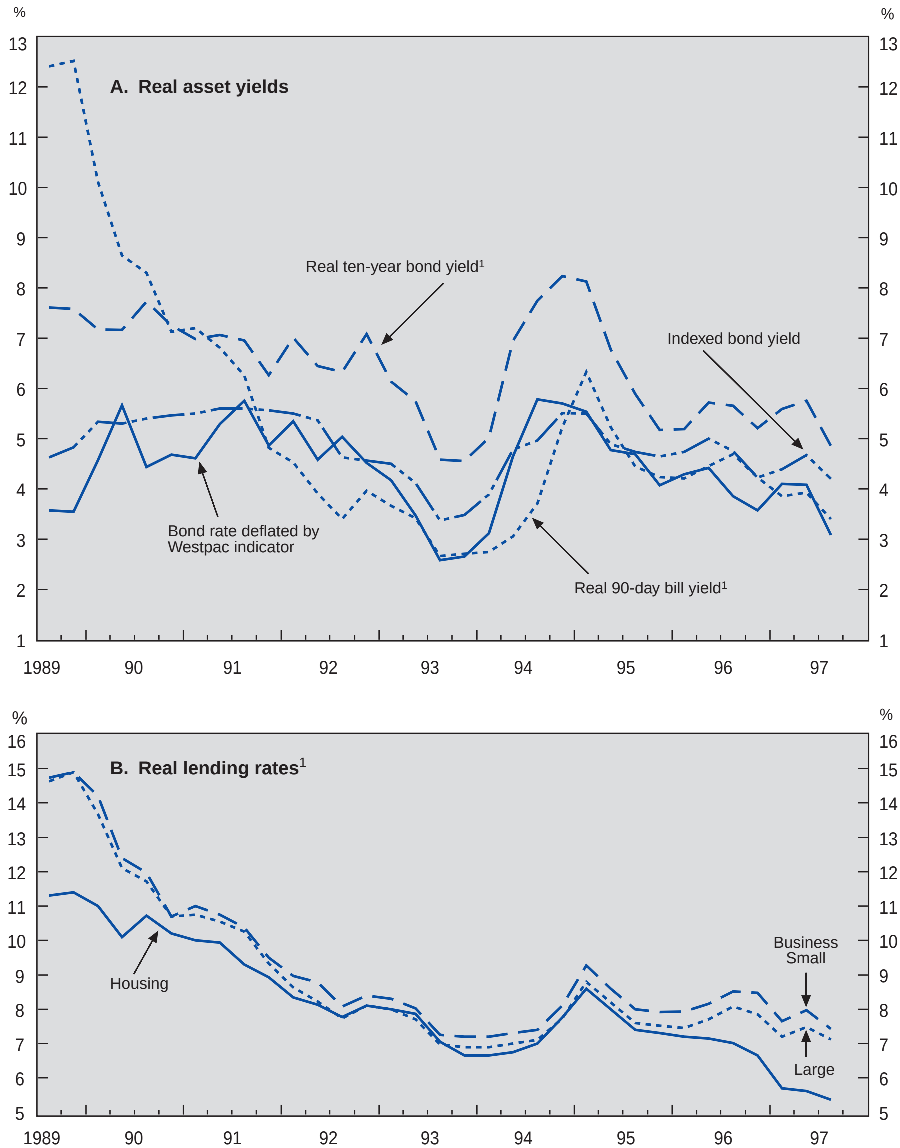
Figure 12. **INTERNATIONAL COMPARISON OF LONG-TERM INTEREST RATES**

Ten-year bond yield



Source: OECD, *Financial Statistics.*

Figure 13. **REAL INTEREST RATES**



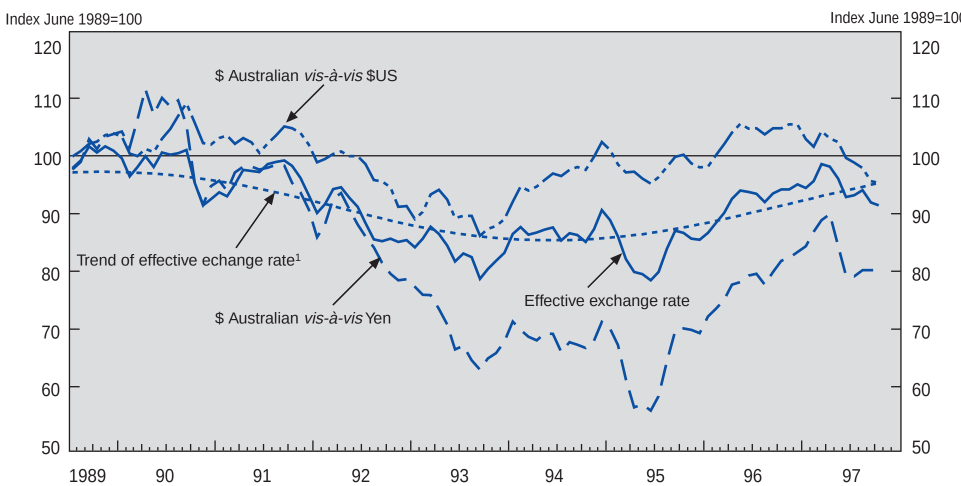
1. Nominal rates less the Treasury underlying rate of inflation.

Source: Reserve Bank of Australia; University of Melbourne, Institute of applied economic and social Research; OECD, *Main Economic Indicators.*

4.2 per cent in November 1997. Real three month interest rates are still above their level in mid-1994, just prior to the commencement of the monetary policy tightening, but are well below their longer term historical averages.

The general rise in the US dollar exchange rate against major currencies since late 1996 also brought to an end the trend appreciation of the Australian dollar against the US currency, which had begun in the second half of 1993 (Figure 14). The Australian dollar declined further in response to the narrowing differential of Australian interest rates over US rates. However, with the Australian dollar strong against other currencies, in particular the yen, the effective (trade-weighted) exchange rate continued to appreciate until May 1997. It has softened since then, due to declining capital inflows from Japan in response to the shrinking interest premium of Australian financial instruments and the changing short-term outlook for export markets in South East Asia. Altogether, during the first ten months of 1997, the effective exchange rate of the Australian dollar stood a little below its average level in the second half of 1996.

Figure 14. **EXCHANGE RATES**



1. Low-frequency component of a Hodrick-Prescott filter (param.=25 000).
Source: OECD, *Main Economic Indicators.*

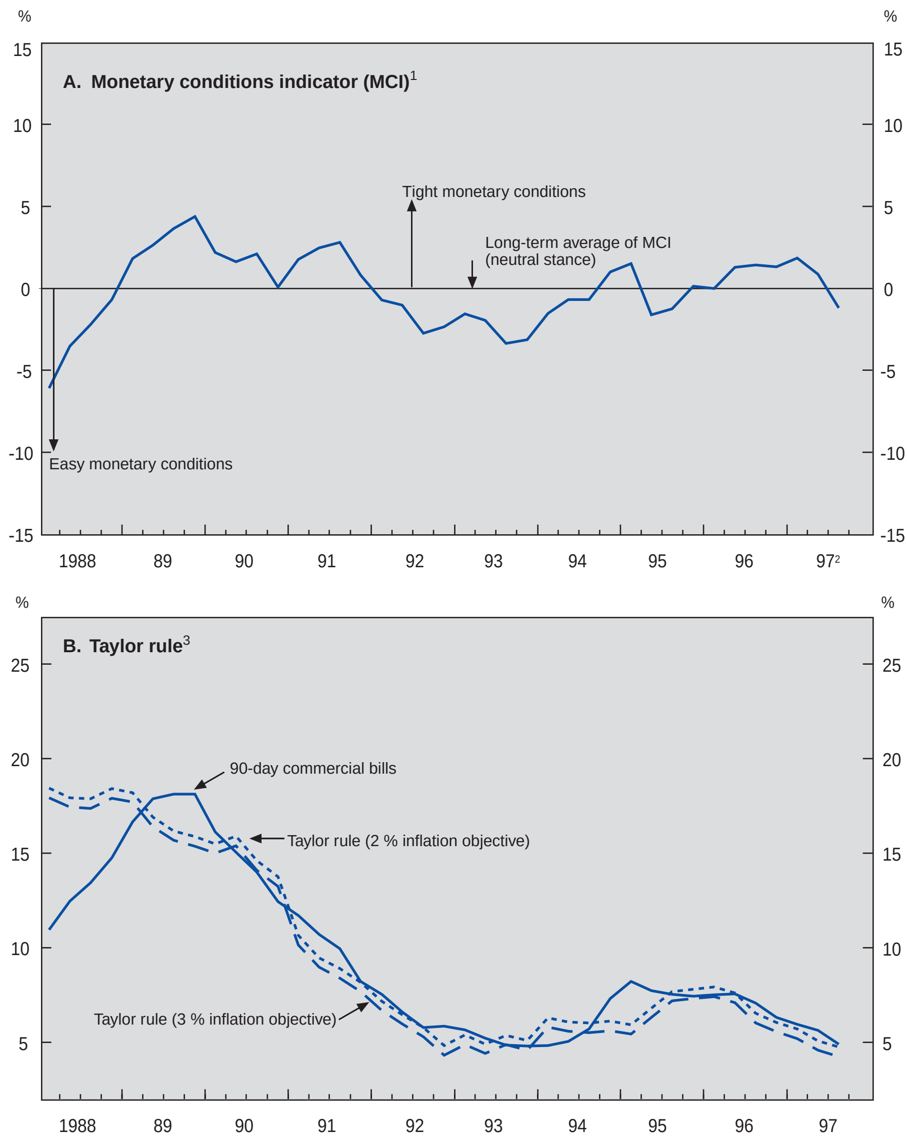
What is the current stance of monetary policy?

The question arises as to the extent to which interest rate cuts since mid-1996 have changed "monetary conditions" and whether the current stance of monetary policy is appropriate. In the framework of inflation targeting, this requires predicting the effects of the change in monetary policy on inflation. For this purpose a structural model can be employed, although the results are subject to errors in the model parameters and in the assumptions about exogenous influences. The projections presented in Chapter I, which are based on the OECD INTERLINK model, indicate that the recent easing of monetary policy is likely to support economic growth over the next two years.[24] For the same period, the projections suggest that the growth in the private consumption deflator – a good proxy for underlying inflation – may accelerate mildly but stay within the RBA's 2 to 3 per cent target range.

It may also be instructive to look at summary measures of overall monetary conditions which concentrate on relationships which are key for the assessment of the stance of monetary policy. One which recently has attracted considerable attention is the "monetary conditions indicator (MCI)", which provides a consistent way of incorporating information about the exchange rate in the assessment of the stance of monetary policy.

MCIs are used by the central banks of Canada, New Zealand, Finland, Norway and Sweden and in its simplest form equal the (weighted[25]) average of changes in the relevant real short-term interest rate and the real effective exchange rate. However, swings in the real effective exchange rate of the Australian dollar are often driven by changes in the terms of trade,[26] which have effects on demand opposite to those of movements in the real exchange rate. It thus appears important to include a terms-of-trade variable in addition to real interest rate and real exchange rate in a MCI for Australia. This has been done for the MCI[27] shown in the upper panel of Figure 15, which suggests that monetary conditions were rather easy from the middle of 1992 until late 1993 when real interest rates fell along with a weakening real effective dollar exchange rate. Monetary conditions moved towards tightening throughout 1994, but then eased until early 1996, primarily induced by real exchange rate depreciation. The strength of the effective Australian dollar exchange rate as from the first quarter of 1996 resulted in firming monetary conditions, in spite of the concomitant terms-of-trade gain and the three cash rate cuts in the second half of 1996. The further two interest rate cuts of 1997 and declines in the trade-weighted exchange rate

Figure 15. **MONETARY CONDITIONS INDICATOR AND THE TAYLOR RULE**



1. For details see endnote 27.
2. Figures underlying the MCI for the third quarter of 1997 are partly OECD Secretariat estimates.
3. For details see endnote 29.

Source: OECD Secretariat.

since early in the year subsequently shifted monetary conditions in an expansionary direction. MCIs calculated from borrowers' interest rates rather than the 90-day bill yield would show a more expansionary stance relative to history as a result of declines in bank interest margins in recent years.

The "Taylor rule"[28] offers another auxiliary indicator of monetary conditions: it determines a normative target interest rate as a function of a "normal" (*i.e.* long-term trend) real short-term interest rate, the output gap and the difference between the actual inflation rate and an inflation objective.[29] Thus the Taylor rule puts equal weights on the deviation of actual inflation from an inflation target and actual output from its potential in determining the desirable short-term interest rate level, implying that the monetary authorities are responsible not only for price stability, but also for the full utilisation of resources. The lower panel of Figure 15 shows the normative short-term interest rates derived from the Taylor rule for both the upper and the lower bound of the RBA's target for the rate of underlying inflation. The calculations are based on OECD Secretariat estimates of the output gap, which are – of course – subject to measurement errors, as are the other parameters in the Taylor rule. The estimates suggest that the rule has broadly tracked policy over the past five years. The main divergence occurred in 1994/95, when policy interest rates were raised earlier than implied by the Taylor rule estimate, reflecting the use by policy makers of forward-looking information not reflected in a backward-looking mechanical rule. The Taylor rule implies declining short-term rates since mid 1996, broadly in line with what has actually occurred. As noted earlier, the expansionary effect of declining cash rates has been reinforced in the past couple of years by declining bank margins, so that borrowers' rates are now lower, relative to history, than the 90-day bill rate. Any assessment of credit conditions also needs to recognise that credit has continued to grow relatively rapidly at rates of over 10 per cent in recent years.

Fiscal policy

The current government, elected in early 1996, has made reform of the fiscal framework and fiscal consolidation top priorities. Late in 1996 the Government introduced fiscal responsibility legislation (the Charter of Budget Honesty Bill 1996) to the Parliament. The Charter will substantially improve the framework in which fiscal policy is developed by requiring the Government to develop fiscal strategies consistent with principles of sound fiscal management embodied in the Charter. It will also substantially increase the accountability of government through improved disclosure of fiscal policy intentions and information on fiscal developments. While the Charter has not yet passed the Parliament, the Government is already complying with its requirements. Consistent with the Charter, the Government laid out the ground rules for the future conduct of fiscal policy in its first budget. It was henceforth to be set in a medium-term context with a central objective of budget balance[30] on average over the economic cycle. This objective was chosen with a view to reversing the structural deterioration in the Government's budgetary position which had occurred in the past two decades and which was seen as largely accounting for the rise in Australia's structural current account deficit (*i.e.* the decline in net national lending) over this period. Budget balance over the cycle will ensure that in future Australia's structural current account position only reflects the private sector's (and, possibly, other parts of the public sector's) net lending decisions. At the same time, it was recognised that fiscal policy should continue to play a short-term stabilisation role, especially through the functioning of the automatic stabilisers. For this reason, the objective of budget balance was expressed in terms of an average over the economic cycle.

Consolidation measures to be implemented over two years were announced in the FY 1996/97[31] budget. These cut A$ 3.9 billion from the forward projections of the deficit in FY 1996/97 and A$ 7.2 billion in the following year. Further consolidation measures were announced in the FY 1997/98 budget, mainly relating to future years. As with the previously announced measures, these also focused mainly on outlays. In all, official projections show that the budget position is to improve from a deficit of A$ 10.3 billion (2.1 per cent of GDP) in FY 1995/96 to a small surplus in FY 1998/99, rising to a surplus of A$ 10.7 billion (1.6 per cent of GDP) by FY 2000/01.

The FY 1996/97 Commonwealth budget out-turn

The budget deficit fell by A$ 5.4 billion to A$ 4.9 billion (1.0 per cent of GDP) in FY 1996/97. This outcome was A$ 0.7 billion better than the original estimate published in the FY 1996/97 budget, the improvement mostly reflecting higher revenues. Their rise as a percentage of GDP was accounted for by a substantial increase in individual- and other income tax receipts (Table 7). The increase in individual income tax receipts was largely due to increased provisional tax collec-

Table 7. **Commonwealth budget developments**

	1995/96	1996/97				1997/98		1998/99	
	Actual % GDP	1996-97 Budget		1996-97 Outcome[1]		1997-98 Budget			
		Estimate		Outcome		Estimate		Projection	
		$ million	% GDP	$ million	% GDP	$ million	% GDP	$ million	% GDP
Revenue									
Individuals income	12.4	65 940	12.8	66 453	13.0	69 760	12.8	75 000	13.0
Companies	3.7	19 700	3.8	19 173	3.8	18 590	3.4		
Other	1.4	6 990	1.4	8 146	1.6	7 720	1.4		
Total income tax	17.5	92 630	18.0	93 773	18.4	96 070	17.7	103 000	17.9
Indirect	5.9	30 260	5.9	29 888	5.9	31 120	5.7		
Other	0.4	2 138	0.4	2 154	0.4	2 243	0.4		
Total tax revenue	23.8	125 028	24.3	125 815	24.7	129 433	23.8	138 248	24.0
Total non-tax revenue	1.1	5 132	1.0	5 216	1.0	3 918	0.7	4 135	0.7
Total revenue	24.9	130 160	25.3	131 031	25.7	133 351	24.5	142 383	24.7
(real growth)[2]		(4.0)				(0.9)		(4.1)	
Outlays									
Salaries	1.7	8 303	1.6	8 498	1.7	8 304	1.5	7 885	1.4
Other final consumption	3.4	14 055	2.7	13 272	2.6	15 144	2.8	15 223	2.6
Personal benefit payments	9.3	47 317	9.2	47 999	9.4	49 030	9.0	49 931	8.7
Interest	1.9	9 884	1.9	9 559	1.9	9 051	1.7	9 115	1.6
Subsidies	0.6	3 074	0.6	2 902	0.6	2 754	0.5	2 669	0.5
Grants to other governments	6.4	32 260	6.3	31 976	6.3	32 222	5.9	33 042	5.7
Other current payments	3.0	17 696	3.4	17 571	3.4	18 632	3.4	18 984	3.3
Total current outlays	26.2	132 589	25.8	131 775	25.8	135 137	24.8	136 849	23.7
Capital outlays on goods and land	0.1	338	0.1	510	0.1	–495	–0.1	390	0.1
Capital transfer payments	0.7	2 939	0.6	3 640	0.7	2 781	0.5	2 652	0.5
Underlying capital outlays	0.8	3 277	0.6	4 151	0.8	2 286	0.4	3 042	0.5
Contingency reserve	0.0	–57	0.0	..	0.0	–219	0.0	895	0.2
Total underlying outlays	27.0	135 810	26.4	135 926	26.7	137 204	25.2	140 786	24.4
(real growth)[1]		(0.1)				(–1.4)		(0.1)	
Underlying balance	–2.1	–5 649	–1.1	–4 895	–1.0	–3 853	–0.7	1 597	0.3
Memorandum items:									
Net advances	–1.1	–6 123	–1.2	–7 448	–1.5	–10 276		–5 187	
Headline balance	–1.0	474	0.1	2553	0.5	6 423	1.2	6 784	1.2

1. Calculated on the classification structure used in the 1997-98 Budget.
2. Calculated using the GDP price deflator.

Source: 1996-97 and 1997-98 Budget Statements, Budget Paper No. 1 and 1996-97 Final Budget Outcome

tions while the rise in other income tax revenue represents higher tax collections from superannuation funds and a substantial one-off payment of Petroleum Resource Rent Tax (PRRT) (which was largely offset by an associated payment to the Victorian Government).[32] Most economic categories of expenditure were broadly stable as a percentage of GDP. The main exception was non-wage consumption, which fell sharply.

The FY 1997/98 Commonwealth budget

The major element of the Government's programme of fiscal consolidation was provided in the FY 1996/97 budget, with the announcement of substantial fiscal measures whose implementation was to be undertaken over both FY 1996/97 and FY 1997/98. The FY 1997/98 budget – delivered only 9 months after the FY 1996/97 budget – was intended to ensure that the Commonwealth fiscal position remained on a path consistent with its announced medium-term objective. It sought to preserve the tightening already in train for FY 1997/98 while introducing some new fiscal consolidation measures in FY 1998/99 and beyond, designed to ensure the achievement of budget balance in FY 1998/99.

Policy decisions taken after the FY 1996/97 budget but prior to the FY 1997/98 budget have only a small effect on the budget balance over the period covered by the Government's forward projections (Table 8). A factor attenuating the impact of policy decisions is that an allowance was made in the Contingency Reserve in the FY 1996/97 budget for the decision to maintain the (old-age) pension at 25 per cent of Male Total Average Weekly Earnings (MTAWE); this has been the most costly of these decisions. In any event, measures introduced in the FY 1997/98 budget more than compensate for these pre-budget decisions, so ensuring that the consolidation put in place by the FY 1996/97 budget is sustained in FY 1997/98, and enhanced in the outyears. The new measures increase forward projections of the budget balance by A$ 2.2 billion in FY 1998/99, rising to A$ 3.2 billion in FY 2000/01 (see Table 8). The decision to convert the "L.A.W." tax commitment[33] to a savings rebate accounts for most of the projected improvement in the forward estimates; by FY 2000/01, the net saving from this decision is A$ 1.9 billion. Other significant savings measures were announced in the administration of health-care and social-security payments, in arrangements for rent relief and the funding of public housing and in raising public sector efficiency (notably, involving the outsourcing of certain services).

The FY 1996/97 budget deficit of A$ 4.9 billion was A$ 2 billion better than estimated in the 1997/98 budget, brought down two months before the end of the 1996/97 financial year. In the FY 1997/98 budget the deficit is forecast to fall to A$ 3.9 billion (0.7 per cent of GDP) in FY 1997/98. A small surplus is forecast in

Table 8. **Budget measures and forecasts**
$ million

	1997/98	1998/99	1999/2000	2000/01
Underlying balance before all measures since the 1996-97 Budget	–4 512	0	3 750	8 313
Per cent of GDP	–0.8	0	0.6	1.3
Measures up to the 1997-98 Budget				
Outlays				
Additional spending				
Commitment to maintain the pension at 25% of MTAWE[1,2]	64	450	700	1 030
Other	358	260	486	517
Total	422	710	1 186	1 547
Savings	–679	–6	0	0
Total impact on outlays[3]	–321	254	486	517
Revenue				
Capital gains	0	–175	–180	–180
Fringe benefits	–30	–75	–55	–55
Other	–95	–56	–57	–53
Total	–125	–306	–292	–288
Total effect of measures[3]	196	–560	–778	–805
Underlying balance before 1997-98 Budget measures	–4 316	–560	2 972	7 508
Per cent of GDP	–0.8	–0.1	0.5	1.2
Measures introduced in the 1997-98 Budget				
Outlays				
Additional spending				
Establishment of the Federation Fund	0	100	200	300
Creation of the NHT[2,4]	162	265	273	255
Other	391	475	471	468
Total	553	840	944	1 023
Savings				
Delivery of LAW tax cut commitment as a savings rebate	1	–1 079	–2 414	–3 980
Health care programmes	–98	–240	–272	–295
Social security, including child care	–53	–137	–206	–228
Public housing	–71	–108	–110	–112
Government administration	–47	–90	–98	–134
Other	–515	–687	–988	–961
Total	–783	–2 341	–4 088	–5 710
Total impact on outlays[3]	–392	–1 766	–3 217	–4 942
Revenue				
Taxation rebate for savings		–350	–1 370	–2 040
Revenue protection/tax avoidance and minimisation	20	290	275	235
Other	51	451	89	47
Total impact on revenue	71	391	–1 006	–1 758
Total of measures[3]	463	2 157	2 411	3 184
Underlying balance, 1997-98 Budget	–3 853	1 597	5 383	10 692
Per cent of GDP	–0.7	0.3	0.9	1.6

1. Male Total Average Weekly Earnings.
2. An allowance was included in the Contingency Reserve in the FY 1996/97 budget.
3. Abstracts from Government spending decisions for which an allowance was already set aside in the Contingency Reserve in the FY 1996/97 budget.
4. Natural Heritage Trust of Australia Fund.

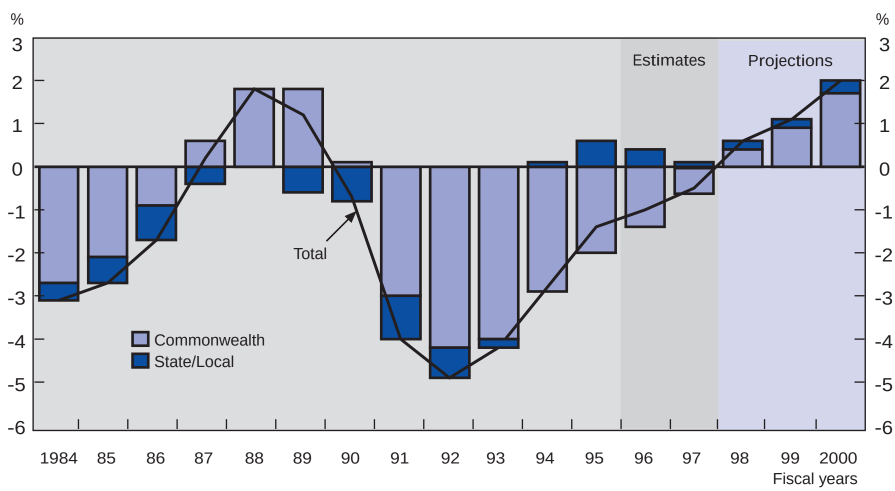
Source: 1997-98 Budget Statements, Budget Paper No. 1.

the following year, rising to A$ 10.7 billion (1.6 per cent of GDP) in FY 2000/01 (Figure 16). The projected rise in the budget balance is to be achieved through restraint in outlays, which are to decline as a percentage of GDP by around 1½ percentage points in FY 1997/98 and a further 2.3 percentage points by FY 2000/01. This will cut outlays to 23 per cent of GDP in FY 2000/01, the lowest level since the early 1970s (Figure 17). At budget time, revenue as a percentage of GDP was estimated to fall by 0.7 percentage point in FY 1997/98, mainly reflecting a lower dividend from the Reserve Bank of Australia and lower business income tax receipts, but to remain stable thereafter.[34]

With economic growth projected to remain around the trend rate (3½ per cent), the improvement in the Commonwealth's fiscal position between FY 1997/98 and FY 2000/01 is largely structural. However, this improvement exceeds the contribution which policy measures alone could be expected to make. The projected substantial decline in outlays as a percentage of GDP, reflects not only the impact of policy

Figure 16. **UNDERLYING BUDGET BALANCE**[1,2,3]

As per cent of GDP

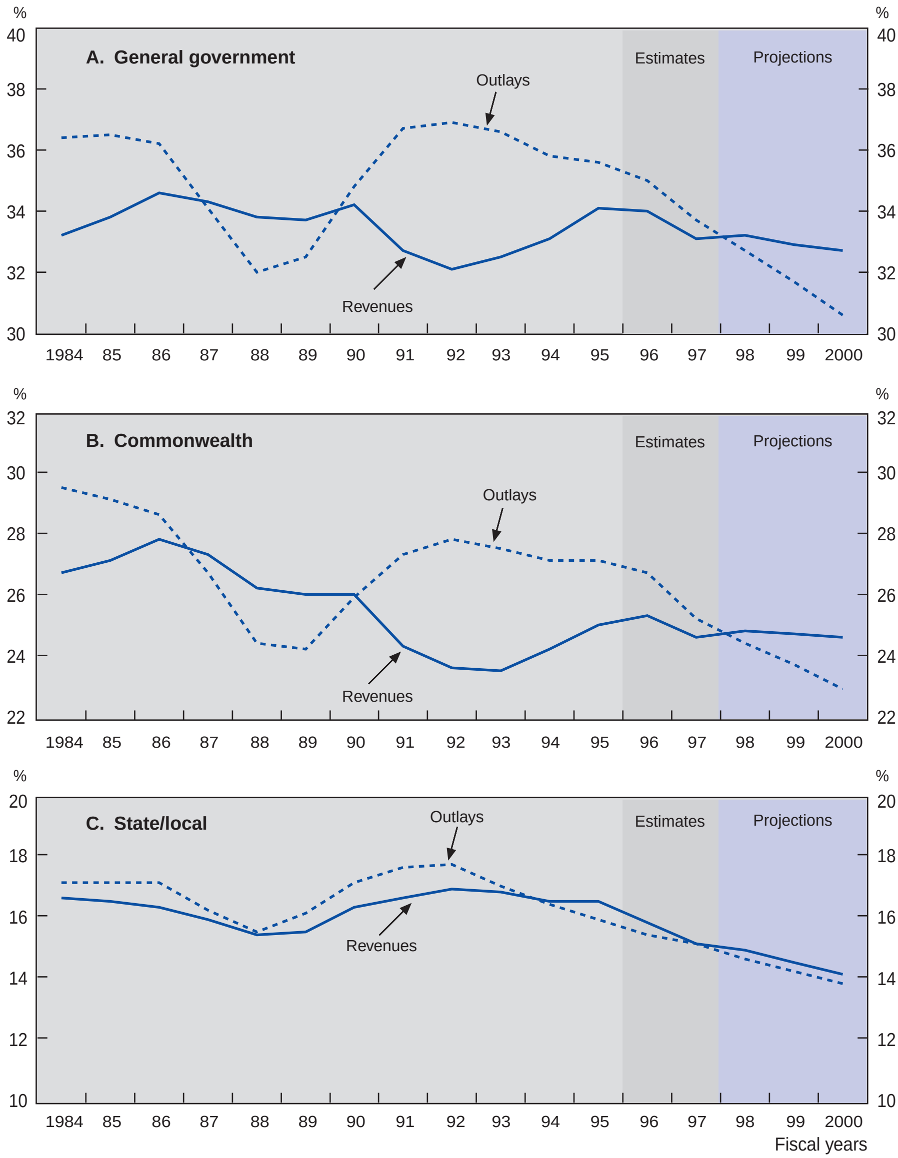


1. Data refer to the general government sector.
2. Excludes net advances, which consist primarily of assets sales and net repayments of debt by the States to the Commonwealth.
3. Fiscal year begins on 1 July of the year indicated.

Source: 1997-98 Budget Statements, Budget Paper No.1.

Figure 17. **REVENUES AND UNDERLYING OUTLAYS**[1]

As per cent of GDP



1. Data refer to the general government sector.

Source: 1997-98 Budget Statements, Budget Paper No.1.

measures, but also other influences such as lower public debt interest payments and the indexation arrangements applying to a number of outlays programmes. In particular, where outlays are indexed to the CPI they can be expected to grow more slowly than nominal GDP. Largely reflecting these arrangements, personal benefit payments[35] (36 per cent of total underlying outlays in FY 1997/98) are projected to decline by 0.9 percentage point of GDP between FY 1997/98 and FY 2000/01. Similarly, current grants to other governments (23 per cent of total underlying outlays in FY 1997/98), the most important of which (*i.e.* Financial Assistance Grants to States) remain constant in real per capita terms (apart from the States' final contribution in FY 1998/99 to the consolidation of the Commonwealth budget), are projected to decline by 0.4 per cent GDP between FY 1997/98 and FY 2000/01. At the same time, non-indexation of personal income tax scales contributes to maintaining revenue stable as a proportion of GDP despite a trend decline in indirect tax receipts as a share of GDP and the introduction of the savings rebate.

The outlook for States/local government

The State/local government sector steadily improved its fiscal position from the early 1990s, reaching a surplus of 0.6 per cent of GDP in FY 1995/96 (see Figure 16). This consolidation largely reflected outlays restraint: as a per cent of GDP, outlays fell by 1.7 percentage points over the four years to FY 1995/96 (see Figure 17). Although outlays continued to decline as a percentage of GDP in FY 1996/97, the estimated surplus nevertheless contracted to 0.4 per cent of GDP. The sector's fiscal position is forecast to deteriorate again in FY 1997/98, but (only just) to remain in surplus. This deterioration, which occurs despite a decline in outlays as a share of GDP, is associated with lower transfers from the Commonwealth and own source revenue as a share of GDP. Small but increasing surpluses are projected in subsequent years, despite a continuing decline in revenue as a percentage of GDP. Outlays are projected to fall markedly as a percentage of GDP owing to improvements in public sector efficiency and lower interest costs associated with falling net debt (assisted by the proceeds of asset sales). The decline in revenue as a per cent of GDP reflects developments in both transfers from the Commonwealth and own-source revenue. The latter is projected to grow more slowly than economic activity because growth in some tax bases is weakly related to economic activity and because a number of States are explicitly seeking to constrain tax levels. Another factor is that privatisation is reducing dividend receipts from public enterprises.

The outlook for general government

Fiscal developments for general government largely reflect those of the Commonwealth. The general government balance is projected to swing from a deficit of 1.0 per cent of GDP in FY 1996/97 to a small surplus in FY 1998/99 and to reach a surplus of 2.0 per cent of GDP in FY 2000/01 (see Figure 16). This consolidation is to be achieved through outlays restraint. As a percentage of GDP, outlays are projected to decline by 4 percentage points to 31 per cent, which is low by the standards of most OECD countries. Revenues are projected to decline slightly as a share of GDP, mainly reflecting developments in Commonwealth finances in FY 1997/98 and in State finances thereafter.

Debt

General government net debt has roughly doubled as a percentage of GDP during the 1990s, reaching a peak of 26 per cent in 1995 (Figure 18). This increase reflected developments in the Commonwealth sector and would have been greater still in the absence of asset sales. For the first time this decade, general government net debt declined as a percentage of GDP in 1996 and is estimated to fall sharply over the next few years, to 13 per cent of GDP in 2001. For the most part, this expected decline reflects the projected halving in the Commonwealth's net-debt-to-GDP ratio from over 19 per cent in FY 1995/96 to around 10½ per cent in FY 2000/01. The State/local government sector is estimated to have almost eliminated its net financial debt by 2001. By the standards of most OECD countries, current and projected net debt-to-GDP ratios are low in Australia.

The stance of fiscal policy

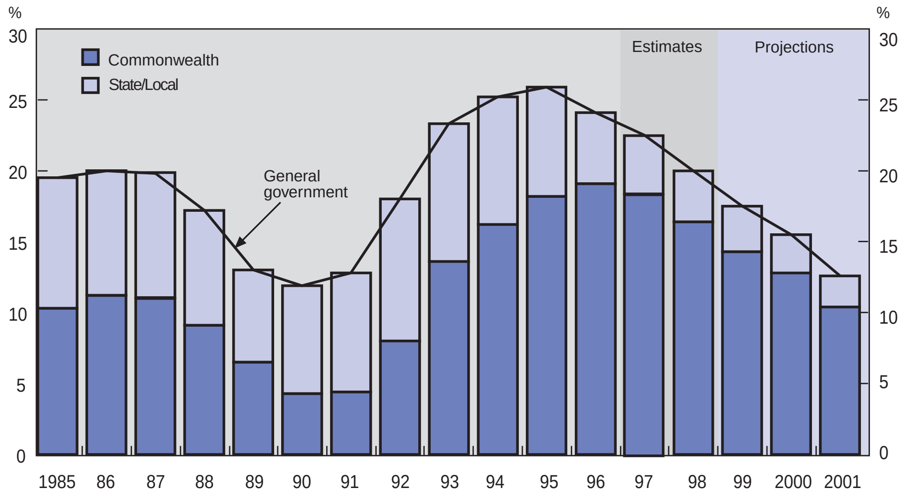
On a calendar year basis, the OECD Secretariat projects that the general government balance will strengthen by almost 2 per cent of GDP over the three years to 1999. As growth is projected broadly to be at the trend rate, estimated changes in the cyclically-adjusted budget balance are similar.

Assessment

The Commonwealth budget position has strengthened significantly in recent years and further substantial improvements are in prospect. The projected consolida-

Figure 18. **NET DEBT**[1]

As per cent of GDP



1. Data refer to the general government sector.

Source: 1997-98 Budget Statements, Budget Paper No.1.

tion is to be achieved through cutting outlays as a share of GDP. In view of the increasing difficulty of taxing internationally mobile factors of production and the distorting effects of higher taxes, the focus on outlays restraint would appear to be prudent. It may also enhance the durability of the consolidation.

The foundations and major elements of this consolidation programme were laid in the FY 1996/97 budget, in line with the Government's medium-term fiscal objectives. Policy measures spread over two years were announced which account for the bulk of the projected reduction in the deficit in FY 1997/98, and a significant reduction in the outyears. Additional measures in the FY 1997/98 budget seek to preserve and build upon the consolidation in the FY 1996/97 budget, with the focus on adding to the consolidation in FY 1998/99 and beyond. In the period ahead, the Government will need to ensure that fiscal policy remains focused on the medium term. In particular, if the Government is to attain its objective of balance over the cycle, the structural tightening undertaken in recent years will need to be kept fully in place and significant surpluses will need to be achieved while economic growth prospects remain favourable.

III. Implementing structural reform: a review of progress

Last year's OECD *Economic Survey of Australia* provided a set of policy recommendations for reducing unemployment and for improving the Australian economy's ability to cope with structural change, through enhancing the ability to adjust and to adapt, and increasing the capacity to innovate and be creative. Along the lines of the OECD *Jobs Study*, these recommendations were derived from a review[36] of structural features of the Australian economy which are likely to determine the incidence of non-cyclical unemployment and the level of productivity. The analysis concluded that past reform efforts moved the Australian economy a long way towards being flexible and adaptable, and that recent policy actions would provide further impetus in the right direction. The area where most progress has been made was in increasing competition in the tradeables sector. The areas where – despite the significant progress made – substantial further scope for reform was seen include the decentralisation in determining pay and working arrangements, exposing the infrastructure service provision to greater competitive pressures and improving the efficiency and effectiveness of education and training. In several of these areas, reforms came into operation at the end of 1996 and during 1997, in others legislation is currently under preparation. This chapter takes stock of recent structural reform measures and tries to identify what remains to be done (Table 9).

Industrial relations reform

The gradual shift in the focus of the bargaining of wages and employment conditions from the central awards system[37] to the level of the enterprise began in 1987 and has improved the organisational flexibility of workplaces (Table 10). But

Table 9. **Implementing the OECD Jobs Strategy: an overview**

Proposal	Action	Assessment/recommendation
I. Increase the flexibility of wages and employment conditions		
• Make a more decisive shift towards enterprise bargaining than has occurred to date.	Implementation of the *Workplace Relations and Other Legislation Amendment Act 1996* (*WRA*) in early 1997.	The *WRA* provides a more favourable environment for enterprise-level bargaining.
• Increases in award wage rates should be modest and focus on the low paid, consistent with the intention that awards operate as true safety net.	April 1997 "Safety-Net Review" delivered annual average award rate increases of about 2 per cent.	It would be preferable to move more quickly away from the award system towards enterprise bargaining, to enhance overall employment flexibility.
• States which maintain award systems should harmonise their industrial relations legislation with that of the Commonwealth.	Government of Victoria transferred a large part of its industrial relations powers to the Commonwealth in early 1997; Queensland aligned labour legislation to *WRA*.	Other States should follow Victoria's and Queensland's example.
• Reform employment protection legislation, limiting the potential costs of dismissal and reduce disincentives to hiring.	Unfair dismissal legislation simplified as from early 1997.	Simplify legislation further; exempt small businesses from unfair dismissal laws.
II. Reform active labour market policies		
• Make labour market assistance more responsive to the needs of the clients and enhance its efficiency by introducing more competition into the market.	The 1996 Budget provided a radical reform of all areas of labour market assistance, through institutional reorganisation and increased private sector involvement.	Should be fully implemented.
• Simplify and rationalise labour-market programmes and their delivery.	Since May 1997, the new Commonwealth Service Delivery Agency provides income support and basic employment assistance as single point of contact.	Make careful evaluation of reform as soon as possible.
• Introduce competitive employment services market.	Introduction planned for May 1998.	Ensure timely implementation.
III. Improve labour force skills and competencies		
• Ensure that reforms of apprenticeship and traineeship arrangements announced in the 1996 Budget are put in place.	Arrangements have been made for government funding for off-the-job training of commencing[1] apprentices and trainees to be allocated on the basis of "user choice" from the beginning of 1998.	These reforms will stimulate the development of a national training market. This should increase the effectiveness of training by making providers more responsive to client needs.

Table 9. **Implementing the OECD Jobs Strategy: an overview** *(continued)*

Proposal	Action	Assessment/recommendation
• Allocate a larger proportion of governments' budgets for vocational training and training on a competitive and non-discriminatory basis.	Progress has also been made in developing a new National Training Framework which is expected to be in place in 1998.	
IV. Enhance product market competition		
• States and Commonwealth regulators should cooperate to ensure that the National Competition Policy works effectively.	All States and Territories passed legislation necessary to apply the Trade Practices Act to all areas of the economy.	Continue to make phased compensation payments to States and Territories dependent on progress in implementation of agreed competition policy reform.
• Establish a tariff reduction programme for the period beyond 2000, when the present programme expires.	In 1997 it was decided to freeze tariffs on cars at 15 per cent from 2000 until 2005, and then cut to 10 per cent.	Large cuts in high tariffs for cars, footwear, clothing them and textiles would boost overall economic efficiency.

1. "User Choice" will be implemented in 1998 for commencing apprentices/trainees rather than all apprentices/trainees. For those already in training, the States/Territories will consider requests to move to user choice on a case-by-case basis. New South Wales has formally reserved its position on "User Choice" and it is still unclear how far they will go in implementing it in 1998.

Source: OECD.

important barriers to decentralised bargaining remained, especially for smaller and medium-sized firms, which are mostly non-unionised or lightly unionised. The Commonwealth Government's *Workplace Relations Act 1996*, which came into effect at the beginning of 1997, is intended to address these barriers. It aims at facilitating the transition to enterprise bargaining, mainly by restricting awards to a safety net of minimum wages and other core conditions of employment, and by providing more effective choice and flexibility for parties in reaching enterprise agreements. To enhance the flexibility of workplaces, the new *Act* provides fornon-union collective agreements (certified agreements), which replace the largely unsuccessful Enterprise Flexibility Agreements for the non-union or lightly-unionised sectors, and modifies Certified Agreements for unionised enterprises. In addition the new Act provides for formalised individual agreements with the introduction of Australian Workplace Agreements. The Act also aims, through a number of provisions, to reduce the monopoly power of unions in the bargaining process. Increased contestability of employee representation should develop more competitive organisations, providing a higher level of service to members. Moreover, a more balanced industrial relations framework with a more equal treatment of bargaining parties will lead to better labour market outcomes and lower structural unemployment. Main features of the Commonwealth Government's draft law were already outlined in last year's *Survey*, but amendments to the Bill were required to gain the approval of the Senate. Although these amendments did not fundamentally change the central intent of the Bill, the new Act's major elements are briefly sketched out[38] below.

A new role for the federal award system

The new role of the award system is to provide a safety net of fair and enforceable minimum wages and other core conditions of employment. To this end, the new *Act* aims at the simplification of awards through confining the employment conditions in awards to 20 "allowable matters",[39] with all other matters being determined at the enterprise or workplace level, either in formal agreements or informally. Transitional arrangements apply, whereby parties to existing awards are encouraged and assisted to simplify them to focus on allowable matters and address other issues by agreement; by mid-1998, any award provisions outside the allowable matters will no longer be enforceable. The Australian Industrial Relations Commission (AIRC) focuses on the setting of minimum wages and conditions in awards but is generally no longer in a position to arbitrate claims above the minimum safety net. Hence, no

Table 10. **Key developments in the federal industrial relations system**

Year	Initiatives in the federal system
1987	Two tiered wage system introduced with the second tier offering wage increases of up to 4 per cent in exchange for productivity improvements which met the Australian Industrial Relations Commission's (AIRC) restructuring and efficiency principle. Agreements settled at enterprise level but required ratification by the AIRC. Matters typically addressed included: greater flexibility in working hours (for example, span of hours worked at ordinary time rates, changed overtime rates); removal of some restrictive work practices (for example, through job sharing, greater casual employment and task broadening); and wage differentials.
1988	Structural efficiency principle introduced to allow wage increases based on commitments to award restructuring. Award based, so negotiations took place at the industry/union level. The most common changes arising from award restructuring were: reductions in the number of job classifications; establishment of new skills-related career paths; and multi-skilling. Also introduced enterprise flexibility clauses into awards.
1989 - 1993	The *Industrial Relations Act 1988* introduced Certified Agreements, albeit heavily constrained by a "public interest" test and confined to unionised enterprises. While seeking to devolve responsibility to the bargaining parties, legislative changes in 1992 gave the AIRC an important role in determining if agreements satisfied statutory tests, including a "no disadvantage test". Effectively, non-union enterprise bargaining continued to be excluded.
1994	The *Industrial Relations Act 1993* which came into operation in March 1994 extended the scope for enterprise bargaining by introducing Enterprise Flexibility Agreements (EFAs). These allow workplace agreements to be negotiated in non-unionised workplaces. EFAs do not require that unions be parties to agreements but unions can challenge their ratification. The AIRC must be satisfied that the terms and conditions in an agreement do not disadvantage employees when compared with the relevant award.
1997	The *Workplace Relations and Other Legislation Amendment Act 1996*, which came into effect at the beginning of1997, restricts awards to a safety net of minimum wages and other core conditions of employment. The new *Act* provides for Australian Workplace Agreements (AWAs), which replace the Enterprise Flexibility Agreements for the non-union or lightly-unionised sectors. It makes AWAs and Certified Agreements subject to a new "global no-disadvantage test".

Source: Productivity Commission (1966), *Stocktake of progress in microeconomic reform*, AGPS, Canberra and Commonwealth Department of Industrial Relations (1996), *Changes in federal workplace relations law - legislation guide*, mimeo.

new "paid rates awards" are allowed, while existing paid rates awards are to be simplified and be treated in the same way as minimum awards. This implies that over time prevailing paid rates structures will be phased out and translated into minimum rates. All these provisions are aimed at promoting the ongoing conversion of the award system into a genuine safety net. The mechanism by which the AIRC adjusts safety net rates of pay and other award minima is not prescribed in the new Act. This will be a matter for the Commission to determine, within the framework and objects of the legislation and after hearing the submissions of all the parties.

Australian Workplace Agreements

Australian Workplace Agreements (AWAs) are intended to introduce an option for enforceable individual employment agreements between corporations and their employees. AWAs are negotiated between an employer and employees either collectively or individually but must be signed individually. Employees may appoint a bargaining agent (which may be a union) to negotiate on their behalf, but the Act rules out uninvited union involvement. AWAs need to be approved by the Employment Advocate, a new statutory office established under the Act. The tasks of the Employment Advocate are to make sure that the nature of an AWA was sufficiently explained to a concerned employee, that the employee genuinely consented to the making of an AWA and that AWAs meet the "global no-disadvantage test". The latter test stipulates that on the whole, the agreement must not be less favourable to the employee concerned than the relevant award and any relevant law.[40] The new "global no-disadvantage test" allows a trade-off in wages and working conditions, in contrast to the "line-by-line" no-disadvantage test of the *Industrial Relations Act 1988*. In case of doubt as to whether an agreement meets the new global no-disadvantage test, the Employment Advocate will refer it to the AIRC to resolve the question. The AIRC even may approve an agreement which does not meet the no-disadvantage test provided it is not contrary to the public interest, for example in the case of a firm's attempt to overcome a short-term business crisis.

Certified Agreements

Introduced by the 1988 *Industrial Relations Act* and amended in 1992, Certified Agreements (CAs) were designed to enable individual firms and trade unions to negotiate agreements on wages and work conditions. Under the Workplace Relations Act, CAs may be negotiated with unions or directly between employees and their firms, but in that latter case, relevant unions will be able to represent individual employees in meeting and conferring with the employer about the agreement and become bound by an agreement where a union member requests this. These agreements are intended to provide a more effective stream for enterprise bargaining in lightly or non-unionised workplaces than Enterprise Flexibility Agreements which invited unwarranted union intervention in non-union workplaces. Until 1996, CAs had to pass the narrow no-disadvantage test in order to be ratified by the AIRC, which limited their diffusion. To make CAs more accessible, the new *Workplace Relations*

Act 1996 makes CAs subject to the same new “global no-disadvantage test” as AWAs. Before certifying an agreement, the AIRC must be satisfied that a majority of employees to whom the agreement applies have genuinely endorsed the agreement.

Freedom of association

The new *Act* contains provisions which establish the principle of freedom of association as a main pillar of the Government’s industrial relations policy. Thus, membership of all organisations has to be voluntary, which rules out compulsory unionism, preference clauses for union members and discrimination based on membership or non-membership of a union. The *Act* also aims at facilitating the establishment of new trade unions (or bargaining units), aiming at increased competition between unions. This has been done by reducing the minimum number of members for a union to be registered from 100 to 50 persons and by making it harder for existing unions to oppose the registration of a new union on the basis that interested workers could “conveniently belong[41]” to an existing union.

Industrial action

There is a limited right to strike or lock out while negotiating CAs and AWAs, but not during the period of an agreement’s operation. Notification of proposed industrial action is required and strike pay is prohibited. The AIRC’s powers to curtail all other (*i.e.* non-protected) industrial action has been strengthened and made enforceable by injunctions. Secondary boycott provisions have also been restored to the Trade Practices Act and contraventions are subject to injunctions, damages, and in certain cases fines up to $750,000.

Unfair dismissals

Anecdotal evidence suggests that changes made to the unfair dismissal legislation in the 1993 *Industrial Relations Reform Act* may have created severe disincentives to hiring workers, particularly in small firms, as these changes seem to have encouraged “recourse to legalism, complexity and technicality”.[42] Out of this concern, the new Government simplified the federal unfair dismissal legislation on the basis of a “fair go all round” (fair to both employers and employees) from the beginning of 1997. Its aim is to minimise legal costs and discourage frivolous and malicious claims, *inter alia* through the requirement of a filing fee, the ability of the AIRC to arbitrate rather than the claim going to court, and award costs in cases of applications instituted vexatiously, and the increased emphasis on the substantive reasons for dismissal rather than procedural aspects. In consequence, the number of federal applications for unfair dismissals fell from 11 693 in the first 42 weeks of 1996 to 5 748 in the first 42 weeks of 1997 – a decrease of 51 per cent. However, the number of State unfair dismissal cases has picked up as employees who previously applied under the federal jurisdiction changed to applying under State jurisdiction. But overall, the number of combined Commonwealth and State unfair dismissal applications has declined by 23 per cent for the period from January-August 1997 compared with the same period in 1996. Restricting the opportunity for federal award employees to transfer to the State system would require substantive legislative change and is therefore not being considered by the Commonwealth Government for the time being. Since it is the Government's view that unfair dismissal provisions continue to be burdensome for small businesses and may have a negative impact on hiring, legislation is currently before Parliament seeking to exempt small business from unfair dismissal legislation.[43]

Harmonisation of federal and State systems

Australia's dual system of federal and state industrial laws and tribunals remains complex and burdensome. This motivates ongoing efforts of harmonisation of federal and state industrial relations systems through complementary legislation and other arrangements (*e.g.* between the federal and state tribunals) and a co-operative approach to administrative arrangements and service delivery. A most significant event in this context was the historic decision of the Victorian Government to transfer a large part of its industrial relations powers to the Commonwealth Government as from the beginning of 1997. This ensures that the Victorian and Commonwealth industrial relations systems operate without wasteful jurisdictional contests. Workers not already covered by the federal system will remain in the State system until their existing agreements expire or both parties agree to enter into federal awards or a federal enterprise agreement. No new formal State agreements are possible. For those without a federal agreement or a federal award, the AIRC will be able to make safety net adjustments to Victorian minimum wages. Queensland has passed legislation which is complementary to the federal Act and closely parallels its provisions; and both South Australia and Western Australia have legislated some aspects of harmonisation. The States, other than Victoria, have tended to retain compulsory arbitration and the award system, but have given employers and employees the opportunity to negotiate enterprise agreements. Employers and their employees in these jurisdictions also have access to federal agreements if they wish. With the exception of Queensland, the spread of formal enterprise agreements in state jurisdictions has hitherto lagged behind that at the federal level.

Assessment

The *Workplace Relations Act 1996* addresses major shortcomings of previous legislation which aimed at a more flexible and adaptable labour market. By further reducing the importance of awards and the role of unions in the industrial relations system the *Act* provides more opportunities for employers to deal directly with employees and to agree on terms and conditions of employment that suit individual workplaces. By being limited to 20 "allowable matters", awards constrain the operation of firms to a lesser extent than was previously the case. Also, vetting of AWAs by the new Employment Advocate rather than by the AIRC is likely to make enterprise bargaining a more informal process. Like its predecessors, the new Act's approach is evolutionary rather than revolutionary as it retains core elements of the industrial relations system: awards continue to play a significant role as a safety net of minimum terms and conditions of employment, the AIRC retains arbitral powers (especially the power of compulsory arbitration over "allowable matters") and protection under federal law for unfair dismissal continues, albeit in a modified way.[44] Hence, while the reforms represent an important progress doubts still prevail as to whether sufficient flexibility in industrial relations can be achieved as long as the award system (including the AIRC) remains such an important part of industrial relations.

The new global "no disadvantage test" introduces greater flexibility into enterprise agreements. Nevertheless, the fact that awards continue to represent the benchmark against which this "no-disadvantage test" is conducted entails the risk that awards continue to constrain direct negotiations, dictate working arrangements, entrench wage relativities, limit wage dispersion and tend to make some registered enterprise agreements de-facto "add-ons" to existing awards rather than true comprehensive agreements. While the "no-disadvantage test" is less binding for the many workers paid at well above safety net levels, the retention of the "no-disadvantage" clause will limit the effect of enterprise agreements on low paid workers, as it provides little flexibility at the bottom end of the wage scale and hence will provide little help to the unemployed in the near term. Further deregulation of wage formation combined with reforms of the tax and welfare system to deal with ensuing equity issues appears a more promising approach to help those at the bottom end of the labour market.[45] In the longer term, however, it is possible that the real value of minimum wages might decline. Whether this happens will depend on the adjustments the AIRC makes to safety net rates of pay and other award minima. In making these adjustments the AIRC is required to consider the needs of the low paid and economic factors including the level of productivity and inflation and the desirability of attaining a high level of employment. The outcome of the "safety-net review" by the AIRC in April 1997, which delivered only moderate increases in award wages in spite of the Australian Council of Trade Unions' (ACTU) "Living Wage Claim", is reassuring in this respect: while the ACTU sought an increase in minimum award wages of $8^3/_4$ per cent over the following year and 30 per cent over the next three years, the actual "safety-net adjustment" granted amounts to an increase in average award rates of pay of just under 2 per cent over the year ahead. However, it has to be kept in mind that this increase starts from a wage floor which is comparatively high; for example, it is some 40 per cent above its US counterpart (at exchange rates of mid-1997). As a consequence of the rather prudent approach to reform, the expected positive effects of the new *Act* on employment are likely to take time to show up.

The introduction of AWAs as well as the new provisions governing non-union CAs will both act to reduce union involvement in enterprise bargaining.[46] But whether the complex new "more conveniently belong to" clause in the *Act* will indeed further the spread of new trade unions is doubtful; Costa (1997), for example, rather expects increased dispute over the concept of effective representation.[47] Moreover, the requirement that an enterprise has at least 50 members excludes the majority of the workplaces.

Another unresolved issue is the continuing existence of separate federal and state industrial relations jurisdictions, in spite of the recent incorporation of the jurisdiction of Victoria, the second-most populous state, into the federal industrial relations system. The fact that most larger worksites, and many small ones, have some employees covered by the federal system and some by the relevant state system implies significant inefficiencies for most businesses, as it forces employers to deal with two distinct systems, which takes considerable managerial resources and appears often to lead to conflicts that would not otherwise arise. However, this administrative burden can be rationalised by the employer formalising a federal certified agreement.

Altogether, the *Workplace Relations Act 1996* is another significant step towards freeing up of the labour market. It is a desirable complement to other microeconomic reforms and can be expected to have beneficial effects on economic efficiency in the long run. But the legislation in itself will not automatically provide for increased workplace flexibility. Instead, the success of the new legislation depends largely on how much use employers make of the new Act's provisions and the extent to which employers work with their employees to make workplaces more productive and efficient. This also requires that many employers, who used to adhere to long-standing processes of dispute resolution and award making, overcome the forces of inertia and capitalise on the Act's possibilities. Since the Act has been in operation for a few months only, it is, however, too early to assess whether such a process is yet under way.

Active labour market policies

A new framework

The *Working Nation* labour market programme[48] – introduced in May 1994 – covered a wide range of employment initiatives which were focused primarily on the long-term unemployed. It entailed a significant increase in labour market expenditures, especially on wage subsidy schemes and direct job creation. However, a comprehensive assessment[49] concluded in 1996 that the overall results of the *Working Nation* package fell short of expectations. In particular, the decline in the number of long-term unemployed (18 months and above), although significant, turned out much lower than projected. In part, this was the result of the greater emphasis placed on the very long-term unemployed (more than 36 month) under the *Job Compact* at the expense of reduced assistance to people unemployed for between 12 and 18 months, which seems to have moved the latter group into longer duration unemployment. The shortfall in the reduction of long-term unemployed required a higher proportion of job placements in brokered programmes[50] than initially projected, which are particularly costly.

In consequence, the new Government announced a radical reform to all areas of labour market assistance in the FY 1996/97 budget. The goal of these reforms is to improve the efficiency of labour market services through institutional reorganisation and increased private sector involvement.[51] The reform maintains the focus on long-term unemployed and those most at risk of becoming so. During the transition to the new employment services market, labour market programmes will continue to operate, but in a more streamlined and simplified way. Funding has been targeted to those programmes found to be most cost-effective in helping people into jobs – wage subsidies and apprenticeships and traineeships. A fundamental aspect of the Government's reforms is to shift the focus of labour market assistance away from placements in short-term programmes toward long-term work placements. Under the new arrangements, contracted employment services providers will have greater flexibility to tailor assistance to the needs and capacities of individual job seekers. Incentives and rewards to employment services providers – namely fee payments and future contracts – will be clearly related to their performance in placing people into jobs.

The reform integrates previously separated government services into the new Commonwealth service delivery agency, Centrelink, as single point of contact, which provides income support and basic employment and student assistance services. Centrelink registers vacancies and maintains a job vacancy database which can be accessed by jobseekers themselves *via* touchscreens. Centrelink also registers jobseekers for benefits and assesses their eligibility for further assistance. Formal job brokerage will not be undertaken by Centrelink. Instead, those eligible for job brokerage assistance will be able to access these services from contracted employment services providers.

From 1 May 1998 labour market programme funds and funding for case management will be "cashed out" to fund the employment services market. Private, community and public sector organisations, including a corporatised public provider, will be contracted to provide employment services. The public provider will be fully separated from Centrelink and will compete for clients on an equal basis with other employment services providers. It will also serve as a "last-resort" option in regions where no other employment services provider exists. Employment services providers will be contracted to provide a new more integrated employment service, FLEX – flexible labour exchange services. FLEX will offer three linked servicing streams of assistance depending on each job seeker's level of need: labour exchange services (matching jobseekers with vacancies); job search training; and individualised intensive job preparation and support. Priority under the new arrangements will be given to the more disadvantaged jobseekers, with a particular focus on the long-term unemployed or those most at risk of joining this group.

Where a choice of providers is available, job seekers who are referred by Centrelink for assistance will be able to nominate their service provider. Employment services providers contracted to provide intensive job preparation and support will work with clients to identify individual job seeker needs and to finalise individual return to work plans. Service providers will also be involved in activity testing arrangements. Payments to employment services providers will largely be based on results achieved. A full fee for providers offering intensive job preparation and support will be paid only after a job seeker has been off allowances for longer than six months. Payments to employment services providers will be financed out of funds freed from the phasing out of most labour market programmes. It is planned that the corporatised public provider, the Public Employment Placement Enterprise, will offer job brokerage services under contract from December 1997. However, the competitive employment services market will not commence until May 1998. The reform looks promising, but with major elements of the planned employment assistance not in operation yet, it seems too early to judge whether the new arrangements will produce better outcomes for the unemployed.

Work for the Dole

The FY 1997/98 Commonwealth budget allocated funding of A$ 21.6 million to the Work for the Dole initiative for unemployed young people. The initiative is intended to involve young job seekers in a work environment, foster appropriate work habits and give young people a chance to engage with the community rather than being isolated from it. The initiative is based on the principle of mutual obligation: that it is fair and just that people be asked to make a contribution to the community in return for payments of unemployment benefits. Under the pilot stage of the initiative, which will cost A$ 12.4 million, 179 pilot projects were approved to provide work experience for 10 488 unemployed young people. To be selected, pilot project sponsors had to demonstrate their experience and credentials in working with young people and their ability to foster links with local community organisations. They also had to provide assurances that there would be no risk to local paid jobs and that they would continue to support participants after the projects finish. The first projects started in November 1997. There are projects in every State and Territory and most of the projects are in rural and non-metropolitan areas with high youth unemployment. Projects are intended to provide participants with a variety of tasks, challenges and responsibilities, opportunities to work in teams and mix with people and give them a sense of pride in their work and achievements. Priority for participation in the pilot projects is given to young people aged 18-24 years who had been unemployed for at least six months, although some projects included volunteers older than 24. A detailed evaluation of the pilot projects will be carried out which will be taken into account in deciding the future of the initiative. An advantage of the initiative is that, being only a part-time job creation scheme, participants can acquire work skills and continue to search for a job. The likelihood of success of the initiative would increase if suitable work projects could be found which provided the young unemployed with experience valuable enough to make them attractive to employers as potential employees.

Education and training

The Coalition Government has been concerned about the lack of progress over the years in raising participation in work-based training. It considers that this has been due in part to the lack of flexibility in the industrial relations system in providing wage arrangements which are appropriate to the particular types of work-based training arrangements which are suitable for different areas of employment. This problem was addressed through the wider industrial relations reforms passed in late 1996 (1996-97 *OECD Survey of Australia*, Chapters III and IV). These reforms enable employers and their apprentices or trainees to enter into Australian Workplace Agreements (AWAs) or Certified Agreements (Cas). Under these agreements there is greater scope to customise the employment conditions for apprentices and trainees to suit enterprise needs, for instance through: access to part-time apprenticeships and traineeships; varying the duration of apprenticeships and traineeships; varying the proportion of training and productive time; and competency based progression through wage levels.

The *Workplace Relations Act 1996* also established approving authorities to determine the mix of productive and training time and the basis for progression through wage levels for apprentices and trainees. These determinations will be used by employers to establish the minimum wage payable to apprentices and trainees employed under AWAs and CAs for the purposes of the no disadvantage test under the Act. These reforms allow for the mix of training and productive time to be varied to suit workplace conditions. A Wage Top-up Scheme was announced in the

FY 1996/97 budget to supplement the wages of full-time apprentices and trainees participating in these new arrangements. Under these arrangements, it is possible that the amount of time spent in training could increase significantly, thereby making it possible for the gross weekly wage of a New Apprentice to fall below minimum levels set by the Commonwealth under the Wage Top-up Scheme. Where this occurs, the New Apprentice is eligible for a wage supplement under the Scheme.

The limited nature of the market for training has been considered to be a barrier to the development of Vocational Education and Training (VET). The Australian National Training Authority (ANTA) (1994) stated in its national strategy that developing such a market was a prime means of increasing the responsiveness of VET providers to the needs of industry and students. Following a review of training reforms (Allen Consulting, 1994), it funded pilot projects for "user choice" in off-the-job training of apprentices and trainees. This meant that employers were able to choose what the nature of training should be, where it should be provided and by whom. From the beginning of 1998, government funding (from both the States and Territories and the Commonwealth) for commencing apprentices and trainees will be allocated in this way. Funds will flow to providers chosen by clients, rather than through centralised allocation processes, and clients will be able to negotiate with providers on aspects of the training to be provided. The generalisation of "user choice" will provide the basis for the consideration of further reforms to introduce greater competition and market-based arrangements.

A building block for the development of a training market is the establishment of national competency standards as they define a "product" for which suppliers can compete. Vocational Competency Standards, which specify the knowledge and skill as well as their application to the standard of performance required in employment, have been developed in recent years. However, the operation of the framework within which training is recognised has been criticised for being excessively bureaucratic and complex, discouraging enterprises and private providers of training from participating in the system (Taylor, 1996). To address these concerns, a new National Training Framework has been under development in the past year and is expected to be implemented fully in 1998. This will see the former emphasis on course accreditation processes and national curriculum replaced with new arrangements focusing on the registration of training organisations and the linking of competency standards to national qualifications. The aim is to increase the diversity of training organisations operating in the training market and to give them greater flexibility to respond to clients' needs while ensuring that training outcomes reflect industry requirements and result in portable qualifications. As part of the new arrangements, mutual recognition of training organisations, products, services and outcomes across State/Territory borders will be strengthened.

Complementing these measures have been reforms in the past year to the industrialarrangements underpinning apprenticeships and traineeships which give employers greater access to arrangements which better suit their particular requirements. In addition, the "red tape" of both levels of government in apprenticeships and traineeships has been streamlined.

Reform of the health care system

Australia's health-care system was last reviewed by the OECD in the 1994-95 OECD *Survey of Australia*. In that *Survey*, it was noted that efforts to contain spending pressures through a cap on budgets for public-sector hospitals had undermined efficiency as restraint had been imposed where capped budgets made it possible, not necessarily where resources were being used least efficiently. Efficiency had been further eroded by the strategies adopted by public hospitals to shift costs onto the ambulatory, private hospital and out-of-hospital pharmaceuticals sectors, where the Commonwealth Government provides subsidies on a fee-for-service basis. New ways of restraining expenditure were required, not only to enhance efficiency, but also because the limits were being reached beyond which service would be adversely affected in some States. To be effective, new approaches had to focus on the root causes of expenditure pressures – fee-for-service payment arrangements for medical services and capped hospital budgets without incentives to improve the efficiency of service delivery.

Casemix funding[52]

Casemix funding was first introduced in Victoria in 1993 as a way of improving incentives for efficiency in public hospitals. Experience with this method of funding has been so encouraging that other States have adopted it. At the time of the 1994-95 *Survey*, South Australia and Queensland had already done so. Since then, all other States and Territories have adopted casemix funding for acute inpatients, although New South Wales has not yet adopted casemix for funding purposes and is instead using it as a tool in the management of services, development of budgets and evaluation of quality.

As recommended in the 1994-95 *Survey*, casemix funding has also been extended to public hospital out-patient departments in all States and Territories except New South Wales, Western Australia, Tasmania and the Northern Territory.[53] This closes one of the main conduits for cost-shifting and helps to limit the extent of fee-for-service arrangements. It also reinforces the effectiveness of the casemix funding reforms for public hospitals by preventing them from cutting their costs by cost shifting. Hospital funding grants to the States were reduced by A$ 75 million per annum in the FY 1996/97 budget (indexed annually) to offset cost shifting of public hospital services already funded by the Commonwealth under the Medicare Agreements.

These reform themes are being taken up in the re-negotiation of the Medicare Agreements, which cover the Commonwealth's contribution to the States for public-hospital funding. This provides an opportunity to improve the interaction of State and Commonwealth funded health-care programmes, to increase the focus on identified outputs and outcomes and to support best practice based on evidence. The existing Agreements expire in June 1998.

General Practitioner (GP) numbers

One of the factors contributing to spending pressures discussed in the 1994-95 *Survey* was the growing number of GPs. This has increased service volumes correspondingly. It was noted that, although there was no absolute way of assessing need, the Australian Medical Workforce Advisory Committee estimated that there were around 25 per cent more GPs than necessary. The introduction in November 1996 of a requirement for new doctors seeking to provide services eligible for Medicare Benefits Scheme benefits to have a relevant post-graduate qualification should slow the growth in GP numbers. This measure should also reassure patients about the quality of services being provided. Incentives such as privileged access to post-graduate training for graduates who work in rural and remote areas have also been announced.

Private health insurance

Another issue discussed in the 1994-95 *Survey* was the steep decline in the proportion of the population covered by private health insurance. The main cause of this decline was the creation of a compulsory tax-financed public system (Medicare). This has limited private insurance to a top-up role. But the decline has been aggravated by community rating, which prohibits the charging of risk-related premiums. In these circumstances, the young and healthy have withdrawn from private health insurance, creating a vicious spiral of deteriorating membership risk profiles and rising premiums. This has been aggravated by "hit and run" behaviour, whereby individuals take insurance for a short period to gain cover for a temporary condition (such as child birth).

The decline in participation in private health insurance is of concern to the Government because it raises costs for the public health system. This concern prompted measures in the FY 1996/97 budget to encourage people to maintain or take out private health insurance. Incentive payments for low and middle income earners with private hospital cover came into effect in July 1997. At the same time, a one per cent Medicare Levy surcharge on high income earners without private health insurance came into effect. It is too early to predict how effective the incentive payment will be in stemming the outflow of members from private insurance. But the surcharge on high income earners should be effective as it amounts to much of the cost of private health insurance.

The Industry Commission (1997b) inquiry into the private health insurance industry made a number of recommendations aimed at increasing efficiency. The most important of these concerned community rating. The Government did not accept the recommendation that community rating should be reviewed as part of a broader review of the health system. However, the Government indicated that it was disposed to support the recommendations to permit unfunded lifetime community rating (where people entering insurance later in life pay higher premiums than those who enter early) and to extend the waiting times for conditions commonly subject to "hit and run" behaviour. Nevertheless, the Government said that community lifetime rating would only be acceptable if existing fund members, especially the elderly, did not have to pay more as a result. Under these conditions, it would take many years for lifetime community rating to have a significant effect on the attractiveness of private insurance to low risk individuals.

Long-term residential care for the elderly

Measures to contain the growth in expenditure on long-term residential care for the elderly were also discussed in the 1994-95 *Survey*. These included limiting growth of bed numbers in nursing homes and hostels to a demographic based benchmark and making access subject to an assessment of need, the redirection of frail elderly people who are still mobile to supported accommodation (hostels) or, if they are not so frail, to their own homes with domiciliary support services. The FY 1996/97 budget builds on these reforms with a range of funding measures aimed at better integrating and targeting support for residential care. They include:

- unifying the hostel and nursing home systems;
- implementing a single resident classification mechanism to assess dependency and allocate funds accordingly;
- income testing of Commonwealth subsidies;
- extending capital contributions to nursing home residents; and
- paying a higher rate of subsidy to facilities with higher proportions of financially disadvantaged residents.

These measures are expected to create a simpler, more flexible and responsive system, with major improvements in the quality of nursing-home buildings[54] and dementia care funding. There will also be improved choice for those who want to purchase higher quality accommodation and services.

Pharmaceutical Benefits Scheme

Expenditure on the Pharmaceutical Benefits Scheme (PBS), through which the Commonwealth provides assistance towards the cost of approved drugs dispensed in the community with prescriptions written by doctors, has grown rapidly since the creation of Medicare in the early 1980s. As discussed in the 1994/95 *Survey*, this has occurred in spite of a range of measures over the years which have successfully restrained pharmaceutical prices. The main cause of this growth has been the shift to new higher priced drugs. Other causes include the increase in the proportion of the population eligible for concession cards (and therefore making smaller co-payments) and the rising number of doctors, which has increased the number of prescriptions being written.

A further measure to constrain pharmaceutical prices was announced in the FY 1997/98 budget and comes into effect in February 1998. From this time, only a set base price within certain therapeutic groups (drugs that are not chemically identical but have similar clinical effects) will be subsidised. The price difference between higher priced drugs and the base price will be paid by the patient in addition to their usual co-payment. This should make doctors and patients more aware of the comparative cost of many similar medications and encourage greater price competition in the pharmaceutical industry.

Implementing the National Competition Policy

Based on the recognition that poor productivity performance of infrastructure industries was one of the factors which kept Australia's per capita growth below the OECD average during the three decades to the early 1990s (Table 11), the Hilmer Commission of Inquiry[55] recommended in 1993 that the Trade Practices Act (TPA) – Australia's main competition policy statute – should be applied universally to all business activities in Australia. This implied the extension of the TPA to cover all Government Business Enterprises, Statutory Marketing Authorities – the main source of assistance to agriculture – and unincorporated associations. However, in spite of the Council of Australian Governments' (COAG) general endorsement of the thrust of the Hilmer Commission's recommendations at its meetings in 1994, the implementation of the reform proposals was initially impeded by the fact that State governments stood to lose monopoly rents. But in view of the expected substantial overall gain of economic efficiency in the long run,[56] and the concomitant increase in state and federal revenues from higher economic activity induced by the reforms, an agreement was found at the COAG meeting in April 1995 about the sharing of estimated revenue gains. The Commonwealth, State and Territory Governments signed three intergovernmental agreements (see Box 1), underpinning the National Competition Policy[57] (NCP) along the lines of the Hilmer Commission's recommendations. This included the formation of a National Competition Council (NCC) to provide independent advice to the Commonwealth, State and Territory governments with respect to the application of structural reform, competitive neutrality,[58] third party access, monopoly pricing oversight and regulatory review principles. The policy package also includes sector specific agreements on electricity, gas, water and road transport and defines a number of reform objectives for the period to the year 2000. As well an enlarged independent body, the Australian Competition and Consumer Commission (ACCC), was established on 6 November 1995 by merging the Trade Practices Commission and the Prices Surveillance Authority. The functions of those merged organisations, including adjudicating on authorisation and notification issues, preparing reports, price oversight and the enforcement of competition and consumer protection laws were also transferred to the ACCC in addition to new functions under the legislated access regime.

Table 11. **Real GDP per capita**
Percentage changes at annual rates

	1960-96	1960-70	1970-80	1980-90	1990-96
Australia	**2.2**	**3.2**	**1.9**	**1.6**	**1.7**
New Zealand	1.2	1.7	0.8	1.0	1.4
United States	2.1	2.8	2.1	1.9	1.0
Japan	4.5	9.0	3.2	3.4	1.5
Germany[1]	2.1	3.5	2.6	2.0	1.0[2]
France	2.6	4.5	2.7	1.8	0.7
Italy	3.0	5.0	3.1	2.2	0.8
United Kingdom	2.0	2.2	1.8	2.4	1.1
Canada	2.3	3.3	3.1	1.7	0.2
Weighted average[3]					
OECD	2.6	4.2	2.5	2.1	1.0
OECD Europe	2.5	4.1	2.5	2.1	1.0
Major 7	2.6	4.3	2.5	2.2	1.0
Non-weighted average[3]					
OECD	2.6	4.1	2.7	2.0	1.2
OECD Europe	2.7	4.2	2.8	2.1	1.2
Major 7	2.6	4.4	2.7	2.2	0.9

1. Up to 1990, Western Germany.
2. 1991-96.
3. Excluding the Czech Republic, Hungary, Poland and Korea.

Source: OECD, *National Accounts*.

As laid out in the inter-governmental *Agreement to Implement the National Competition Policy and Related Reforms*, the Commonwealth will provide phased competition payments to the States and Territories, conditional on the progress these make in implementing the agreed competition policy reforms. The payments are estimated to amount to a total of A$ 16.1 billion over the period from FY 1997/98 to FY 2005/06. The COAG charged the NCC – founded in November 1995 – with the evaluation of the progress of jurisdictions in implementing the agreed reforms as the basis of the payments from the Commonwealth.

As of July 1996, Commonwealth State and Territory legislation came into effect to apply the competitive conduct rules of the Trade Practices Act to the unincorporated sector and State and local government businesses. The Commonwealth and each of the States had also published their respective 1996-97 policy statements on the application of agreed competitive neutrality principles, the application of

Box 1. **Intergovernmental agreements on National Competition Policy**

The intergovernmental agreements are major components of the competition policy package.

The *Conduct Code Agreement* sets out the basis for extending the application of the *Trade Practices Act* and the consultative processes for making modifications to the competition laws.

The *Competition Principles Agreement* establishes principles on structural reform of public monopolies, competitive neutrality between the public and private sectors, prices oversight of government enterprises, a regime to provide access to essential facilities, a programme of review of legislation restricting competition and consultative processes for appointments to the NCC.

Under the *Agreement to Implement the National Competition Policy and Related Reforms*, the Commonwealth will provide payments in return for States and Territories which give effect to the intergovernmental agreements, and meet reform commitments in electricity, gas, water, and road transport.

Source: Industry Commission (1996), *Annual Report 1995-96*, AGPS, Canberra, p. 179.

National Competition Policy at the local government level, and the review of legislation to identify and where appropriate reform provisions that create anti-competitive effects.

In its report[59] of 30 June 1997, the National Competition Council attested on the basis of the States and Territories 1996-97 annual reports that:

– good progress has been made towards implementing the National Electricity Market in eastern and southern Australia, including commitments for interconnection by both Queensland and Tasmania; this will offer new scope for greater competition in the electricity market[60] with the commencement of cross-border trading;
– a well advanced framework is now in place for introducing free and fair trade in gas (already implemented in New South Wales);

- there is continued implementation of competitive neutrality policy principles in significant business activities in line with governments' focus on the performance of their business enterprises, and mechanisms for consideration of complaints;
- there are extensive legislative review programmes in place and the potential for reduced costs to businesses through the repeal of redundant or unjustified legislation; and
- there is greater recognition of the importance of applying the reforms to local government businesses.

The NCC, therefore, recommended that all States and Territories should receive their competition payments in FY 1997/98, amounting to a total of A$ 406 million.

The NCC, however, expressed concerns about the potential for delay in the adoption of national gas regulation, the failure by some governments to include all their anti-competitive regulation for review, and generally slower than anticipated application of competition principles to local government. The NCC also considers that the decision by the government of New South Wales to continue the current (anti-competitive) vesting arrangements available to the NSW Rice Marketing Board does not meet the spirit of the Competition Principles Agreement. The NCC recommends that the payments to jurisdictions in FY 1998/99 should be subject to further assessment by the Council by June 1998 of the performance of jurisdictions in implementing certain reforms, in particular in respect of the uniform national gas access code.

Reform efforts have also been undertaken in other key infrastructure areas such as:

- *telecommunications*, where the Commonwealth Government enacted legislation which provides full and open competition with no restriction on the number of providers or installers of network structure, and no industry-specific limits on foreign investment in new carriers as from July 1997; in the 1990s, business telecommunication charges were substantially above the OECD average and followed only hesitantly their global downward trend (Table 12).
- the single *aviation* market with New Zealand, which commenced in November 1996 and which should increase the scope for greater competition in Australia's domestic aviation market with the potential for further consumer gains;

Table 12. **Business telecommunications charges**

Index, basket of services[1]

	Total charge US$	Total charge PPPs	1991	1992	1993	1994	1995	1996
Australia (Telstra)	**1 190**	**1 181**	**109.3**	**112.3**	**111.9**	**108.5**	**106.0**	**107.2**
Austria	1 861	1 330	100.1	91.4	88.2	86.8	86.9	86.3
Belgium	1 048	825	98.7	99.0	99.0	101.0	107.9	110.4
Canada (Bell Canada)	902	990	95.6	94.0	96.2	98.4	97.9	97.9
Denmark	680	436	108.2	107.0	108.1	107.3	103.4	112.5
Finland (HTC)	528	369	115.2	106.0	105.2	87.8	93.1	84.4
France	998	748	101.5	102.5	102.3	96.6	86.8	69.2
Germany	1 258	863	86.0	84.4	82.9	82.5	83.7	67.7
Greece	1 061	1 159	106.5	97.4	92.3	113.2	121.1	119.6
Iceland	434	332	85.2	85.7	91.1	92.3	98.2	92.4
Ireland	1 201	1 177	104.1	85.0	86.7	83.0	83.3	77.4
Italy	1 210	1 241	108.6	106.1	103.4	102.5	95.5	94.5
Japan (NTT)	1 793	959	91.3	91.7	93.2	79.2	82.6	86.7
Netherlands	648	488	100.2	104.2	101.9	109.6	111.6	102.7
New Zealand (TCNZ)	915	924	113.1	98.2	90.9	88.9	90.7	83.6
Norway	602	412	68.3	64.5	65.8	53.9	52.4	47.7
Portugal (TP/TLP)	1 352	1 661	102.9	93.3	91.3	92.6	107.7	97.8
Spain	1 211	1 208	116.5	113.3	115.4	114.5	135.3	105.8
Sweden (Telia)	620	438	114.8	102.7	101.1	86.7	87.8	89.4
Turkey	471	952	133.1	122.8	109.7	107.1	89.7	51.1
Switzerland	1 782	989	103.1	115.6	116.9	119.4	132.5	126.8
United Kingdom (BT)	844	826	98.6	99.0	95.7	88.3	83.0	85.5
United States (Nynex)	1 026	1 026	100.0	101.0	95.2	88.7	88.7	89.2
Average	1 028	893	102.6	99.0	97.6	95.2	96.8	90.7
Weighted average	–	–	99.8	99.3	96.6	91.2	91.0	87.1

1. Data is from business tariff basket which includes 2 911 calls. The basket is expressed in the form of an index that makes 1990 = 100. The weighted average is calculated with 1992 telecommunication mainlines. Values express the average annual spending by a business user, in 1995 US$, excluding tax. For a full description of the tariff comparison methodology for these and other baskets, see OECD, ICCP Series No. 22, "Performance Indicators for Public Telecommunications Operators".

Source: OECD.

– the transfer of Melbourne, Brisbane and Perth *airports* to private operators in July 1997, which should promote a more efficient allocation of airport infrastructure and facilitate the liberalisation of the aviation sector on the basis of commercial relationships between airport operators and airlines. A regulatory regime has been developed to protect the public interest.

Unfinished infrastructure industry reforms

Major reforms continue to be needed in the following areas:

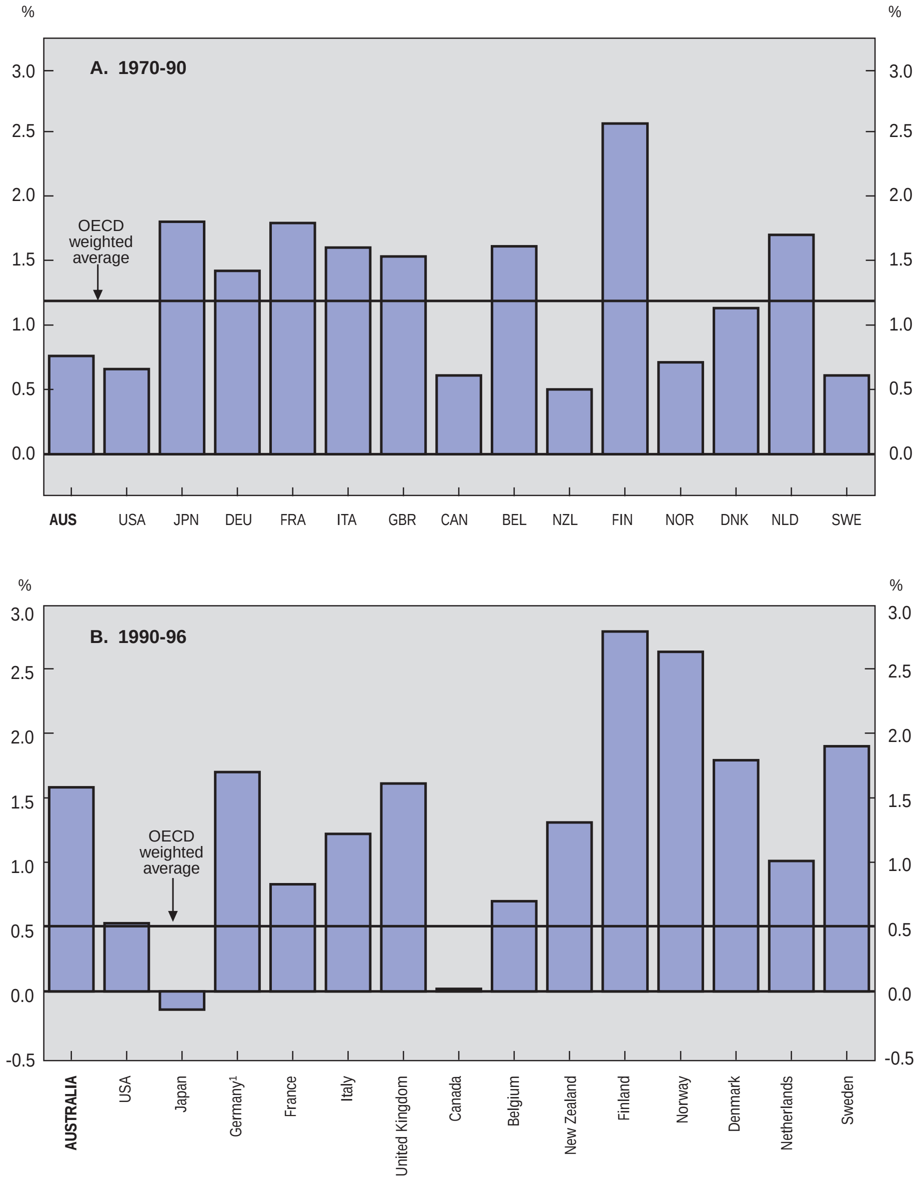
The shipping industry: Restrictive practices such as prohibition of cabotage, which restricts the use of foreign vessels in Australia's coastal waters, and the requirement for majority Australian ownership for the registration of ships, have made the Australian fleet increasingly uncompetitive in terms of operating cost and labour arrangements and led to a shrinking market share. Recent industrial relations reforms, which strengthen anti-boycott provisions, end closed-shop union monopoly and encourage enterprise bargaining should help enhance the flexibility of maritime operations and contain crewing costs, which are, for example some $2^1/_2$ times those of comparable Norwegian operations. This should be complemented by the winding-back and eventual removal of cabotage restriction and the establishment of a second register for Australian shipping, as proposed by the *Shipping Reform Group*.[61]

Postal services: A review of the postal services market by the NCC has already commenced as part of the Commonwealth Government's commitment under the *Competition Principles Agreement* to review legislative restrictions on competition at the Commonwealth level. The review aims at identifying ways to increase the efficiency of postal services while recognising the Government's commitment to a standard letter service meeting community needs. The NCC released an interim report in October 1997. The final report is scheduled to be sent to the Government in February 1998.

The railway system: With the exception of the interstate track, the Commonwealth Government has sold the businesses of the Australian National Railways Commission[62] and the Commonwealth intends to sell its interest in the National Rail Corporation.[63] The Australian National businesses were sold to three consortia for $95.4m and the consortia plan significant service expansions and capital injections (including capital expenditure of $97m over the next four to six years). In September 1997, the Government announced it had reached agreement with the mainland States on interstate rail reform. As a first step, the Commonwealth and Victoria will place their interstate track under single management by 1 July 1998 and a plan is being considered for the extension of this network to Perth. Under the agreement, operators will be able to access the interstate network through a single point of entry providing seamless access and operations across the network.

Figure 19. **TOTAL FACTOR PRODUCTIVITY IN THE BUSINESS SECTOR**

Average annual rate of growth



1. 1970-90 growth for Western Germany; 1991-96 for Germany.
Source: OECD.

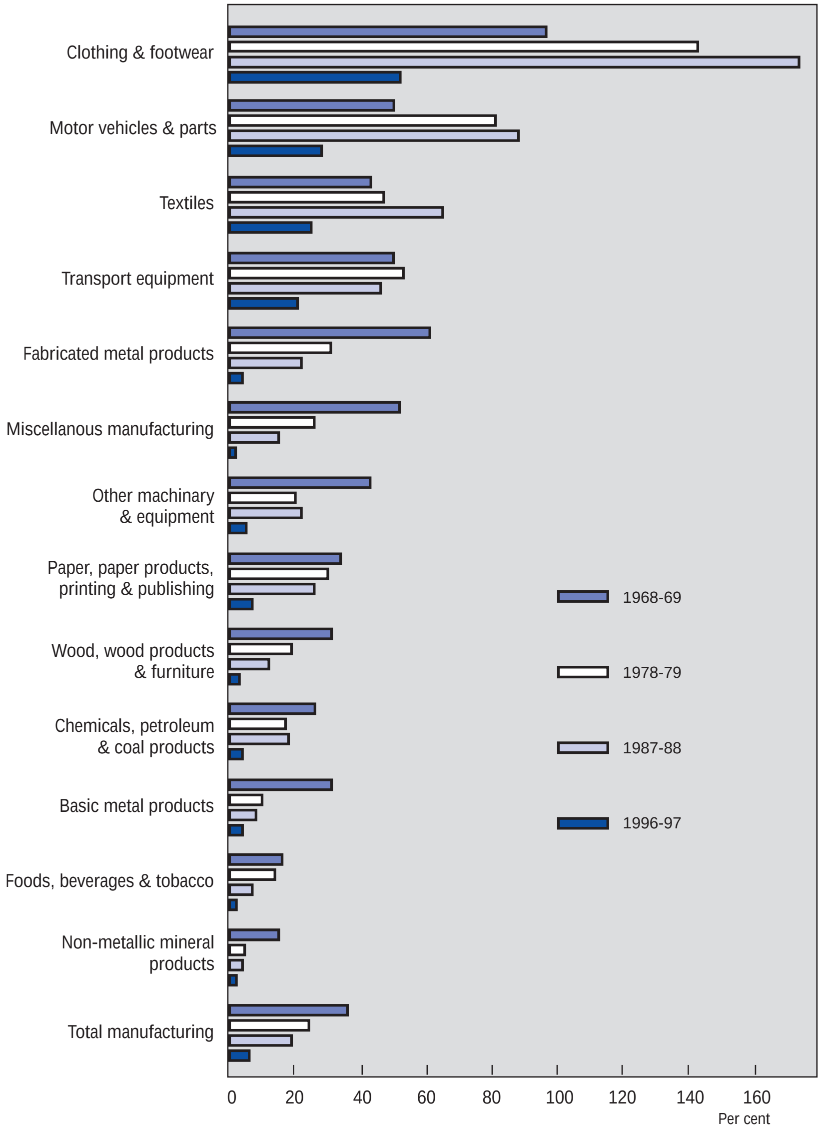
Tariff policy

International trade is a powerful source of competition. However, for most of the 20th century, Australia restricted this avenue of competition by erecting high import barriers to protect its manufacturing sector and ancillary industries. According to a study of EPAC (1995) most of Australia's below average per capita income growth and total factor productivity growth between 1970 and 1989 (Figure 19) is attributable to the failure to match tariff reductions[64] and accompanying economic reforms in other OECD countries for much of that period. In 1988, Australia reversed its previous policy by moving to substantially reduce industry protection. And in March 1991, the Commonwealth Government announced a new programme of tariff reductions which led to a fall of all tariffs other than those on passenger motor vehicles and on textiles, clothing and footwear[65] to a maximum of 5 per cent on 1 July 1996. Tariffs on textile, clothing and footwear imports were reduced from a maximum of 55 per cent in 1990 to 37 per cent in 1996; during the same period, the tariff on passenger motor vehicles fell from 57.5 per cent to 25 per cent.

Tariffs on passenger motor vehicles are scheduled to be reduced further by $2^1/_2$ percentage points per annum to 15 per cent in the year 2000 and tariffs on textiles, clothing and footwear are scheduled to come down to levels of 25 per cent, 15 per cent and 10 per cent, respectively, by 2000. Altogether, the average *effective* rate of assistance for all manufactures will fall from 19 per cent in the late 1980s to some 5 per cent in 2000, close to that in most other OECD countries (Figure 20). The 1991 programme of tariff reductions did not determine post-2000 assistance arrangements. To assist policy decision making, the new Government requested the Industry Commission in 1996 to undertake inquiries of the overall economic effects of high tariffs on automobiles and on textiles, clothing and footwear.

In its inquiry into the automotive industry, the Industry Commission (1997c) estimates the extra cost of automobiles for consumers stemming from the tariffs at a substantial A$ 1.8 billion in 1996 or an extra A$ 3 400 per vehicle sold on the Australian market. By the year 2000, when the tariff will be reduced to 15 per cent, the effect of assistance on new car prices is likely to be on average around A$ 2 100 per vehicle sold. Alternatively, with employment in the vehicle and component manufacturing sectors of around 47 000 in 1996, the cost of tariff protection presently amounts to about A$ 38 000 per employee per year. In its majority report,

Figure 20. **EFFECTIVE RATES OF ASSISTANCE IN MANUFACTURING**



Source: Industry Commission, Assistance to Agriculture and Manufacturing Industries, Information Paper, March 1995 and Industry Commission, *Annual Report 1995-96*, September 1996 the Industry Commission could find no convincing justification for suspending tariff cuts in 2000 and, therefore, recommended that tariffs continue to be reduced by $2^1/_2$ percentage points per annum after the year 2000, reaching a rate of 5 per cent in 2004, the maximum rate for most other industries. The size of likely long-term gains from reducing tariffs from 15 to 5 per cent from 2000 to 2004 – and allowing for the effects of economies of scale – are estimated[66] by the Industry Commission to amount to about 0.2 per cent of GDP per annum. The benefits arise from lower car prices for households and businesses,[67] enhanced economic growth and a better allocation of Australia's labour and capital. The recommended tariff cut would increase economic activity in all States and Territories except South Australia and Victoria, where the car industry is mainly located. These latter States would suffer total employment losses of about 0.2 and 0.1 per cent, respectively.[68] The estimates are based on rather conservative assumptions so as not to overstate the benefits which would flow from reform.

The Industry Commission (1997d) has also attempted to quantify[69] the sectoral and economy-wide effects of phased reductions of tariffs on textiles, clothing and footwear (TCF) to a uniform rate of 5 per cent by 2008. The estimates suggest that because of the tariff reductions TCF output would be 7 per cent lower by 2013-14 than in the status quo scenario. But due to improved resource allocation, lower input cost of other industries and lower cost of living for consumers from reduced TCF prices, the level of real GDP would rise relative to the base case of unchanged tariffs. However, the gain in GDP would be rather small – some 0.04 per cent initially and about 0.02 per cent of GDP in the long run – mainly owing to the low share of TCF value added in GDP (0.6 per cent in 1996).

Recent initiatives of the Commonwealth Government to reduce industry protection levels are the abolition of bounties granted to the machine tool and computer industries and the removal of tariffs applicable to sugar imports as of July 1997; bounties on book printing are set to be abolished at the end of 1997. In June 1997, however, the Government decided to freeze passenger motor vehicle tariffs at 15 per cent between the years 2000 and 2004, when they will step down to 10 per cent on 1 January 2005. And in September the Government decided on a broadly parallel tariff pause between the years 2000 and 2004 for the textile, clothing and footwear industries. While these decisions maintain Australia's commitment to its APEC obligations they also reflect considerations such as the likely adjustment costs to the workers, firms and regions concerned. Although the Government insists that this decision is not a departure from its resolve to move Australia towards a freer trading environment the decision risks encouraging other industries to call for a slow-down of the pace of trade liberalisation or even for enhanced industry assistance. Resisting such demands is important for long-term economic performance.

Reform of the financial system

The Government announced in September a path-breaking set of financial system reforms in response to the recommendations of the Financial System Inquiry (S. Wallis, Chairman) (1997). The reforms, which largely follow the recommendations of the Inquiry, are aimed at increasing competition and improving efficiency while preserving the integrity, security and fairness of the financial system. The centrepiece of the reforms is a new regulatory structure based on three agencies, each of which will be responsible across the financial system respectively for: financial safety; systemic stability and payments; and conduct and disclosure. This framework is being established in place of existing institution-based regulation because of changes in the nature of the financial sector. The boundaries between financial instruments and institutions are blurring, especially through activities of conglomerates, competition from non-financial institutions and from abroad is intensifying and financial market transactions are being substituted for financial intermediation. Moreover, institution-based regulation inhibits efficiency because market structures and activities are not treated equally: the most efficient players and processes are not necessarily able to prevail.

Financial safety

The Australian Prudential Regulation Authority (APRA) will be established to carry out prudential supervision and licensing of deposit-taking institutions, life and general insurance companies, friendly societies and superannuation funds. It will combine the existing prudential regulation functions of the Reserve Bank of Australia (RBA), the Financial Institutions (FI) Scheme (if agreed by the States and Territories) and the Insurance and Superannuation Commission (ISC). Combining prudential regulation in a single regulator will achieve more neutral regulatory treatment across all providers of similar products. A single regulator should also accommodate better the emergence of financial conglomerates and enable a more flexible approach over time to changes in the focus of prudential regulation. The APRA is to be separate from the RBA so as to emphasise that there is no implied or automatic guarantee of any financial institution or its promises in the event of insolvency. To maximise public certainty as to the scope of prudential regulation, its coverage is to be clearly defined by the requirement that supervised financial service providers be licensed by the APRA. There will continue to be no requirement for deposit insurance.[70]

The broad objectives of the APRA are to be set out in its charter and are to be such that standards of financial safety are not diminished. In particular, the conduct of regulation will ensure that the risk of loss of depositor funds remains remote and that regulation is consistent with international standards. Prudential standards will be reinforced as far as possible by encouraging greater public disclosure by financial institutions of their risks, management systems and ratings.

Systemic stability and payments

Systemic stability remains the responsibility of the RBA. It will continue to have powers as a lender of last resort to certain financial corporations operating exchange settlement accounts with it, but will cease to have responsibilities for the protection of bank depositors. This will make it clear that, while the RBA may intervene to maintain systemic stability, its balance sheet is not available to guarantee deposits. A Payments System Board (PSB) and new regulatory powers will be established within the RBA to regulate clearing and settlement systems, to control counter-party risk and to promote efficiency and competition. The RBA will have the power to ensure that clearing stream bodies provide third-party access to their facilities on reasonable terms. Access to clearing streams and settlement accounts will be liberalised on the basis of transparent guidelines to be determined by the PSB.

Conduct and disclosure

Regulation of conduct and disclosure in financial markets has been provided through a variety of agencies, with arrangements governed by the institutional form of the service provider. The main disadvantages of these arrangements are that:

- regulation is inconsistent across the range of competing financial products;
- financial service providers face a range of different regulatory rules that raise the complexity and cost of compliance;
- and consumers face inconsistent rules resulting in difficulties in understanding and comparing competing products.

For these reasons a single market integrity and consumer protection regulator – the Australian Corporations and Financial Services Commission (CFSC) – will be established, drawing together the existing Australian Securities Commission (ASC) and that part of the Insurance and Superannuation Commission (ISC) dealing with disclosure, sales and advice. In addition, the relevant responsibilities of the State-based Australian Financial Institutions Commission (AFIC) and associated State Supervisory Agencies (SSAs) that deal with building societies, credit unions and friendly societies, will also be transferred to the ACFSC, subject to agreement with State and Territory Governments. The CFSC will apply regulation for the integrity of financial market conduct, consumer protection and the regulation of companies. In addition to current powers, the CFSC will be given the same general consumer protection laws to enforce as currently exist under the Trade Practices Act as well as a range of enforcement powers. Disclosure requirements for providers of retail financial products are to be reviewed by the new regulator to ensure that they provide information which enables comparison between products to be made.

Mergers and acquisitions

The Government announced soon after the Inquiry was released in April that the "six pillars" policy, which prohibits mergers among the four major Australian banks and two largest insurance companies, and the policy prohibiting foreign take-overs of any of the four major Australian banks, would be abolished, as recommended in the Report. However, the Treasurer is to retain discretionary powers to approve mergers and, for the time being, considers that there is insufficient competition to justify a merger among the four largest banks.

Implementation

Many of these reforms require the co-operation and support of the States and Territories to be implemented in full. If they agree, the reforms should become operational in 1998 and 1999.

Tax reform

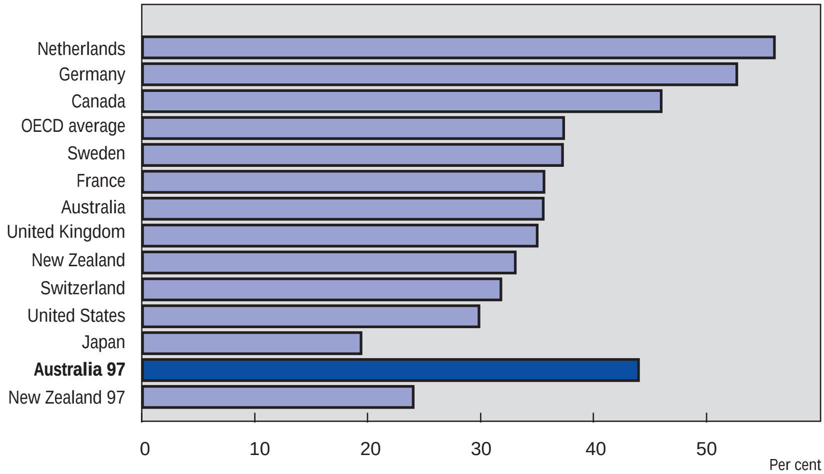
Comprehensive tax reform has remained elusive in Australia. An attempt was made to negotiate such a reform in 1985, including the introduction of a general consumption tax, but foundered on opposition to the latter. The Liberal-National Coalition parties, now in government, lost the 1993 election on a platform of comprehensive tax reform involving the introduction of GST, abolition of most other indirect taxes and substantial income tax cuts. This policy was dropped for the last election, with the Coalition promising not to introduce a GST during its first term in office. Since then, however, public opinion has become more favourable to tax reform, including the introduction of a GST. Moreover, a recent High Court ruling that State levies (franchise fees) on petrol, tobacco and alcohol were invalid has both added urgency to the issue of tax reform and underlined that it must be set in the context of Commonwealth-State financial relations.

The main concerns about the tax system in Australia arise from the narrow and eroding bases for indirect taxes. The principal indirect tax is the Commonwealth's Wholesale Sales Tax (WST), which is levied only on goods. This tax base is steadily eroding as the share of services in GDP rises. Moreover, with services now having reached 78 per cent of GDP, the base for the WST is already narrow. This means that for any given amount of revenue to be raised, rates must be higher than would be necessary under a broad-based tax, increasing the excess burden of taxation (from distorting relative prices) compared with a broad-based alternative. Another factor contributing to the higher excess burden of taxation under the WST is that it distorts the allocation of resources between the goods- and service sectors, favouring the latter at the expense of the former. Most other indirect tax revenue in Australia is raised from taxes on specific goods and services which are levied by both the Commonwealth and the States. These taxes account for a much higher proportion of indirect tax revenue in Australia than in most other OECD countries, undoubtedly reflecting the fact that most other countries have a VAT. As there are no externalities which could justify taxing individually most of these goods and services, these taxes are likely to impose a high "excess burden" compared with the alternative of a broad-based indirect tax. It has been estimated (Albon, 1996) that replacing the WST, excise taxes and business franchise fees with a uniform consumption tax to collect an equivalent amount of revenue would result in efficiency gains of at least A$ 2 billion per year.

Another concern is that high marginal income tax rates become effective at modest incomes. The marginal tax rate (including employee social security contributions or, in Australia, the medicare levy) at the average wage is 45 per cent, one of the highest rates in the OECD outside continental Europe (Figure 21). This is striking

Figure 21. **MARGINAL INCOME TAX RATES, 1995**[1]

At 100% of average wage



1. Marginal tax rate for a single taxpayer covering employees' social security contributions and personal income tax.
Source: OECD estimates; Access Economics, 1997.

Table 13. **Social security contributions and taxes on individual income and payrolls, 1995**

Per cent of GDP

	Employee			Employer		
	Personal income	Social security	Total	Social security	Payroll	Total
Australia	12.6	–	12.6	–	2.1	2.1
Canada	13.9	2.0	15.9	4.1	–	4.1
France	6.2	5.9	12.0	11.9	1.1	13.0
Germany	10.7	6.7	17.4	7.8	–	7.8
Italy	10.8	2.8	13.6	8.6	0.1	8.7
Japan	6.1	4.1	10.2	5.2	–	5.2
New Zealand	16.9	–	16.9	–	0.4	0.4
United Kingdom	9.7	2.6	12.3	3.4	–	3.4
United States	10.1	3.0	13.1	3.6	–	3.6
OECD total[1]	10.4	3.2	13.6	5.8	0.3	6.1

1. Unweighted average of all OECD countries.
Source: OECD (1997), *Revenue Statistics*.

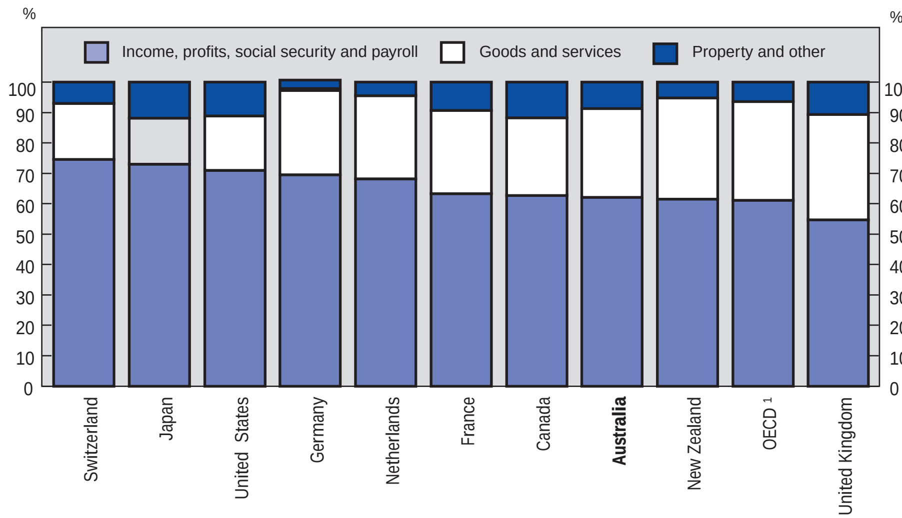
considering that individual income tax receipts and employee social security contributions amount to only 12 per cent of GDP, lower than in most other OECD countries (Table 13). Marginal income tax rates in Australia are high in relation to the amount of revenue raised mainly because there is a significant zero-rated band at the base of the income tax schedule. Abolition of this band would release sufficient revenue both to flatten the income tax schedule substantially and to compensate fully low income earners. While marginal tax rates would fall for most individuals, those in receipt of social security benefits would still face high combined rates of tax and benefit withdrawal. This consideration is a more important constraint on reform in Australia than in most other OECD countries because social security benefits are provided subject to a means test for an unlimited duration.

Cuts in income tax rates could also be financed by an increase in the proportion of revenue raised from indirect taxes. This would also have the advantage of reducing disincentives to save. For the time being, the relative weights of direct and indirect taxes in Australia are close to the (unweighted) average for OECD countries (Figure 22). Nevertheless, average effective tax rates on capital income in Australia are high relative to those in most other OECD countries (Table 14), despite Australia's low overall tax burden. This is mainly because social security expenditure is financed out of general taxation in Australia but primarily through social security charges on labour in most other OECD countries. Primarily for the same reason, average effective tax rates on labour income are low in Australia, especially for employers. Maintaining high taxes on mobile factors of production may become increasingly difficult in the future.

In the wake of the High Court decision, which wiped out around 7 per cent of States' own-source revenue and raised doubts over the validity of other sources of revenue, a rescue package was put in place by the Commonwealth Government at the unanimous request of the States and Territories. National taxes on tobacco, alcohol and petrol were increased, with surcharge rates set in each case to raise sufficient revenue so that no State or Territory is worse off. All revenue raised is being returned to the States and Territories (net of administrative costs). Where the revenue raised exceeds the revenue from the former State and Territory taxes, States and Territories have indicated that they will refund the excess revenue to manufacturers or to wholesalers in order to avoid as far as possible price increases for consumers. These arrangements are intended to be temporary and are to be reviewed within 6 months. While an immediate crisis in State funding has been averted,

Figure 22. **SOURCE OF TAX REVENUE, 1995**

As a percentage of total taxation



1. Unweighted average of all OECD countries.
Source: OECD (1997), *Revenue Statistics.*

vertical fiscal imbalance has become even more pronounced: the States are responsible for around 40 per cent of government expenditure but raise only 22 per cent of government revenue. Restoring vertical fiscal balance would enhance State accountability for expenditures and reduce the need for States to resort to highly distorting taxes on individual goods and services (such as stamp duties). Under the Federal Constitution, restoring vertical fiscal balance may involve making room for State income taxes (which could differ between States) within the income tax system by cutting Commonwealth income taxes (and transfers to the States) correspondingly. Unless otherwise stated, the Constitution gives the responsibility of providing government services to the States. The Constitution gives the States the right to levy income taxes (this right was ceded to the Commonwealth during the Second World War but could be restored to the States) but prevents them from imposing duties of customs and excise. The extent of re-balancing required is likely to be substantial in the context of indirect tax reform if this involved replacing many of the indirect taxes presently levied by States with a broad-based indirect tax which can only be levied by the Commonwealth.

Table 14. **Average effective tax rates[1] on capital and labour**

	Capital[2]			Labour[3]		
	1970	1980	1994	1970	1980	1994
United States	0.48	0.46	0.41 [4]	0.18	0.21	0.23 [4]
Japan	0.21	0.34	0.40	0.12	0.17	0.21
Germany	0.19	0.31	0.24	0.28	0.35	0.38
France	0.16	0.26	0.24	0.28	0.37	0.45
Italy	–	0.18	0.30	–	0.26	0.35
United Kingdom	0.55	0.63	0.41	–	0.24	0.21
Canada	0.45	0.37	0.46	0.19	0.21	0.29
Australia	**0.35**	**0.42**	**0.43**	**0.13**	**0.18**	**0.19**
Austria	0.16	0.21	0.20	0.31	0.39	0.43
Belgium	0.21	0.36	0.35	0.28	0.36	0.40
Denmark	–	–	0.39	–	–	0.45
Finland	0.20	0.27	0.36	0.23	0.30	0.44
Netherlands	–	0.34	0.29	–	0.42	0.46
New Zealand	–	0.38	–	–	0.35	–
Spain	–	–	0.20 [4]	–	–	0.32 [4]
Sweden	–	0.45	0.48	–	0.45	0.46
Switzerland	0.17	0.22	0.24 [4]	0.18	0.25	0.27 [4]
Total of above OECD countries[5]	0.36	0.39	0.36	0.19	0.25	0.28
Total of above EU countries[5]	0.27	0.34	0.29	0.28	0.32	0.36

1. The methodology used to calculate the effective tax rates shown in this table allocates personal income-tax revenue between wage and non-wage revenue in accordance with their shares in national income. To the extent that the structure of special credits and deductions incorporated in the personal income tax in fact deviates from these assigned weights, the estimated tax rates on capital and income may be deviate from their true values.
2. Average effective tax rate on capital defined as household income taxes paid on operating surplus of private unincorporated enterprises and on household property and entrepreneurial income; plus tax on income, profit and capital gains of corporations; plus recurrent taxes on immovable property; plus taxes on financial and capital transactions; all divided by total operating surplus of the economy.
3. Average effective tax rate on labour defined as household income tax paid on wages plus payroll or manpower taxes, divided by wages and salaries (including income of self-employed) plus employers' contribution to social security and to private pension schemes.
4. Figure for 1993.
5. Weighted average, using 1991 GDP weights.

Source: Mendoza, E., A. Raxin and L. Tesar, "Effective tax rates in macroeconomics: cross-country estimates of tax rates on factor incomes and consumption", *NBER Working Paper*, No. 4864, September 1994; and Leibfritz, W. *et al*., "Taxation and Economic Performance", *OECD Economics Department Working Papers* (forthcoming), OECD, Paris.

The Government has indicated that it will seek a mandate for tax reform at the next election. The central element of the proposed reform is to be the introduction of a broad-based indirect tax, with the revenue raised to be used to abolish some or all of the existing indirect taxes and possibly, to finance income tax cuts. A special task force is to be set up to consider all options for reform. The guidelines given to the Taxation Task Force by the Government are:

- there should be no increase in the overall tax burden;
- that any new taxation system should involve major reductions in personal income tax with special regard for the taxation treatment of families;
- consideration should be given to a broad based, indirect tax to replace some or all of the existing indirect taxes;
- there should be appropriate compensation for those deserving of special consideration; and
- reform of Commonwealth/State financial relations must be addressed.

A special meeting with the State Premiers to consider Commonwealth-State financial relations and tax reform was held on 6 November. The Premiers and Chief Ministers unanimously agreed with the Commonwealth Government that Australia needed fundamental tax reform and any such reform should not involve any increase in the overall taxation burden.

IV. Current issues in corporate governance

Corporate governance refers to the mechanisms by which enterprises are directed, and in particular, to the means by which those who control an enterprise's on-going operations are held accountable for that enterprise's performance (Box 2). Arrangements which work well contribute to low costs of capital for companies as investors can have greater confidence that management will act in their interests – ideally, seeking to maximise profits or, if not that, at least not misappropriating the company's funds. This facilitates the development of corporate economic activity and hence, the exploitation of the gains from specialisation in activities which can most efficiently be carried out by corporations (which generally are enterprises too large to be run directly by their owners). It also contributes to the efficient use of resources by corporations, enhancing national economic performance.

In Australia, concern about corporate governance has been stimulated by periodic episodes of corporate misbehaviour. Already in the late 1960s, allegations about the activities of the securities industry during the mining boom of those years provoked calls for a move away from State-based regulation and towards a uniform national system of corporate law, with a Senate Select Committee finding that the regulation of the securities markets, of the intermediaries which operate in those markets, and of some of the activities of public companies and investment funds was in need of fundamental reform (Senate Select Committee on Securities and Exchange, 1974).

Although important steps in this direction were made in the subsequent decade, it was only in 1991, with the enactment of the Corporations Law, that a single national regulatory framework was established. This removed the impediment to business operating on a national basis and recognised the development of a national market. Historically, the policy approach taken by the Commonwealth and State and

Territory Governments in the development of the law during the 1980s was a prescriptive black letter law approach to regulation. In addition, just as the new regime came into being, a number of substantial corporations collapsed, imposing large losses on investors, creditors and suppliers. Mounting evidence linking these collapses to various kinds of corporate fraud, related-party transactions and misleading financial disclosure created an atmosphere of distrust, and it was in this atmosphere that the new framework was first implemented and then refined.[71] Moreover, subsequent developments in the common law, which also regulates corporate activity, increased further the weight of the obligations bearing on those responsible for the governance of enterprises. A central question therefore, which is being addressed in the context of the Corporate Law Economic Reform Program (CLERP), is whether the current framework represents a reasonable balance between the costs and benefits of regulation and, if change is needed, where the priority areas for reform might lie. Six issues have been the subject of particular attention in this respect. These are:

- the composition of boards;
- the duties of directors;
- the quality of financial disclosure;
- the role of, and scope for action by, institutional investors;
- shareholders' access to legal recourse;
- the regulation of take-overs.

Following a brief description of Australian corporate governance arrangements in an international context, each of these issues is discussed in turn.

Corporate governance in Australia: an international perspective

Corporate governance arrangements in Australia are similar to those in the United States and the United Kingdom.[72] These and other English-speaking countries, and (amongst other OECD countries) increasingly the Netherlands, Sweden and Switzerland also, have what may be described as an "outsider" model of corporate governance. In this model, managers are relatively free from day to day control by the board and control mostly relies on the discipline of capital markets. This model presumes that information flows are relatively good and that the regulatory system requires ample disclosure of information, enforces strict trading rules and allows a market in corporate control (*via* hostile take-overs) to flourish. The model is also based on liquid stock markets and diversification of portfolios. The contrasting

Box 2. **The role of corporate governance**

Corporate governance concerns the mechanism for holding management accountable for an enterprise's performance. In competitive markets, good management performance is enforced by the disciplines of rivalry, as better managed firms displace poorly managed rivals; this factor has become more important in Australia in recent years as product markets have become more competitive. But good management is secured in the first place by ensuring that those who run firms are focused on the job, and are replaced if they prove ineffective. This requires that the interests of management are aligned with those of the owners and that the owners are in a position to assess management performance and to take remedial action when required. Owners too must be subject to the disciplines of possible displacement, so that those who fail in the task of monitoring managerial efficiency can be replaced by others better placed to carry out the job. Effective corporate governance therefore rests on twin pillars: the ability of owners to monitor and when required, intervene in the operations of management; and the vigour of the market for corporate control, which should vest the monitoring task in the owners most capable of carrying it out.

The quality of corporate governance has an obvious bearing on the performance of economies in which a large share of economic activity is accounted for by firms too big to be run directly by their owners. In these circumstances, the gains available from specialisation will only be fully obtained if professional managers can contract efficiently with those who own the resources firms need. Efficiency in this respect requires that low-cost mechanisms be available for defining, implementing and where necessary revising the contract at issue. Corporate law plays a central role here, notably by establishing and enforcing standard terms for this contract and by providing mechanisms for the resolution of disputes between owners and managers and between classes of owners. When the mechanisms of corporate law are weakened or impaired, and resource owners lose confidence in the effectiveness of their claims, firms' input costs rise as these owners seek compensation for the greater risk they are being asked to bear. Even those firms which do adhere to the letter and spirit of the law may be penalised, if the resource markets in which they secure needed inputs become thinner and/or the investments they have to make in retaining their corporate reputation become greater. Maintaining confidence in the effectiveness of corporate law is therefore an important concern of governments, and has become ever more so as the international mobility of resources has risen.

Good corporate governance practices can be a source of competitive advantage for a firm by lowering its cost of capital. A McKinsey report on corporate governance in the United States suggested that investors in American companies were prepared to pay an 11 to 16 per cent premium for companies with sound corporate governance practices. Unfortunately, there is little empirical evidence available on the premium for good governance practices in Australia.

"insider" model, found in most other OECD countries, relies on the representation of specific interests on the board of directors, which is expected to play a strong monitoring and disciplining role vis-à-vis management. Management discipline via securities markets is often weak in this model. There is often concentrated share-holding, with cross-holdings among companies being fairly common. Another feature of the "insider" model is that securities regulators often permit asymmetric information policy and are not overly concerned about the rights of minority shareholders.

As in other countries with an "outsider" model, Australia has a relatively large market in publicly traded equities (Table 15). Market capitalisation was almost 70 per cent of GDP in 1994, near the United States level but far above the levels in most other countries, especially continental European countries. Australia has also experienced one of the largest increases in market capitalisation relative to GDP amongst OECD countries in the early 1990s. A special factor contributing to this outcome was large privatisations.

Table 15. **Market capitalisation of listed domestic equity issues at year-end**
Per cent of GDP

	1975	1980	1985	1990	1994
Australia (Assoc. of SE)	**22**	**40**	**37**	**37**	**68**
Austria (Vienna)	3	3	7	17	15
Belgium (Brussels)	15	8	26	34	37
Canada (Toronto)	30	45	45	42	57
Denmark (Copenhagen)	11	8	26	30	32
Finland (Helsinki)	..	..	11	17	39
France (Paris)	10	8	15	26	34
Germany (Assoc. of SE)	12	9	29	24	24
Italy (Milan)[1]	5	6	14	14	26
Japan (Tokyo)[2]	28	36	71	100	78
Netherlands (Amsterdam)	21	17	47	42	67
New Zealand	..	..	39	20	54
Norway (Oslo)	..	..	16	23	30
Spain (Madrid)	32	8	12	23	32
Sweden (Stockholm)	3	10	37	40	61
Switzerland (Zurich)[3]	30	42	91	70	111
Turkey (Istanbul)	..	..	..	..	17
United Kingdom (London)	37	38	77	87	112
United States (NYSE, AMEX and NASDAQ)[4]	48	50	57	56	75

1. All Italy on a net basis since 1985.
2. Tokyo and Osaka on a net basis in 1990.
3. All Switzerland on a net basis in 1994.
4. Including foreign shares in 1975.

Source: Fédération internationale des Bourses de valeur, NASD, OECD Secretariat estimates.

Table 16. **Large share-holdings: an international comparison**

	Ownership by the 3 largest shareholders				Market capitalisation of firms	
	10 largest non-financial domestic firms		10 largest private firms		10 last private and government	10 largest private
	Includes government	Excludes government	Mean	Median	US$ million	
Australia	**0.32**	**0.32**	**0.28**	**0.28**	**5 940**	**5 943**
Canada	0.48	0.39	0.40	0.24	3 589	3 015
France	0.33	0.22	0.34	0.24	11 713	8 914
Germany	0.42	0.38	0.48	0.50	9 465	8 540
Italy	0.58	0.58	0.58	0.60	3 140	3 140
Japan	0.22	0.15	0.18	0.13	37 532	26 677
South Korea	0.23	0.23	0.23	0.20	1 034	1 034
New Zealand	0.48	0.48	0.48	0.51	1 019	1 019
Sweden	0.28	0.27	0.28	0.28	6 830	6 216
Switzerland	0.41	0.41	0.41	0.48	9 578	9 578
United Kingdom	0.22	0.17	0.19	0.15	21 019	13 511
United States	0.20	0.20	0.20	0.12	71 650	71 650

Note: This table shows ownership of firms by large shareholders. The first column gives the average percentage of common shares owned by the 3 largest shareholders in the 10 largest domestic firms in the non-financial sector in each country. The second column provides the average percentage of common stock owned by the 3 largest shareholders excluding the government, *i.e.* when the government was one of the largest shareholders it was substituted with the next largest shareholder. The third column shows the average percentage of common shares owned by the 3 largest shareholders in the 10 largest non-financial, *privately-owned-domestic* firms in a given country. A firm is considered privately owned if the State is not a known shareholder in it. The fourth column gives the median ownership of the 3 largest shareholders in the 10 largest non-financial *privately-owned-domestic* firms. The last two columns provide average market capital of the 10 firms in each of the two samples of firms respectively.

Source: La Porta *et al*. (1996).

Large shareholders are more dominant in Australia than in the United States or the United Kingdom, but less so than in most of the countries with an "insider" model (Table 16). The three largest shareholders in the ten largest firms without government ownership hold on average 28 per cent of the shares on issue, compared with around 20 per cent in the United States and the United Kingdom but almost 50 per cent in Germany. The greater concentration of large share-holdings in Australia than in the United States or the United Kingdom seems to be related to the smaller number of large companies in the Australian market – the top 100 companies account for 80 per cent of market capitalisation. As institutional investors need to invest in liquid stocks to be able to measure performance adequately, these investors are obliged to concentrate their holdings in large companies, which alone have liquid markets for their stock.

Insurance companies, pension funds and mutual funds together hold about one-third of the equity in exchange-listed firms (Table 17). This is less than in the United States and much less than in the United Kingdom, but considerably higher than in

Table 17. **Ownership of exchange-listed firms**

Per cent at year-end 1993[1]

	Australia	United States	Japan	Germany	France	United Kingdom	Italy	Sweden
Financial sector	38	46	45	29	8	62	19	24
of which:								
Insurance companies and pension funds	26	31	18 [2]	7	1	51	2	17 [4]
Mutual funds	8	11	3	8	2	7	6	6
Banks and other financial institutions	4	4	23 [2]	14	5	4	11	1
Non-financial enterprises	10	–	24	39	59	2	32	34
Public authorities	3	–	1	4	4	1	28	7
Non-residents	26	5	7	12	11	16	5	9
Individuals	23	49	24	17	19	20 [3]	17	26 [5]
Total	100	100	100	100	100	100	100	100

Note: Due to rounding, the figures may not add up to the total.
1. End March for Australia.
2. Division between banks and insurance companies estimated.
3. Includes other (2 per cent).
4. Includes investment funds.
5. Includes other (10 per cent).

Source: For Australia, Stapledon (forthcoming); for other countries, OECD (1995), Table 3.

countries with an "insider model". As in other countries with an "outsider" system, only a small proportion of shares is held by banks. A little over 20 per cent of shares are held directly by households, similar to the proportion in most other countries but lower than in the United States. Non-residents own an unusually large proportion of the listed equities in Australia.

Table 18. **Business sector investment-output ratios**

Per cent

	Averages for all available years in the			
	1960s	1970s	1980s	1990s
Australia	**19.9**	**18.8**	**21.2**	**17.0**
Austria	20.0	22.4	19.7	21.0
Belgium	. .	14.4	13.4	15.1
Canada	17.1	17.7	17.1	14.3
Denmark	17.4	16.6	17.0	16.1
Finland	20.7	21.5	20.3	15.2
France	18.1	17.4	15.6	14.9
Germany	17.0	15.5	15.1	16.2
Ireland	. .	21.4	18.7	13.2
Italy	17.5	16.6	14.5	13.4
Japan	21.0	19.5	18.7	20.0
Mexico	15.7	. .	9.4	11.3
Netherlands	. .	16.4	14.8	15.2
New Zealand	12.2	14.8	16.5	14.1
Norway	23.4	29.6	31.4	25.3
Spain	18.5	18.8	15.8	16.5
Sweden	16.8	17.6	17.6	14.8
Switzerland	16.7	13.5	14.1	13.9
United Kingdom	10.5	12.2	14.6	14.1
United States	12.3	13.8	14.5	12.0

Source: OECD.

Australian companies have reduced investment as a proportion of output in recent years, as have companies in many other countries (Table 18). Nevertheless, the investment-output ratio in Australia remains relatively high, especially compared with other countries having an "outsider" model. This may reflect the importance of mining in Australia, which is capital intensive, although Canada, which also has a large mining sector, does not stand out as having a high investment-output ratio. Rates of return on capital in the business sector have increased somewhat in recent years, as has occurred in most other OECD countries (Table 19).

Table 19. **Rates of return on capital in the business sector**[1]

	1970s[2]	1980s	1990s
Australia	**11.8**	**11.0**	**12.8**
Austria[4]	..	11.6	12.4
Belgium	13.4	12.8	13.6
Canada[4]	14.6	16.7	15.3
Denmark	10.4	9.4	10.4
Finland[4]	7.9	8.6	8.0
France[3]	12.6	11.8	14.7
Germany[3]	11.8	11.2	12.9
Ireland	6.1	7.3	12.4
Italy[4]	11.8	12.9	14.5
Japan	17.2	13.7	13.8
Netherlands[4]	. .	17.0	18.1
New Zealand[4]	. .	12.9	16.7
Norway[5]	8.7	6.6	7.3
Spain	17.9	16.1	17.9
Sweden	10.8	10.2	11.6
Switzerland[3]	10.8	8.1	4.3
United Kingdom[3]	10.1	9.5	10.8
United States	19.5	20.8	25.3
Average (16 countries)	12.2	11.7	12.9
Average (19 countries)	. .	12.0	13.3

1. Difficulties in making an appropriate imputation for the labour income of the self-employed and in deriving a consistent measure of the capital stock across countries mean that great care is needed in interpreting cross-country differences in the levels of rates of return. For details see "Sources and Methods", OECD *Economic Outlook*.
2. Average 1975-79 in the case of Canada and 1977-79 in the case of Italy and Finland.
3. Excluding the adjustment to employment for unpaid family workers for which data are not available.
4. Excluding the employment adjustment for unpaid family workers prior to: 1975 for Canada; 1977 for Italy and Finland; 1985 for Austria; 1986 for New Zealand and 1987 for the Netherlands.
5. Mainland business sector (*i.e.* excluding shipping as well as crude petroleum and gas extraction).

Source: OECD.

Current issues

The composition of boards

In the Australian system of corporate governance, boards have the primary responsibility for selecting, monitoring and where necessary, controlling the actions of corporate managers. In open corporations, and notably in those whose shares are publicly traded, boards are the main link between shareholders on the one hand and management on the other. The quality of boards is widely seen as a central determinant of the effectiveness of the system of corporate governance.

Notably in the United States, specific requirements have been imposed on the composition and structure of corporate boards. Thus, since 1956, all domestic companies listed on the New York Stock Exchange have been required to have at least two "outside" directors on their board. Moreover, since 1978, all domestic companies have been required to have an audit committee comprising only directors who are independent of management and are free from any relationship that could interfere with the exercise of independent judgement as a member of that committee.

In Australia, the Corporations Law, while requiring corporations to have at least a minimum number of directors, and making provision for prohibiting particular individuals from acting as directors, does not impose specific requirements on the composition or structure of boards. Nor does the Australian Stock Exchange (ASX) do so through its Listing Rules.[73] Rather, the ASX has recently introduced a Rule requiring each listed company to include in its annual report a statement of the main corporate governance practices the company had in place during the reporting period.[74] The ASX provides a list of corporate governance matters on which companies may report, including the number of non-executive directors, whether the Chairperson is a non-executive Director, and whether the board has Committees with particular responsibilities for audit and for remuneration. The ASX list of corporate governance matters is purely indicative, and unlike the disclosure requirement imposed by the London Stock Exchange Ltd. in the United Kingdom, companies are not obliged to explain departures from a "Code of Best Practice".[75] The question has therefore been raised of whether the ASX standard is set too low, and whether a more prescriptive approach might not be desirable.

The Government's CLERP paper "Directors' Duties and Corporate Governance" (the Director's Duties paper) recommends continuous monitoring of corporate governance practices by the ASX, relevant industry and professional bodies, investors and Government. It considers that the Government should not impose additional mandatory legislative requirements unless there is a failure of current requirements or regulatory mechanisms.

In practice, the bulk of Australian listed companies have boards in which non-executive directors are in a majority, with the typical large listed company having some five non-executive directors on a board of seven or eight (Clifford and Evans, 1996, p. 60, Table 2). The roles of Chairperson and CEO are separated in most listed companies, with the Chair being a non-executive director. Moreover, the boards of virtually all large listed companies now have specialised Audit and Remuneration Committees, comprised solely or very largely of non-executive directors.[76] Nonetheless, there has been some concern that the interests of the board, and especially of non-executive directors, are not sufficiently aligned with those of the owners.[77] Such an alignment could be achieved by board members investing a significant proportion of their wealth in the shares of the company. This approach, which is considered in the United States and by the Australian Investment Managers' Association (AIMA) to be best practice, would expose board members to both the upside and downside risks of being a shareholder, something not achieved through holding share options or similar. Indeed, non-executive directors should not participate in incentive schemes set up for executives as this can undermine the prime role of those directors in representing the interests of the general body of shareholders. For the time being, few Australian companies disclose their policy on equity participation by non-executive directors (and of those that do, none requires them to have a significant personal investment in the company) or on offering them equity incentives.

There has also been concern about whether the non-executive directors are genuinely independent, in the sense of having no substantial link to the company other than through their ownership interest (Bird, 1995). In assessing these concerns, it is important to note that the independence of directors from the firm's on-going operations may come at a cost. In effect, it seems reasonable to suppose that boards can gain by drawing on directors who have experience of the company as an on-going supplier or consumer of its products. If firms are prevented or seriously discouraged from achieving such gains, they may be forced either to forego economies in transactions costs or to engage in full vertical integration where it is not desirable. This merely illustrates the fact that no single model of corporate governance will be appropriate for all instances and situations. As a result, there seems to be little case for going beyond the current indicative arrangements, all the more so as they have only so recently been introduced.

The duties of directors

Given the central role of boards in the Australian system of corporate governance, the legal duties of directors have been an issue of continuing concern. Historically, the duties of directors in Australia were established primarily under the common law, with English law providing the guiding principles. Fiduciary duties of loyalty and good faith were paralleled by duties of skill, care and diligence. In practice, however, the Courts interpreted at least the latter duties as imposing obligations which were “remarkably low” (Corkery, 1987, p. 131). Thus, the leading case, (*Re City Equitable Fire Insurance Co. Ltd*., 1925, 1 Ch 407) establishes that a Director need not bring any special care or knowledge to the task; need not show a greater degree of care and skill than would reasonably be expected of a person of the same knowledge and experience; and is not bound to give continuous or even close attention to the affairs of the company. In their reluctance to pass judgement on the merits of management decisions, the Courts held that directors did not breach their duty by the “omission to take all possible care”; rather, their conduct “must be much more blameable than that: it must be in a business sense culpable or gross”, (*Lagunas Nitrate Co. v Lagunas Syndicate*, 1899, 2 Ch 392, per Lindlay MR at 435). Directors’ conduct, if it was in good faith, was therefore substantially protected, even when it seemed clearly irresponsible.

Over the years, the community has come to expect more of directors and those expectations have been reflected in statute, most notably in the Corporations Law. The relevant provisions require a director to exercise at least as much care and diligence as would be exercised by a “reasonable person in a like position” (Corporations Law, section 232(4)). They also provide for substantial duties of disclosure, especially with respect to possible conflicts of interest, and strengthen the penalties available for breaches of the duties of care and of good faith. As statute has changed, so has the standard imposed by the Courts, with three developments being especially important.

First, recent decisions, most notably (*Daniel and Ors v AWA Ltd*., 1995, 16 ACSR 607; 13 ACLC 614) imply that directors, including non-executive directors, will be held accountable at law for the conduct of senior managers, with not much weight being given to the claim that these directors cannot practically supervise every aspect of a large company’s activities. Courts have been at some pains to emphasise that “the mere fact that a director participates in conduct that carries with it a foreseeable risk of harm to the interests of the company will not necessarily mean that he has failed to exercise a reasonable degree of care and diligence in the discharge of his duties” (*Vrisakis v Australian Securities Commission*, 1993, 11 ACSR 162 at 212 per Ipp J.). Nonetheless, there is a perception that directors are now substantially more likely to find conduct entered into in good faith being regarded as culpable (Baxt, 1995 and Tomasic, 1995).

Second, Courts appear to have raised the standard in respect of the duty of honesty and propriety, long established in the common law and codified in sections 232(2), (5) and (6) of the Corporations Law. The duty of honesty guards against fraud, which is an activity with no redeeming economic value. The duty of propriety creates a requirement for directors to declare and seek company approval of situations which may involve conflicts of interest. The scope for these to be ratified confirms that there are circumstances in which seeming conflicts may benefit the company or at least cause it no harm; the likelihood that directors, notably in a small economy, may find themselves in situations where they have a range of involvements highlights the importance of ensuring that the mere fact of a conflict does not create culpability. However, in a recent case (*R v Byrnes, R v Hopwood. Byrnes v The Queen*, 1995, 17 ACSR 551), the High Court appears to have interpreted the duty of propriety as creating a liability independently of the likelihood of harm being caused to the company (Whincop, 1996). Notably when criminal penalties are available for the resulting breach, such an interpretation could have serious consequences. The Australian provisions in respect of related-party transactions are already exceptionally stringent; changes which go further in this direction are likely to be counter-productive.

Third, there have been some limited moves to extend the duties of directors from being solely to shareholders to also encompassing creditors. A new insolvent trading regime has been introduced which imposes personal liability on directors if their company continues to trade when it is insolvent. To avoid this liability, a company which may be insolvent must be placed in voluntary administration. The administrator will then decide within three weeks whether the company can trade its way out of difficulty. The new regime has reduced the tendency to liquidate companies experiencing difficulties and has increased repayments to creditors. However, directors' responsibilities to creditors have also been extended in respect first, to new loans made to companies whose cash flow is precarious, and second, with respect to companies which are closely held (Byrne, 1994). As there is no general reason to presume that those lending to these companies do so in ignorance of their situation[78] it is not apparent why directors' duties should have been extended in this way.

In short, the trend has been for the legal duties bearing on directors to become more onerous. This can be economically costly as directors – who can practically hold only a small number of directorships – are less well-placed than shareholders and creditors to diversify risk. In principle, the resulting risk could be partly offset by increasing the insurance and indemnity available to directors, and companies are now permitted to provide such indemnity in respect of liabilities to unrelated third parties and which do not involve a lack of good faith. Nonetheless, the cost of securing such insurance, notably when the law remains in flux, suggests that there would be gains from clarifying the range of circumstances in which directors' actions would be legally protected.

A "business judgement" rule would seem a useful step in this respect. Such a rule, which is an accepted part of US corporate law, would explicitly remove liability from decisions made by directors when those decisions were made in good faith and through an orderly and proper deliberative process, as evidenced by the efforts made by those directors to secure and assess relevant information. Without in any way permitting or condoning fraud, the resulting "safe haven" would help reduce the uncertainty directors now face. The Government's Directors' Duties paper proposes a statutory form of business judgement rule, which would offer directors a safe harbour from personal liability for breaches of the duty of care and diligence in relation to honest, informed and rational business judgements. The business judgement rule would not be designed to insulate directors from liability, but rather to protect the authority of directors to exercise their duties in good faith and with due care.

The Directors' Duties paper proposes a number of other amendments to the Corporations Law to clarify certain aspects of Director' obligations:

- The existing duty of care and diligence should be amended to make it clear that the standard of care required by the duty must be assessed by reference to the particular circumstances of the individual officer concerned;
- In order to recognise the oversight role played by directors and their reliance on delegates to manage the company's day-to-day affairs, the Corporations Law should expressly provide that directors may delegate their functions and rely on the advice of experts when making decisions;
- The existing duty to act honestly should be reformulated to capture the fiduciary principles that a director or other officer must exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose. Breach of this duty will continue to have both criminal and civil consequences;
- Breach of the duty of care and diligence will only give rise to civil sanctions - the concept of negligence is inconsistent with dishonesty, in that dishonesty suggests an active awareness of wrongdoing rather than failure to exercise sufficient care and diligence; and

– A company’s ability to indemnify officers for legal expenses should be clarified.

The quality of financial disclosure

Investors and their representatives can only monitor the performance of management if they have access to relevant and reliable financial information. Moreover, taken as a whole, investors and firms gain if this information is standardised, although any individual firm might prefer a situation in which its accounts were not readily comparable to those of others. Accounting regulations can improve the efficiency of monitoring and of capital markets by providing for a standard form of accounts and by ensuring that relevant and reliable information, produced in a manner consistent with this standard form, is available on a timely basis.

Historically, Australian accounting requirements followed those in the United Kingdom in imposing on directors an obligation to provide accounts reflecting a “true and fair” view of a company’s situation. However, according to two prominent commentators, the concept of “true and fair” proved sufficiently elastic to encompass reports which, when set against the ostensible purpose of the reporting requirement, were manifestly “absurd” (Chambers and Wolnizer, 1990, p. 360). The license the law then granted directors to depart from accounting standards when they judged that such departures were needed to provide a “true and fair” view therefore substantially weakened the effectiveness of corporate disclosure.

As a result of these deficiencies, the Corporations Law was amended in 1991 to require directors to ensure that the company’s financial statements were made out in accordance with applicable accounting standards. The Law was also amended at that time to provide that where the company’s financial statements would not provide a true and fair view, the directors must add, by way of notes, such explanation and information which providing a true and fair view would require. The overall result of these amendments is that Australian accounting standards have legal backing in respect of their application to entities subject to the Corporations Law. The Government’s CLERP paper on “Accounting Standards” indicates that it is not proposed to amend the Corporation’s Law to reintroduce a true and fair override in Australia, notwithstanding the recent decision of the International Accounting Standards Committee to adopt a true and fair override in its standard on the presentation of financial statements.

By and large, Australian accounting standards are of high quality and yield information which capital markets appear to consider relevant and reliable. Moreover, the recent move to a continuous disclosure system, in which entities whose securities are traded or offered to sell must notify the authorities of all material changes likely to have a significant effect on their financial position, means that investors are provided with information on a timely basis.[79] Nonetheless, the Accounting Standards paper raises several concerns, of which two are dealt with here.

The first is that of the role of historical cost accounting. While Australian accounting standards remain oriented to historical cost accounting, the paper notes that this approach may be poorly adapted to a world in which price levels and structures are undergoing continuous change. The paper sets a move to current cost accounting as a long term goal for Australian accounting standards, on the basis that a move in this direction could increase the reliability and relevance of accounting information.

In practice, Australian accounting standards are less rigidly oriented to historic costs than those typically found elsewhere. Thus, the concept of income set out in Australian Accounting Standards Board (AASB) 1 018 is broadly inclusive, and hence comes closer to a comprehensive or "clean surplus" basis. Moreover, the standards make far greater provision for non-current assets to be re-valued than notably applies in the United States, with AASB 1 010 requiring that non-current assets not be shown at above recoverable amount, this being defined as "the net amount that is expected to be recovered through the cash inflows and outflows arising from (the asset's) continued use and subsequent disposal". Indeed, revaluations are relatively frequent, and became more so in the course of the 1980s (Whittred and Zimmer, 1988, pp. 192-94). Equally, AASB 1 021 requires annual reviews of useful life, and hence is intended to encourage depreciation on a basis consistent with likely asset use. Finally, "mark to market" accounting is now required for certain reporting entities, including for most investments related to real estate and for holdings by reporting entities in insurance and superannuation. Overall, current price valuations are now an important feature of Australian financial reporting, with there being "too many instances of the use of market prices as the basis for valuation … for anyone to say that market prices do not constitute sufficient objective evidence" (Godfrey *et al.*, 1994, p. 476).

It need not follow, however, that a full move to current cost accounting would be simple or even yield benefits in excess of the likely costs. It is, in particular, not certain that current cost accounting would be readily reconciled with the emphasis which Australian accounting standards place on the maintenance of operating capability as the benchmark income concept. Moreover, important parts of the Australian standards, and notably those related to depreciation, are still very much oriented to historical costs and reform would be a difficult undertaking. Experience elsewhere, as well as the Australian experience with the Current Cost approach recommended by Statement of Accounting Practice 1, issued in November 1983, highlights the practical difficulties entailed with accounting systems based fully on current costs. Nor does experience elsewhere, and notably in the United States and the United Kingdom, suggest that investors derive added information from accounts based on current costs. Careful consideration therefore needs to be given in framing moves in this direction.

A second issue relates to the extent to which Australian accounting standards conform to those used overseas. At present, accounting standards differ materially between countries, with international standards playing a relatively minor role. For example, Australian standards differ substantially from those established by the International Accounting Standards Committee (IASC) in the treatment of goodwill and in the accounting treatment of take-overs. In principle, greater harmonisation could be desirable, at least if it were accompanied by a move to standards which better reflected firms' situations and prospects. It would reduce costs for Australian companies issuing securities in other countries and for foreign companies doing likewise in Australia as well as facilitating the analysis of Australian corporate accounts, especially by foreign investors.[80] The paper proposes that, for the immediate future, Australia should harmonise its accounting standards with those of the IASC. Under this arrangement, compliance with Australian standards would automatically result in compliance with those made by the IASC. The paper proposes that, from 1999 on, IASC standards would be progressively adopted subject to the Government being satisfied that it was in Australia's best interests to do so and that the IASC standards had gained a satisfactory level of acceptance in overseas markets. However, before a final decision is made about the adoption of new international accounting standards from 1 January 1999, the proposed Financial Reporting Council will be required to report to the Government about the progress being made by the IASC towards the completion of its core set of standards and the likelihood of approval of those standards by the International Organisation of Securities Commissions. The paper notes that this goal is an ambitious one, especially given the slow pace of international efforts at accounting standardisation and the extent and significance of the compromises which have had to be made for international standards to be approved. While there is much to be commended in the paper's proposal, its feasibility will ultimately depend on the commitment which other countries make to the work of the relevant standards bodies.

The role of institutional investors

Although the ultimate ownership of corporate assets may be becoming more dispersed as households shift the weight of their portfolios from intermediated claims on companies (*i.e.* deposits with financial intermediaries) to equity-based claims (*i.e.* claims on pension funds or mutual funds/unit trusts, and direct share holdings), the direct holding of shares appears to have become more concentrated in recent years. Precise comparisons are not possible but the average share of the twenty largest investors in the holding of equity of listed companies appears to have increased from less than 40 per cent in the 1950s to over 70 per cent today (Ramsey and Blair, 1993, pp. 165 and 168). This is a substantially more concentrated structure than prevails in the admittedly much larger economies of the United States and Japan.

An important factor underpinning this trend has been the strong growth of institutional investors, and notably of superannuation funds and life insurance companies. After the introduction of compulsory superannuation in 1987, the total assets of superannuation funds and approved deposit funds grew from A$ 94 932 million at 30 June 1988 to A$ 271 300 million at the end of 1996. It has been estimated that these funds will grow in value to between A $1 494 000 million and A$ 1 825 000 million (a real increase of over 200 per cent) by 2020 (Financial System Inquiry (S. Wallis, Chairman), 1997, pp. 128-129).

The funds management firms which manage the equities owned by institutional investors now hold large positions in most listed companies. Defining a 'substantial shareholder' as one entitled to not less than 5 per cent of any class of a company's voting shares, as in the Corporations Law, an institution was the largest or only substantial shareholder in 34 per cent of All Ordinaries Index companies in 1996 (Table 20). This was a marked increase from 1993, when the proportion was 24 per cent. The pattern of these investments is now such that at least one Australian institution, and more usually two to three such institutions, is likely to hold a substantial share in any major listed company.

Table 20. **Substantial shareholdings in All Ordinaries Index companies**[1]

	1993		1996	
	Number of companies	Per cent of index[1]	Number of companies	Per cent of index[1]
Largest or only substantial shareholder a non-institution stake $\geq$ 30 per cent	98	41.9	87	33.5
Largest or only substantial shareholder a non-institution 20 per cent $\leq$ stake $\leq$ 30 per cent	26	11.1	30	11.5
Largest or only substantial shareholder a non-institution 5 per cent $\leq$ stake $\leq$ 20 per cent	43	18.4	47	18.1
Largest or only substantial shareholder an institution[2]	57	24.4	88	33.8
Zero substantial shareholders	10	4.3	8	3.1
Total	234	100.0	260	100.0

1. As the study focuses on *operational Australian* companies, several All Ordinaries Index companies (42 out of 276 in 1993; 55 out of 315 in 1996) are excluded. These are overseas-based companies (10 in 1993; 11 in 1996); and property trust companies and companies involved merely in equity investment (32 in 1993; 44 in 1996). The All Ordinaries Index generally consists of the largest companies (measured by market capitalisation) listed on the ASX, the monthly trading in whose shares meets a minimum turnover threshold.
2. All substantial shareholders that were custodians or trustee companies were ignored.

Source: Stapledon (forthcoming).

In principle, institutional investors may be especially well-placed to monitor the performance of managers because they can achieve economies of scale and scope in the monitoring function. There have indeed been some recent instances in which these investors have intervened publicly in company affairs. Nonetheless, there appear to be some regulatory barriers to greater activism by institutional investors. Most importantly, the Corporations Law (section 615) restricts a person from becoming "entitled" to more than 20 per cent of the shares in a company except in specified situations, including those in which that person makes a bid for all of that company's shares. "Entitlement" for this purpose may in some circumstances be obtained by association. Uncertainty about the operation of the provisions has given rise to concerns about the efficacy of institutions conferring on the attitude they should adopt at a company's general meeting. While the extent of the impediment is the subject of some debate, it is fair to say that Australian institutions, in contrast to those in the United States, are potentially inappropriately impeded in coordinating their efforts at securing performance. In late 1996 the Australian Securities Commission (ASC) commenced a consultation process on how it might use its discretionary powers to facilitate collective action by institutions. The issue is being examined in the context of the Australian Government's CLERP with the purpose of removing existing technical impediments to collective actions by shareholders. Even in the absence of any regulatory barriers, incentives for institutions to be active shareholders are relatively weak, as in other "outsider systems". An active shareholder who succeeds in obtaining changes which improve a company's performance shares the increased returns with all shareholders but bears all the costs of activism: each shareholder has an incentive to free ride on the activism of other shareholders. While co-operation amongst large shareholders could reduce this free-rider problem, institutions which are underweight in the stock concerned may be unwilling to co-operate for fear of reducing their performance relative to their competitors. A lack of shareholder activism may not, however, be a serious problem in the presence of an active independent board. Such a board can be viewed as a means of internalising the costs of monitoring and so overcoming this free-rider problem.

Shareholders' access to legal recourse

Even with effective provisions for disclosure and for active monitoring, there will be circumstances in which legal action is needed to enforce acceptable standards of corporate governance. The Corporations Law vests very substantial powers and responsibilities in this respect in the ASC, as well as in the ASX's enforcement of its listing rules. These bodies have taken an activist approach to their tasks, with the ASC being especially vigorous in identifying and prosecuting criminal breaches of the Corporations Law.[81] Moreover, Australian administrative law provides scope for the Courts to issue, on application, an order of *mandamus* requiring an agency to act more firmly or expeditiously in the performance of its public legal duty. An aggrieved party can therefore look to the ASC for redress in the event of corporate misbehaviour.

Yet it is impractical to rely exclusively on public enforcement. Resource constraints mean that regulators cannot pursue all breaches of the law. At the same time, regulatory priorities may differ from those of the aggrieved parties and may not always be correct. For these reasons, private enforcement provides a reliable means of ensuring stability in the application of the law.[82]

While the Corporations Law creates many avenues for private action, the view has frequently been put that shareholders' scope for redress is limited by restrictions on derivative actions.[83] These restrictions arise from the rule articulated in (*Foss v Harbottle*, 1843, 2 Hare 461) which states first, that the power to initiate, prosecute, settle or otherwise deal with legal proceedings by a company resides in its board of directors (the 'proper plaintiff' rule); and second, that a shareholder has no standing to bring an action for any matter that is, or possibly even could be, lawfully ratified by the company's general meeting (the 'internal management' rule). While the rule has continued vitality, it has been appropriately noted that its precise application, "as analysed in a labyrinthine case law, is a legal quagmire" (Kluver, 1993, p. 9).

The law does recognise a number of significant exceptions to the rule in *Foss v Harbottle*. The most important of these relate to the provisions against oppression, contained in section 260 of the Corporations Law, which allow a shareholder to seek relief where the affairs of the company are being conducted "in a manner that is contrary to the interests of the members as a whole". However, the practical relevance of these provisions is uncertain, first, because of uncertainty as to their interpretation, second, because the standard of proof required of shareholders is onerous and – last but by no means least – because they do not deal explicitly with costs. Equally, the provisions of section 1 324 of the Law, which create scope for any person "whose interests have been, are or would be affected" by a breach of the Corporations Law to seek an injunction and/or damages, have most recently been interpreted in fairly narrow terms by the Courts (Baxt, 1996).

Responding to these apparent constraints on shareholders' rights of action, a number of authorities have sought the introduction into Australian law of a statutory derivative action, possibly modelled on that in place in Canada (Companies and Securities Law Review Committee, 1990, House of Representatives Standing Committee on Legal and Constitutional Affairs, 1991 and Legal Committee of the Companies and Securities Advisory Committee, 1993). In practice, however, too much should not be expected from the introduction of statutory derivative action. Even in the United States, where restrictions such as those imposed by the rule in *Foss v Harbottle* play no role, derivative actions are extremely rare. In the Australian legal system, where costs can fall entirely on the unsuccessful party, contingency fees are rare and class suits restricted, private plaintiffs will continue to face substantial disincentives to litigation. The fact that the damages secured in such suits must generally flow to the company makes private action even less likely. Nonetheless, the introduction of such a right would clarify a situation which is currently uncertain and would usefully complement the “business judgement” rule discussed above.

The Director’s Duties paper proposes a statutory form of derivative action, to enable shareholders or directors of a company to bring an action on behalf of the company, for a wrong done to the company where the company is unwilling or unable to do so. The proposal paper envisages the objective of a statutory derivative action not as providing additional grounds to sue directors but to overcome a number of key procedural difficulties currently facing shareholders who wish to bring an action on behalf of the company.

It is considered that a statutory form of derivative action is potentially a valuable tool to enhance corporate governance and to maintain investor confidence. In particular it is perceived as having the effect of reducing agency costs between the director/managers of a company and its shareholders. It is posited that a statutory form of derivative action will provide strong encouragement for company managers to be accountable to shareholders. It should also be noted that the proposals for a statutory derivative action would give the courts broad discretions as to costs, which may help to ease the disincentives to take such action.

The proposal paper emphasises the natural connection between a statutory derivative action and a business judgement rule: while the statutory derivative action will promote accountability of company managers, the business judgement rule will encourage business managers in their proper decision making role. Such managers will know that if they have conducted themselves in good faith and with due care they will be able to account for their business decisions without fear of liability.

The regulation of take-overs

Compared to those in force in the United States and the United Kingdom, the laws relating to take-overs in Australia are relatively complex. The sheer mass of the regulatory requirements – which are claimed to be among the longest take-over regulations in the world – complicates compliance and makes for a formalistic approach to enforcement. At the same time, the provisions vest substantial discretion in a non-judicial Panel (albeit rarely used), which may prevent take-overs even if they comply in all respects with the provisions of the Corporations Law. Finally, substantial parts of the provisions are capable of being amended at the discretion of the ASC. Making these requirements simpler and more certain would seem to be an important area for policy attention.

As well as achieving simplification, it may be desirable to review specific restrictions the provisions now impose. In particular, since the early 1980s Australian law has embodied an equality of opportunity principle. This principle, which originates in a review of company law by Sir Richard Eggleston in 1967, aims at ensuring that all shareholders can benefit from the "control premium" paid by the purchaser in a takeover transaction. This is enforced by requiring bidders, once they achieve a relatively low level of holding of stock of a particular kind, to make an unrestricted bid for all the remaining stock of that kind. Moreover, the takeover provisions have the effect of enabling 'auctions' for corporate control to take place by requiring bids to be made in a manner which also allows rival bidders to make offers.

The takeover rules have been in place in substantially their current form for over fifteen years, and impede takeover activity in various ways. In light of these concerns, a review of takeover law, with an economic focus, is being conducted in the context of the Australian Government's CLERP. That review, which is ongoing, has to date resulted in the release of a paper by the Australian Treasurer setting out proposals for reform. Key features of the proposals are:

- the equality of opportunity principle to be retained as a basis for takeover regulation;
- comments are sought whether the legislation should cease to facilitate "auctions" for corporate control, specifically by the introduction of a mandatory bid rule which would permit persons to acquire shares in excess of the takeover threshold provided that a subsequent offer is made on equivalent terms to the outstanding shareholders;
- improvements are to be made to the compulsory acquisitions provisions to enable persons with an overwhelming interest in a class of securities to compulsorily acquire the outstanding minorities and thereby move towards obtaining the benefits of 100% ownership;
- shift the focus of takeovers dispute resolution away from the courts and into an expert non-judicial body with a view to ensuring commercially sensitive outcomes; and
- the application of takeover rules to managed investment schemes.

Many OECD countries, including the United Kingdom, also retain the equality of opportunity principle, generally through a mandatory bid rule such as that advanced in the CLERP paper.[84] Among those which do not are (all but two states[85] of) the United States. One consequence of having mandatory takeover rules is that the cost of takeovers tends to be raised,[86] thereby reducing the scope to improve the efficiency with which corporate assets are used through changes in corporate control. However, in those jurisdictions where mandatory takeover rules do not apply, other elements of the legal environment, such as those relating to oppression and minority rights, can have the effect of raising the cost of takeover activity.

Finally, it needs to be noted that the provisions of the *Foreign Acquisition and Takeovers Act 1975* do not continue to impede the functioning of the Australian market for corporate control. Australia's foreign investment policy is, in fact, notably open and liberal; approval is almost invariably granted, and given speedily, for foreign takeovers in respect of the great majority of industry sectors. In relation to telecommunications, the restrictions only relate to ownership limits for one entity, Telstra. In respect of certain sectors, namely real estate, banking, civil aviation and airports, shipping and the media, restrictions apply to foreign investment as they do to many countries.

Assessment

For much of the last decade, public attention in Australia has focused on instances of serious corporate misconduct. However spectacular these instances may have been, they have never accounted for more than a small share of corporate activity taken as a whole. It would be unfortunate if the legacy of distrust which they have left resulted in excessive burdens being imposed on the governance of enterprises. After all, the more time boards must devote to ensuring compliance with corporate law, the less time they will have for their key task of improving management's performance. By and large, the balance in Australian corporate regulation appears to have shifted too far towards a prescriptive and intrusive approach. The core goals of ensuring honesty and efficiency in business could be achieved while streamlining some important aspects of the current regulations. Continued progress in the reform and simplification of corporate law should therefore remain a priority for government.

V. Entrepreneurship

In several respects the Australian business sector cannot be considered as particularly entrepreneurial. The rate of enterprise creation has not stood out as high by international comparison, relatively few companies have grown beyond medium size and the industrial sector is still dominated by large resource-based – many foreign-owned – companies (see Box 3). As well, the fact that many well-known world-class inventions originating in Australia, such as xerography and the black-box flight recorder, have been commercialised elsewhere suggests lukewarm attitudes towards risk-taking. Such attitudes may have been nurtured by the sense of wealthiness engendered by rich natural resource endowments and, until fairly recently, by a business environment shielded from foreign competition. However, over the last decade border protection has been substantially reduced, financial markets liberalised, industrial relations modernised, and competition in the non-tradeables sector stimulated through deregulation. The result is an environment more conducive to the development of a dynamic, entrepreneurial business sector, which is a key to higher incomes and better employment prospects. As a follow-up to the OECD Jobs Study this chapter first documents various aspects of entrepreneurial phenomena in Australia, evaluates factors pertaining to the creation and growth of enterprises and concludes with a discussion of policy implications of the findings.

Measuring entrepreneurship

At its most general, entrepreneurship can be defined as the dynamic process of identifying economic opportunities and acting upon them by developing, producing and selling goods and services. As such, it is central to the functioning of market economies. This, however, allows many specific definitions depending on the stress put on different aspects of entrepreneurial activity. To some, it implies control of the

Box 3. The Australian business sector: an overview

The Australian business sector differs from that of most other OECD countries in the limited overall role of manufacturing and, within manufacturing, a strong reliance on the traditional resource-based industries. At less than 14 per cent, the share of manufacturing value added in the economy is the lowest in any OECD country. As a corollary to this the service sector share is large and sharply increasing. In addition, the share of manufacturing value added which takes place in sectors classified as "high-tech" or "medium to high-tech" is the second lowest in the area. The Business Longitudinal Study shows a very high share of foreign ownership of larger companies (Table 21), particularly pronounced in the traditional and resource based industries.

Family-owned companies – a major source of entrepreneurial activity in many European countries – make up a very large share of the Australian enterprises, and the share of companies which are relatively young is high across the size categories. Women's share in top-management is relatively high: in some of the rapidly growing segments of the service sector the share of female decision makers exceeds 20 per cent. However, the level of formal education in top-management, particularly in small enterprises, is relatively low.

decision process by the entrepreneur, and therefore tends to be identified with small businesses, including self-employment. Alternatively, entrepreneurs are seen as risk-takers or innovators. Thus, while there is no standard measure of entrepreneurship, it has often been connected to firms' size, their age, their growth and the extent of their engagement in risk-taking activity or particularly innovative activity. For companies whose shares are traded publicly, the extent to which managers and directors are innovative and risk-taking largely depends on corporate culture which in turn is strongly influenced by corporate governance. Proposals for corporate law reform arising from the Government's Corporate Law Economic Reform Program should be conducive to entrepreneurial behaviour on the part of the company managers and directors.

A commonly used proxy for entrepreneurship is the economic importance of the small business sector. As in most other countries, small firms make up the bulk of enterprises in Australia: over 95 per cent of firms are Small and Medium-sized Enterprises (SMEs, defined as those employing fewer than 100 persons in manufac-

Table 21. **A snapshot of the Australian business sector**

	Share of all enterprises in relevant category (per cent)
Age and ownership	
Companies less than 5 years old:	
1 to 19 employees	37.4
20 to 99 employees	26.4
At least 100 employees	13.8
Family-owned companies[1]	46.2
Foreign ownership[2]	24.3
Self-employment[3]	14.0
Management	
Decision maker having tertiary education:	
1 to 19 employees	33.2
20 to 99 employees	43.0
At least 100 employees	64.2
Female decision maker	9.5
Flexibility	
Coverage of award arrangements	52.2
Business improvement activities in medium-sized companies[4]	31.6
Having undertaken major changes[5]:	
Product range	27.4
Market focus	20.7
Production technology	12.0
Management training	12.8

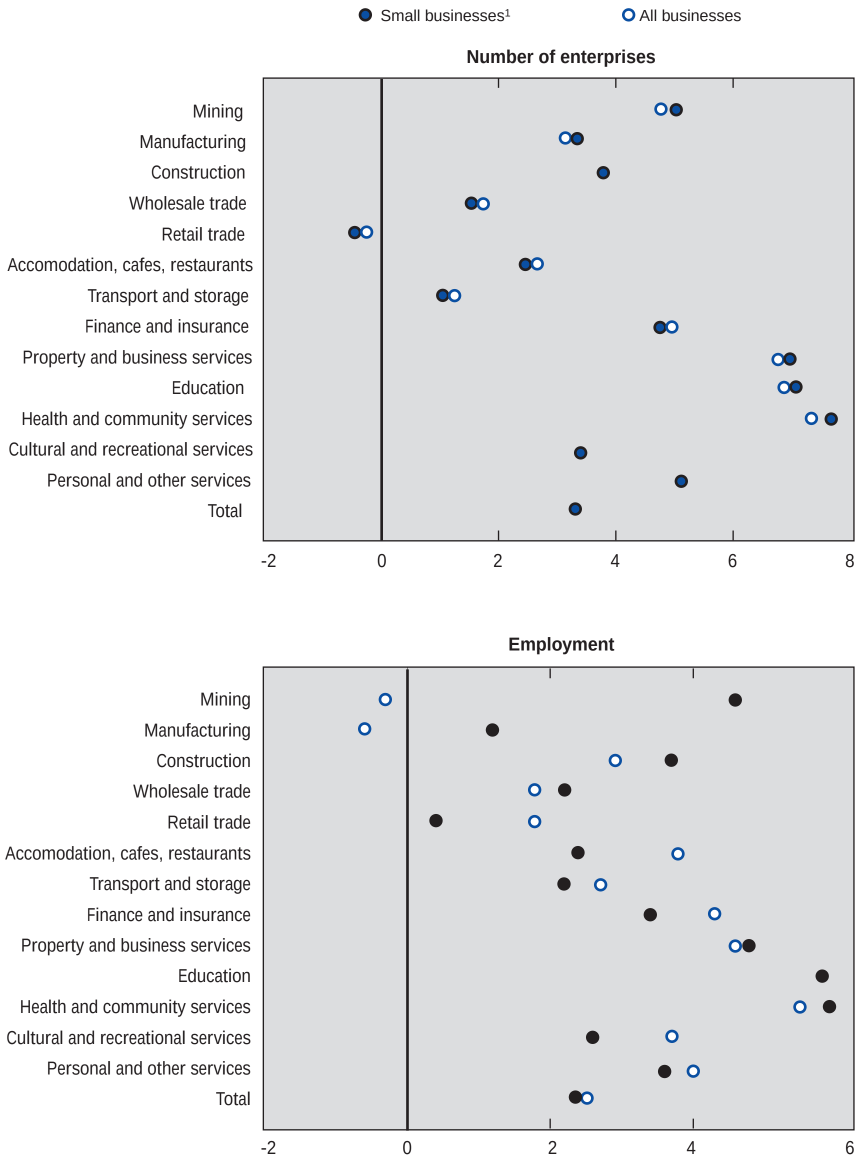
1. Companies with more than one proprietor, all from the same family.
2. Companies with at least 100 employees.
3. Share of total employment.
4. Companies with 20 to 99 employees, having introduced such activities as quality management or just-in-time inventory control within last three years.
5. Companies which estimate that they have undertaken “major” changes within the last three years.

Source: Business Longitudinal Study.

turing and 20 persons in services). Moreover, they employ 56 per cent of the workforce, a share which has been increasing somewhat over the last decade. The main drawback of this measure is that to be meaningful it has to be evaluated at a rather disaggregated level since an aggregate measure is influenced by compositional changes. Indeed, a recent study attributes most of the higher share of SMEs in total employment to the increasing importance of the service sector (which typically operates in smaller units) and to decreases in the average size of industrial enterprises.[87] The same study concludes that one of the forces driving increases in

Figure 23. **ENTERPRISES AND EMPLOYMENT BY INDUSTRY**

Average annual growth, 1983-84 to 1994-95



1. Less than 100 employees for mining and manufacturing, less than 20 for other.

Source: Australian Bureau of Statistics.

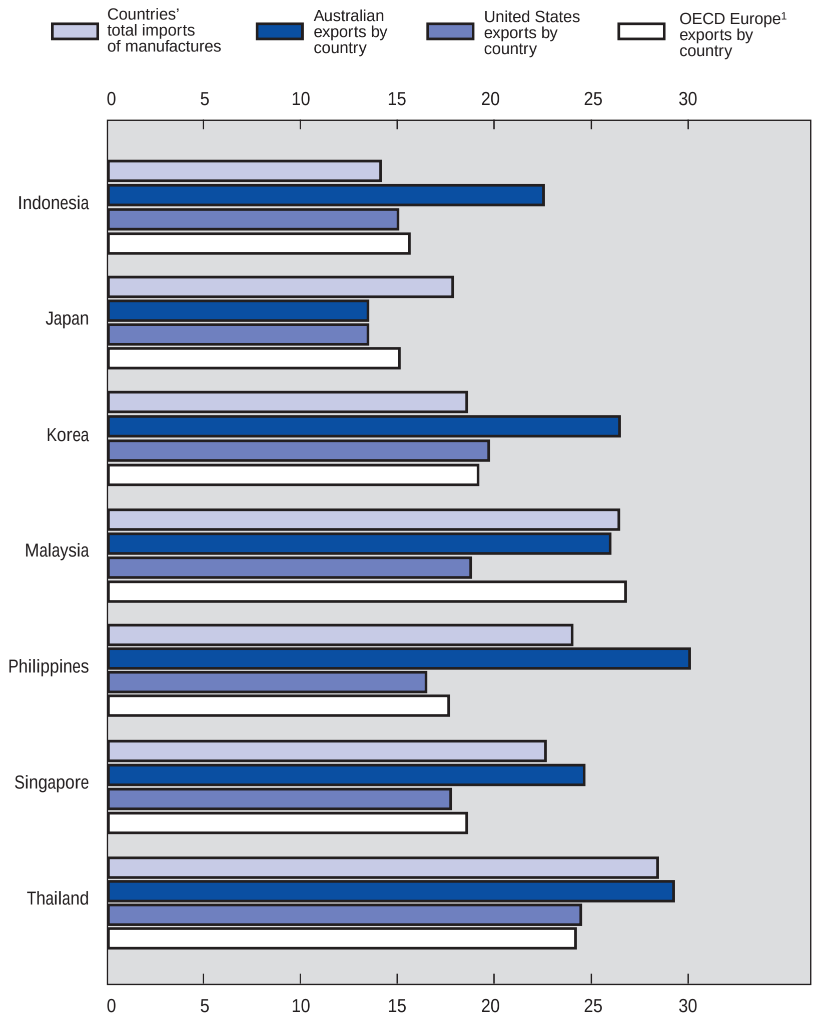
self-employment are rises in the unemployment rate and other factors depressing the chances of finding paid work. However, while such "self-employment by default" may not primarily reflect entrepreneurial endeavour, it does arguably involve a significant element of individual risk-taking. Furthermore, over the period 1983/84 to 1994/95 there was virtually no difference in growth rates between the number of small and large enterprises[88] (Figure 23). Overall, it is difficult to draw any clear conclusions about the significance of entrepreneurship on the basis of size-related measures. Referring to small business and self-employment as a proxy for entrepreneurship may, moreover, be misleading since many of them are not particularly innovative or risk-taking.

Another indicator which may be relevant is the pace at which firms are starting up and closing down. This notion of turbulence has the advantage of not relying on definitions of firms' size, age, or growth. It attempts to capture the dynamic nature of entrepreneurial activity in the Schumpeterian sense of creative destruction. While little hard evidence is available for Australia, the Business Longitudinal Study allows a rough estimate of an annual start-up rate of somewhere less than 13 per cent in recent years and a recent study shows that the exit rate is some 7 to 8 per cent. These figures are broadly comparable with other countries' experience, though differences in definition across countries make international comparisons difficult.

A sign of increasing entrepreneurial spirit may, however, be discerned from a sharp strengthening of export orientation of Australian companies in recent years. Given the small size of the domestic market, a business success often depends on its ability to tap the external market. Indeed, Australian exporters have in recent years been capable of gaining market shares in the rapidly growing Southeast Asian markets, and they have on the whole performed more strongly in the region than their European and American competitors (Figure 24). While some increase in export orientation is a normal consequence of an on-going integration of the Australian economy with the rest of the world and a strong share in the close-by markets would be expected, – and, indeed, a weaker exchange rate has helped – a close inspection shows there is something special about the recent phenomenon. Studies found that even comparatively small and young enterprises are now successful exporters and active participants in cross-border networking, with their success built not only on uniqueness of their products or cost advantage but also on managerial competence, commitment to growth and a willingness to tailor their products to the local markets (McKinsey, 1993, and Ministry of Foreign Affairs and Trade, 1995).

Figure 24. **EXPORT PERFORMANCE IN SOUTH EAST ASIA**

Annual per cent change, 1986-95



1. OECD Europe not including the Czech Republic, Hungary and Poland.
Source: United Nations and OECD.

Another example of emerging entrepreneurial phenomena is a strong performance of companies backed by venture capital. A recent survey (Coopers and Lybrand, 1997) showed that between 1992 and 1996 average sales of venture-backed companies grew by 42 per cent per year and their profits by 59 per cent per year, compared with 6 per cent and 7 per cent, respectively, for the top 100 Australian companies.

The regional dimension. Entrepreneurial dynamism varies between states, though little formal analysis of such inter-state variations has been undertaken. Over the last decade, the average annual growth rate of the number of firms ranged from just over 2 per cent in Northern Territory and New South Wales to nearly 5 per cent in Queensland and Western Australia (Table 22), where construction and the service sector particularly stood out. The apparent entrepreneurial dynamism of the service sector of Queensland, however, may be slightly overstated. Semi-retired people have been known to move to this state and invest part of their superannuation money in self-employment in the service sector. As of recently, the incorporation of companies, as proportion of all firms (1994/95), varies from 3.9 per cent in Tasmania to 11.7 per cent in Victoria, and the variation of the number of new registered firms relative to the labour force is of the same magnitude. Thus, while enterprise creation in Victoria has been low on average in recent decades, it seems to have picked up recently. This is related to both the impressive recovery of the state economy and to policies of deregulation, privatisation and tax cuts.

Within states, entrepreneurship is generally more prevalent in urban regions than elsewhere, but little hard evidence is available. One well-known form of regional specialisation relates to the existence of "clusters" where specialised, and often complementary, firms concentrate within a small geographic area. Clusters are recognised as potentially conducive to innovation and entrepreneurship, since they help overcome the disadvantage of small size in scale-intensive industries and enable groups of companies to internalise some of the externalities connected with marketing, training and R&D. Some information is available for Queensland, where the government has identified some clusters in places such as Gladstone, specialised in aluminium and light metal, and Cairns, in tourism and agro- and food industries. Enhanced information on clusters would facilitate the ongoing discussion about restructuring service delivery, whether private or public, to these groups of inter-dependent firms – as recently discussed in OECD (1996b).

Table 22. **Enterprises and enterprise creation by States and Territories**

	Company incorporations (1)	All firms (thousands) (2)	Average annual rate of growth (1983/84 to 1994/95) (3)	Labour force (thousands) (4)	Company incorporation as per cent of all firms (1), (2)	Company incorporation as per 1 000 members of the labour force (1), (4)
New South Wales	29 119	262.3	2.4	2 709.1	11.1	10.7
Victoria	23 853	203.5	2.9	2 056.5	11.7	11.6
Queensland	14 251	156.2	4.8	1 385.2	9.1	10.3
South Australia	4 457	66.4	3.6	684.0	6.7	6.5
West Australia	7 526	86.4	4.8	759.6	8.7	9.9
Tasmania	735	18.8	2.6	205.6	3.9	3.6
Northern Territories	539	6.1	2.4	83.4	8.8	6.4
ACT	1 256	12.8	3.9	151.1	9.8	8.3
Total	**81 736**	**812.4**	**3.3**	**8 034.6**	**10.1**	**10.2**

Source: (1) Australian Securities Commission, *ASC Digest*, 1994/95; (2) & (3) Chapter 3 State Profiles, pp. 29 and 30, 1994/95; (4) Labour Force Statistics, 1991.

Table 23. **Registration requirements and costs in a sample of OECD countries for three legal forms**

Unlimited liability (limited), private limited company and public limited company

	Legal form[1]	Pre-registration requirements[2]	Registration offices[3]	Post-registration requirements	Time[4] (weeks)	Minimum charter capital[5] (ECU)	Cost[6] (ECU)
Australia	Proprietary	3	1	1-5	1	0	200-480
	Public	4	1	1-5	1	0	200-480
France	Artisan	6	1	4	1-7	0	1 100-2 700
	SARL/EURL	10	1	5	4-8	8 000	1 900-4 600
	SA à conseil	14	1	7	7-15	40 000/250 000	2 200-6 100
Germany	KG	1	1	2	1 day	0	10-25
	GmbH	6	2	2	8-24	25 000	750-2 000
	AG	6	2	2	8-24	50 000	750-2 000
Italy	Artigiana	7	1	4	4-16	0	1 150
	SRL/SuRL	17	5	3	4-16	10 000	2 200
	SPA	18	4	3	22	100 000	7 700
Netherlands	Eenmanszaak	1	1	5	3-7	0	0
	BV	3	1	5	12	19 000	1 000+
	NV	2	1	5	12	0	0
Spain	EI	0	3	5	1-4	0	0
	SRL	7	5	5	19-28	3	330+
	SA	7	5	5	19-28	62	330+
Sweden	Enskild Firma	0	1	2	0-4	0	90
	AB	3	1	3	2-4	12 000	1 130
	AB (public)	3	1	3	2-4	60 000	1 130

Table 23. **Registration requirements and costs in a sample of OECD countries for three legal forms** *(continued)*

Unlimited liability (limited), private limited company and public limited company

	Legal form[1]	Pre-registration requirements[2]	Registration offices[3]	Post-registration requirements	Time[4] (weeks)	Minimum charter capital[5] (ECU)	Cost[6] (ECU)
United Kingdom	Sole Trader	0	0	3	0	0	300
	Private	1	1	3	1	2	420
	Public Limited	1	1	3	1	70 000	900
United States	Sole Proprietor	0	2-6	2-5	1-2	0	200-800+
	LLC	0	2-6	2-5	1-2	0	200-800+
	Corporation	0	2-6	2-5	1-2	0	200-800+

1. Three different forms have been selected among each country's many different forms: unlimited liability forms, limited liability corporate form and public corporations.
2. The number of procedures which must be completed before registering.
3. The number of offices where the business entity must be registered.
4. The number of weeks required before the registration has been processed by the authorities.
5. The value of assets which a business entity must have and maintain.
6. The direct (fees paid to the registering authorities) and indirect (fees paid to lawyers, agents and consultants) costs of registration.

Source: Logotech S.A. (April 1997), *Etude comparative internationale des dispositions légales et administratives pour la formation de petites et moyennes entreprises aux pays de l'Union Européenne, les Etats-Unis et le Japon*. Projet EIMS 96/142 and submissions from the Australian authorities.

Factors affecting entrepreneurship

Culture. One of the rare opinion surveys in this regard reports that community opinion is not particularly positive about small business (Task Force on Leadership and Management Skills, 1995). Perceptions that the overall reward gained does not justify the effort or risk involved "may reflect a low risk tolerance or lack of entrepreneurial spirit within Australian culture, or perhaps a particular work ethic (or combination of these factors)".[89] A lack of appreciation of the entrepreneurs may be partly attributable to the feeling that the natural wealth of Australia is the primary source of growth and well-being (Hartwell and Lane, 1991).

Entry and exit. Costs and procedural delays in setting up an enterprise are not significant in Australia (Table 23). On top of this, some accountants and lawyers – drawing on their obvious "economies of scale" – specialise in the sale of "shelf-companies" whereby entrepreneurs, for a minor extra cost, can acquire a limited company without delay. This is one reason why the total number of Australian limited companies is close to one million – it is estimated that a significant part of these are not actively trading.

Also, the willingness to undertake entrepreneurial risk must be affected by financial and legal penalties in the case of personal bankruptcy and corporate insolvency. In Australia these are not particularly harsh by international comparison, although the three-year waiting period before discharge in the case of personal bankruptcy discourages risk-taking compared with the United States (Table 24). Indeed, in the United States "a good try" is reportedly encouraged, and many successful entrepreneurs have one or two bankruptcies behind them before they succeed. Also, persons affected by personal bankruptcy are legally barred from acting as directors in limited companies, and persons who have been directors in companies with particularly severe cases of insolvency can be barred from participating in the management of new companies.[90]

Cost of tax and regulatory compliance. Compliance costs are considered as a major impediment to entrepreneurship, and the burden of compliance has, therefore, been the target of recent central government efforts at deregulation and simplification. A recent report finds that the burden of compliance is considerably higher for companies which are either small or new in business, and compliance costs can therefore be said to bear particularly heavily on nascent entrepreneurship.[91] Indeed, the burden of compliance is listed as a primary concern of Australia's small and new

Table 24. **Bankruptcy proceedings**

	Filing	Discharge clause
Australia	Entrepreneurs can voluntarily file for bankruptcy. For limited companies a number of procedures for liquidation and voluntary administration are in place.	Discharged after three years. For negligible amounts discharge can be granted after three months. Managers are not liable unless involved in improper dealing.
Germany		Currently, no discharge. Company managers incur civil liability and may also be liable for criminal penalties. Reforms to be enacted will discharge liability companies after seven years.
Sweden	Entrepreneurs can voluntarily file for bankruptcy. However, high- priority debt must be settled, and some additional costs are involved.	No discharge. Managers and owners of limited companies can be made personally liability for tax debts.
United Kingdom		Discharged after two years if the debt is lower than £20 000; three years if the debt is greater.
United States	Entrepreneurs can voluntarily file for bankruptcy. Many bankruptcies are settled outside the courtroom.	Discharge effective immediately.

Source: Submissions from national authorities.

enterprises.[92] Numerous studies have looked into this issue in the past and concluded that, except for some sectors subject to particular regulation and licensing rules, the main problems relate to tax compliance and, to some extent, superannuation.[93] Other kinds of compliance activities under survey related to unfair dismissals and health and safety standards. But enterprises generally rank them as less burdensome than tax compliance. Indeed, a recent study found that more than 70 per cent of all enterprises considered the frequency and complexity of changes to federal tax rules as a major concern, and for small and medium-sized enterprises this percentage was even larger.[94] Two areas singled out as being particularly burdensome are the reporting in connection with the fringe benefit tax and wholesale tax. A recent survey of small business in Queensland concluded that compliance costs run as high as 40 per cent of the net operating profit of enterprises – a figure which is largely related to the imputed price of in-house work performed by the entrepreneur (Table 25). Moreover, for certain kinds of business taxation compliance costs reportedly run as high as 40 per cent of the taxes actually collected. However, in comparison with other industrialised countries Australia does not come across as having particularly high compliance costs. For example, total compliance costs in UK enterprises in the 1980s were estimated at 1½ to 2 per cent of GDP, while recent estimates for Germany are as high as 3 to 4 per cent.[95] According to estimates by Bickerdyke and Lattimore (1997) the burden of compliance in Australia is likely to lie within this range. Finally, it should be noted that a large part of the burden of compliance relate to activities – accounting and auditing – which the companies would arguably have to undertake even in the absence of regulation and taxation.

Table 25. **Compliance costs in small enterprises**[1]

	Construction	Food retailing	Road transport	Auto repairs	Metal fabrication	Total
Annual hours spent on compliance	326	201	395	186	376	296
Annual cost per company (in dollars)	9 688	9 570	31 214	8 053	11 923	14 026
of which:						
fees and purchase of services (per cent)	26	49	72	44	31	52
inhouse efforts (per cent)	74	51	28	56	69	48
Costs as a share of turnover (per cent)	3	5	4	4	3	4
Costs as a share of profits (per cent)	29	37	42	32	24	32

1. Survey covering Queensland companies with less than 20 employees.
Source: Deborah Wilson Consulting Services (1996).

Policy initiatives were taken recently to reduce the compliance burden of enterprises.[96] In particular, the burden of complying with the fringe benefit taxation (FBT) has been eased, *i.e.* by abolishing the demand for record-keeping by companies with small FBT liabilities. Also, a set of rather complex rules guiding the taxation of employer-provided parking and transportation was significantly simplified. More significantly, by mid-1998 the government intends to establish a single registration process for the Taxation Office, Securities Commission, Bureau of Statistics and the Insurance and Superannuation Commission whereby duplication of reporting can be reduced. There are also, less concrete, plans about co-operating with state and territory governments to establish single entry points to all levels of government through which business can obtain information on all official requirements and programmes.

Migration. The presence of migrants and temporary entrants to Australia adds an element of dynamism to the Australian business sector. For example, the recent surge in exports to South East Asia has been facilitated by the availability of people originating from this region. There is also evidence of migrants entering the labour market by starting small family-run shops and enterprises. As well, the generation entering Australia during the years following the second world war is, reportedly, much more prone to start own enterprises than the average of the population. The 1996 Labour Force Survey shows that the share of self-employment among foreign-born persons was 15.4 per cent, compared with 14.3 per cent among native Australians. One of the only detailed surveys, using data for 1981, concludes that immigrants' propensity to become self-employed or employers is not significantly above that of others, although immigrants from South Europe seem to stand out somewhat (Table 26). Moreover, there has been a tendency for self-employed persons from Asia to move to Australia but – typically citing the higher economic growth and fewer regulations in this region – to continue doing business in their countries of origin. Since 1992 immigration visas have been granted to Business Skill Class (BSC) settlers who were previously self-employed business executives or investors, or who possess a proven ability to set up their own enterprise. Not surprisingly, more than 75 per cent of the BSC immigrants have been found to be in business within two years after their arrival.[97]

Finance and risk capital. A lack of finance is often quoted as a major impediment to enterprise growth, particularly as regards small and new enterprises. In the absence of sufficient collateral banks lending to enterprises have to compensate for the higher risk through either significantly higher interest rates or restrictive lending

Table 26. **Labour force status of workforce by region of birth, 1981**
Percentage share of labour force within each group

	Men		Women	
	Employer	Self-employed	Employer	Self-employed
Natives	6.2	10.2	4.5	7.6
All foreign-born	5.7	10.1	3.9	7.3
United Kingdom and Ireland	4.0	8.4	3.1	5.8
Germany	6.7	13.0	5.4	9.5
Greece	9.1	16.8	6.6	14.1
Italy	8.6	15.5	5.6	11.9
India	5.3	4.7	2.9	4.0
Vietnam	0.6	1.2	0.6	1.6

Source: Colins (1991).

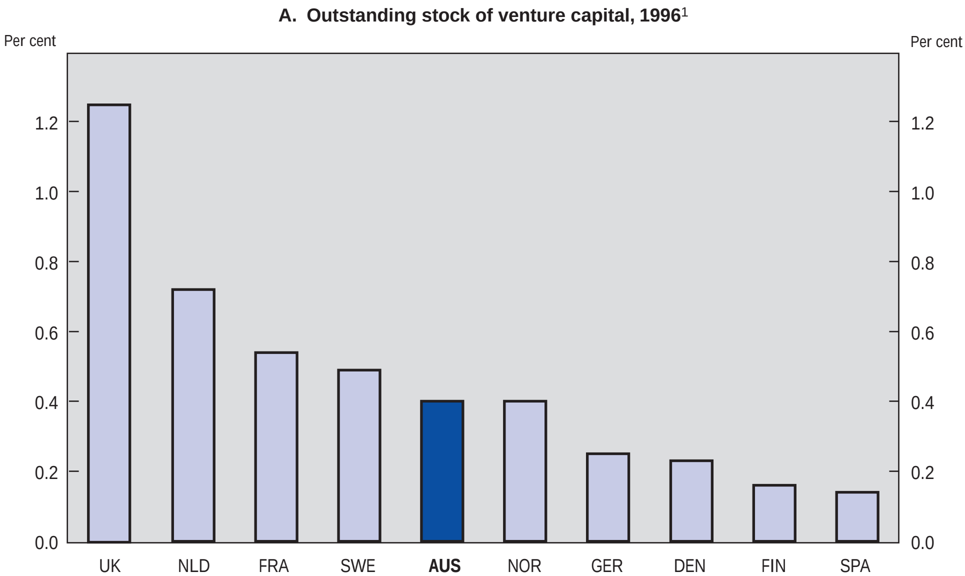
practices. In the case of Australia, however, there is no evidence of banks being unduly restrictive *vis-à-vis* small and medium-sized enterprises and surveys of manufacturing companies indicate that the easing of financial constraints during the current economic recovery has, in particular, benefited small and medium-sized enterprises.[98] According to a recent study the premium charged on short-term loans to small enterprises is typically fixed at around 200 basis points over the prime rate and varies little across clients. This implies that banks have, in fact, been cross-subsidising higher-risk loans among their small business clients. In any event, high risk enterprise start-ups and expansion may more appropriately be financed through equity capital, rather than borrowed funds.

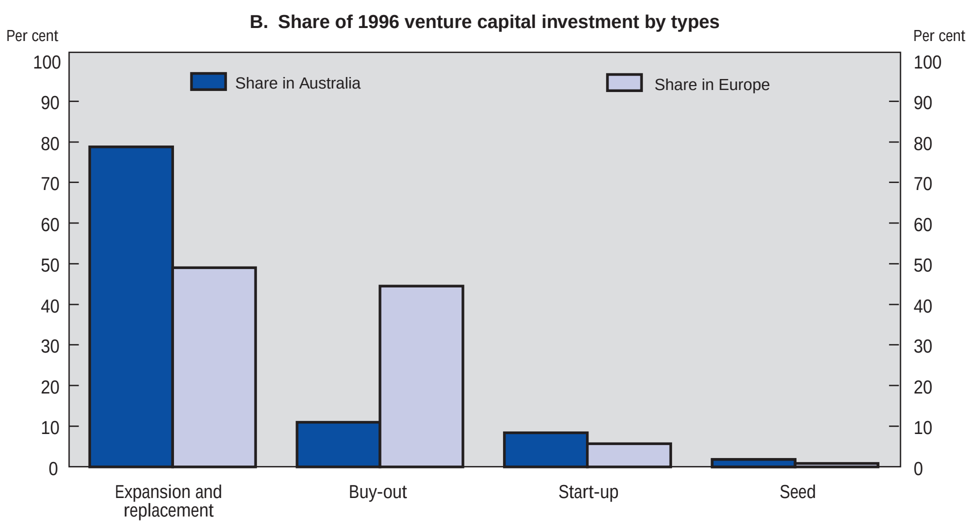
As for equity finance, listing on the Australian Stock Exchange (ASX) is generally not an option to newly started enterprises, and on all accounts the costs of public listing – issuing a prospectus costs an estimated A$ 250 000 to 500 000 – are out of line with the capital needed for expansion in most smaller enterprises. Indeed, a 1995 study concluded that around 97 per cent of small businesses seeking external equity finance to fund their growth require less than A$ 0.5 million.[99] A second-tier stock market was established in the 1980s but was merged with the ASX after the stock-market crash in 1987. This explains the presence of many relatively small companies on the ASX. Nevertheless, the ASX does not stand out as particularly important as a way of acquiring new capital. The market capitalisation was around 70 per cent of GDP in 1994 – high in comparison with most continental European countries, but low relative to the United Kingdom and the United States – and the share of initial public offerings relative to total capitalisation is around 1 per cent, which is below most other OECD countries.

During the current economic expansion, venture capital firms have developed rapidly, but the stock of venture capital invested in Australian businesses, estimated at around A$ 1 to 1½ billion, seems somewhat below OECD Europe relative to GDP (Figure 25, panel A) – though the European data include loans. Compared with these countries, a larger share of the venture capital investment goes into expansion and start-up than buy-outs (Figure 25, panel B). However, there is some indication that comparatively less capital is available early in the life-cycle of an Australian company compared with an American counterpart: an average venture capital-based company in Australia is nine years old compared with five in the United States. A recent study finds that venture capital-backed companies are generally successful. Some 56 per cent of those not already listed expect to become listed companies within the next five years, of which 67 per cent on the ASX and another 30 per cent on the NASDAQ in the United States.[100]

While the supply of venture capital at present seems somewhat low, there is no lack of funds which could, potentially, be made available for such equity investment. Regulatory restrictions on banks' investment in unlisted equity would limit their role as a source of venture capital.[101] But the capital under administration by institutional investors – notably superannuation funds – is considerable. In 1995 institutional investors controlled funds corresponding to some 76 per cent of GDP. This is above the average for OECD Europe, though significantly below levels in the United Kingdom and the United States. Nevertheless, there seem to be some problems with making these funds available for entrepreneurial investment concerning both suppliers and demanders of venture capital.[102] Venture capital firms normally do not find it profitable to invest less than two to three million dollars due to their fixed costs, *i.e.* related to monitoring of the investment, and in order to maximise the probability of success often demand share-holder agreements, effectively giving them control of the company. Venture capitalists are estimated to have insisted on management changes in about half of the companies in which they have invested. Finally, venture capital companies limit their investments to companies with a perceived profitability of some 25 to 35 per cent annual rates of return on the investment – up to 50 per cent in the case of start-up investment – earnings generally possible only in companies with unique products or processes.

Figure 25. **VENTURE CAPITAL**





1. Stock as a per cent of GDP. Australian data are for FY 1994/95.

Source: OECD (1996), *Network of Enterprises and Local Development.*

Entrepreneurs, on the other hand, are generally reluctant to acquire funds at the cost of limiting their operational freedom and the risk of being put out of their own company. This aversion to outsider interference is particularly strong among the family-owned companies which account for a large share of companies in Australia. Furthermore, according to a recent study,[103] small and young companies are often found to be not "investment ready" – *i.e.* having adequately separated the business from their personal finances, and having achieved a level of accounting and information sufficient to attract professional investors.

The scope for financing expansion through injection of additional funds from the entrepreneur himself, persons close to him or informal investors (often referred to as "business angels") could arguably be more limited in Australia due to comparatively low household financial wealth.[104] On average gross financial wealth (net of claims on institutional investors) stands at around 75 per cent of GDP, compared with 200 per cent in the United Kingdom and 275 per cent in the United States. Even so, business angels have become increasingly visible in recent years. The typical profile of such an investor in Australia as in other countries is a wealthy senior executive or retiree with extensive business experience in the sector in which he invests. Recent studies show that it is fairly common for "business angels" to put their expertise at the service of the companies where they have invested.[105] Also the size and the nature of individual "angel" investments are comparable with the experience from other countries (Table 27), with the maximum size generally believed to be around A$ 0.5 million. On the other hand, the outstanding amount of "angel" capital is estimated to be around A$ 1 billion which, relative to the size of the formal venture capital market, is small compared with the United States where "business angels" provide at least twice as much equity capital as venture capitalists. A study by the Productivity Commission (1997) finds that enterprises which gain access to informal equity perform better than average in terms of sales, employment and innovation. To some extent, however, their superior performance reflects a selection bias.[106]

One further impediment for companies seeking small amounts of equity capital from private investors is the fact that Australian law stipulates that individual enterprises may not contact more than 20 potential investors within a year unless each of them is willing to contribute more than A$ 0.5 million. In an attempt to overcome this – while, at the same time, enabling investors to take very small unlisted positions and providing exit mechanisms – the Enterprise Market has been established. The

Table 27. **International comparison of informal investor characteristics**

	United Kingdom	Sweden	United States	Canada	**Australia**
Age (years)	53	54	47	47	45
Annual family income	UK 46K	60% > 500K SEK	$90K	$177K (Cdn)	$179K
Net worth	UK 312K	57% > 5M SEK	$750K	$1.36M (Cdn)	$2.1M
Previous entrepreneurial experience	57%	96%	83%	75%	75%
Number of investments	2 every 3 years	1 a year	2 every 3 years	1 a year	1 every 2 years
Rejection rate	7 out of 8	7 out of 10	7 out of 9	9 out of 10	3 out of 4
Average size of the investment	UK 10K	500K SEK	$58K	$207K (Cdn)	$193K (A)

Source: Ernst and Young (1997).

company is setting up an Internet-based matchmaking service for both primary and secondary offerings of non-listed equity. This service is scheduled to start in February 1998, by which time it is estimated that 1 000 companies and 2 000 to 3 000 potential investors will have joined.

The Government has also recently released proposals under the Corporate Law Economic Reform Program aimed at facilitating capital raising by small and medium enterprises. In particular, companies would be able to raise up to A$ 2 million each year from up to 20 persons without issuing a prospectus, up to A$ 5 million based on an offer information statement rather than a full prospectus, and raise funds below the current A$ 0.5 million threshold from persons with a gross income of A$ 0.25 million or net assets of A$ 2.5 million without a prospectus.

Taxation. While the system of personal income taxation (treated in Chapter III) is broadly neutral with respect to risk-taking, some special problems could arguably relate to taxation of capital gains. In particular, financial entities which are tax exempt in their domestic markets and which are exempt from Australian taxation on gains and investments made directly, can be exposed to Australian taxation on gains made indirectly through a company or an entity treated as a company (*e.g.* limited partnership). That is, tax paid by the company or limited partnership in respect of capital gains is not refunded to the exempt financial entity. While some argue there is a risk of limiting the flow of foreign funds into the nascent venture capital market, it is difficult to assess the extent of any effect. While scarcity of funds is not currently a problem, attracting foreign investors may still be beneficial for other reasons – *i.e.* by introducing corporate governance practices which would lead to better company performances (for a discussion of corporate governance, see Chapter IV). Some easing of the capital gains taxation has been put in place for smaller enterprises. The most important elements are: *i)* a partial exemption of goodwill, half of which is now tax free up to a ceiling of A$ 2.2 million (indexed); and *ii)* enterprises with net assets of up to A$ 5 million are eligible to roll over capital gains where they are used to expand an existing business or acquire a new enterprise. It has been argued that further relief should be granted, *inter alia*, in the field of partly exempting capital gains on the transfer of intellectual property. However, the concessions put in place already make it easier for inventors to commercialise intellectual property; it is doubtful whether the benefits of further concessionary treatment would exceed the cost of a less coherent treatment of capital gains and the risk of increasing tax evation.

Invention, innovation and R&D. At first glance, Australian companies seem to have an internationally rather low propensity to innovate and develop new products. For example, R&D spending by the corporate sector is far below the OECD average. Moreover, the Department of Industry (1996) found that, although Australian firms seem broadly in line with those in the advanced medium-sized OECD economies with regards to innovation through channels other than R&D, they lag in adopting advanced manufacturing technology and new management techniques. On the other hand, business R&D spending has increased strongly in recent years, surpassed only by Ireland and Southeast Asian economies.[107] Also, Australia ranks high among OECD countries in inventiveness, as measured by the number of resident patent applications per 10 000 population as well as the growth in external patent applications (close to 20 per cent per year from 1981 to 1994). Altogether, typical Australian firms operate in sectors not characterised by very high research intensity, but they are, at a comparatively low cost, able to generate an internationally high number of inventions. There remains anecdotal evidence that many of these patents are either sold for commercialisation abroad, or generated in subsidiaries of foreign companies and transferred to the parent company.

Management skills. The quality of management is a vital determinant of the success of those firms and of their capacity to capture the value of innovation and technological development. There has been a general concern in Australia about the low level of management skills of entrepreneurs and managers, especially compared to its main trading partners (Karpin report). As measured by formal tertiary qualification, only 19 per cent of senior managers had a degree in 1995 compared with more than 60 per cent in Germany and France, and more than 80 per cent in Japan and the United States, while more than 50 per cent of front line managers had received no formal training for that role. This picture of poor Australian management quality has been reinforced by other studies. The World Competitiveness Report ranked Australian management as 12th out of 20 OECD countries in 1997 (and far behind other trading partners), though improving from 15th in 1993. According to Business Longitudinal Survey, 34 per cent of business decision-makers had tertiary education, of whom about two-fifths had management qualifications. Even though some progress has been made recently, proficiency of management and manager education attainment seem to remain poor by international standards, in sharp contrast with a quite good overall education attainment (13 per cent of the Australian population having a higher education degree, above the OECD average). It indicates that the best-educated people do not often go into business and that the education and training system gives insufficient emphasis on management education. Required management skills vary according to firms' stage of development, size, industry, or to whether they are independent or a subsidiary of large firms. The lack of diversity in management skills seems to be another weak point which the education and training system has failed to address.

The role of public authorities

The main objective of overall policy toward the business sector has been *i)* to increase the degree of internationalisation of Australian enterprises, and, as a corollary to this, *ii)* to help raise their international competitiveness. The first has been achieved through the reduction in import tariffs, quotas and other barriers to trade mentioned above as well as the ongoing work on improved market access through APEC and CER initiatives. The second is pursued primarily through ongoing efforts to foster a good business environment, including by progressing market based reform, establishing stable macroeconomic underpinnings, and maintaining a competitive corporate tax rate. There are also a wide range of schemes and programmes, especially focused on promoting R&D and investment and providing export financing and insurance. A large part of the government outlays (see Table 28) relate to export promotion and finance. Almost all of the tax reductions, on the other hand, are connected with a 125 per cent tax break on certain R&D expenditure – down from 150 per cent previously[108] – and with a temporary 10% investment allowance for tangible investments. Finally, at the state level, the considerable forgone revenue from payroll taxes almost exclusively supports small enterprises, who benefit from thresholds and exemptions, the extent of which varies from state to state. As for support more directly targeted towards promoting entrepreneurship and new business activities, several hundred programmes are in place. Generally operating at a very limited budget cost, most of them focus on correcting market failure by improving the flow of information or compensate small companies for lack of scale in area where economies of scale are presumed. Some of the more important schemes are listed below.

Encouraging new businesses. Like many other OECD countries, Australia maintains a programme for encouraging self-employment for previously unemployed persons. Basically, persons wishing to be self-employed are allowed to retain their

Table 28. **Government support for the business sector**[1]
A$ million

	Central Government		States[2]	Total
	Tax exemption[3]	Outlays	Outlays	
Primary excluding mining	170	605	682	1 457
Manufacturing	1 114	750	924	2 788
Mining	400	119	138	657
Services	75	507	732	1 314
Total	1 759	1 981	2 477	6 217
Per cent of GDP	0.4	0.4	0.5	1.3

1. Financial year 1994/95. Central Government outlays: 1995/96.
2. Not including foregone revenue from payroll tax thresholds and exemptions. They are estimated to A$4.8 billion (1993/94).
3. Based on a different methodology the 1994-95 Tax Expenditure Statement estimated that overall tax expenditures were around A$1.1 billion higher.

Source: Industry Commission (1996) and OECD Secretariat.

unemployment insurance allowance for one year while starting the enterprise. The programme is judged as a success, since the dead-weight loss has been minimised and 82 per cent of all enterprises thus started survive after the termination of the programme. Another important recent initiative to help start up new ventures is the establishment of the *Innovation Investment Fund* programme (IIF). The IIF is based on the long running SBIC programme in the USA, and will create up to six new early stage venture capital funds focusing on commercialising R&D. The Australian Government will contribute A$ 130 million on the basis of $2 for every $1 raised by private sector venture capital funds licensed under the programme.

The Pooled Development Funds (PDFs) programme was established in 1992 to increase the supply of patient equity capital to small and medium sized enterprises (SMEs). PDFs are venture capital funds investing in Australian SMEs which have total assets of less than A$ 50 million and where their primary activity is in either property development or retail sales operations. The incentives under the programme are that PDFs are taxed at concessional rates (being 15 per cent on income from investments) compared with the usual company tax rate of 36 per cent, and investors in PDFs receive both dividends and are capital gains exempt from tax. Under the programme, PDFs have raised over A$ 270 million.

Another way of facilitating the start-up phase, which has gained considerable attention in recent years, is the so-called business incubators, which provide rented office or workshop space to new enterprises for a limited period. Originally grown out of regional support schemes, incubators are typically owned by local authorities or non-profit corporate structures, and while they generally do not require ongoing funding an element of subsidisation is imbedded in the fact that some 70 per cent of them either own their own building or pay a symbolic rent. This implicit subsidy is, however, generally not passed on to the tenants in the form of rents exorbitantly below ongoing market rates. Rather, a considerable demand for "incubation" by small enterprises derives from short rental contracts, quick entry and exit and on the divisibility of the available space, all of which tends to make the costs of a "good try" manageable and provides for an easy exit. Local authorities and business associations perceive business incubators as a useful way of nurturing a more entrepreneurial climate while reducing the failure rate of small enterprises (the failure rate within the first year is an estimated 8 per cent among companies in incubators, compared with a national average of 32 per cent). This has, in turn, given rise to a spectacular increase in the number of such establishments. In 1997, 63 incubators operated in Australia, up from 39 in 1994, with a further 17 scheduled to be established in 1998. It should be noted that while Australian business incubators do tend to encourage similar enterprises to locate close to each other, specialised incubators remain rare. Indeed, only nine of them are industry specific, and only five are designated technology incubators.

Promoting R&D. The justification for public sector involvement in private R&D in Australia is based on the argument that private firms need to be compensated for the "positive externalities" or "spillovers" that result from their R&D investment; the conclusion from empirical evidence that R&D is a substantial driver of economic growth; and the pragmatic observation that Australian levels of private R&D are well below international norms for major developed economies. The Australian Government plays an active role in encouraging R&D through a general tax concession and other programs of a more targeted nature. Networking is encouraged, *inter alia*, to assist in technology diffusion.

The major single government institution involved in R&D activities is the Commonwealth Scientific and Industrial Research Organisation (CSIRO). It covers a broad span of scientific research and technology activities relevant to the manufacturing and resource sectors of the economy, as well as the environment. The

Organisation receives annual Commonwealth Government funding of around A$ 500 million, which is, in principle, earmarked for generic research and administrative purposes. CSIRO derives an additional A$ 250 million from various sources, including some $60 million from the business sector and $40 million for research conducted in Cooperative Research Centres (CRCs).

CSIRO generates its private sector income through licensing technology and by undertaking contract and collaborative research. CSIRO participates in 56 of the 67 Cooperative Research Centres which are research, training and commercial development partnerships between universities, other public sector research bodies and industry. The CRCs' research is oriented toward commercial and/or environmental application and many of the Centres operate as formal networks, having geographically widely dispersed partners. These Centres may be seen as a complement to the regionally-based science and technology parks which derive most of their support from State Governments and universities. Finally, CSIRO actively encourages the spin-off of new companies and negotiates arrangements to bring intellectual property generated from publicly funded research results into newly started companies. Over the last decade, some 50 such technology-based companies have been created, of which few have failed.

Promoting information flows: Like other countries, Australia assists exports in a variety of ways, *inter alia* to promote the "export culture" which seems to be developing among companies. In the light of the rising importance of SME exporters, incentives to networking and company linkages have gained increasing attention. Recent reports show that companies engaging in formalised co-operation with others are likely to gain advantages in terms of technological innovation and productivity.[109] In addition to this, small and new exporters often co-operate with other enterprises in marketing and delivery in foreign markets. It is estimated that more than half of all exporting companies are involved in some kind of formalised co-operation (Table 29), and in recent surveys 22 per cent of all companies indicated that they would be interested in networking if they could find the right partner. Aiming at overcoming a perceived information asymmetry regarding potential partners, the central government encourages inter-firm co-operation in several ways, most notably AusIndustry's Business Networks Program (BNP). The basis of the BNP is a network formation process, in which brokers paid by the programme play an active role in close contact with state governments and local business associations. The central government essentially covers the costs of the matchmaking, but is normally

Table 29. **Formal co-operation between companies**

	Per cent of firms co-operating
All firms	41
Industry	
Clothing and footwear	32
Engineering	41
IT&T	54
Science/medicine	48
Food	39
Exporters	
Exporter	54
Non-exporter	35
Size (employees)	
Micro	36
Small	44
Medium	43
Large	63
Technology	
Low	32
Medium	40
High	50
Performance	
High	50
Low	35
State	
New South Wales	40
Victoria	42
Queensland	37
Southern Australia	38
Western Australia	48

Source: Bureau of Industry Economics (1995).

not involved in the financing of the implementation. In 1995 there were 144 government assisted networks covering more than 1 500 companies.

Moreover, in order to generate employment and to integrate Australia more strongly in the global economy, programmes are in place to encourage foreign direct investment. The Investment Promotion and Facilitation Program (IPFP) operates, at a limited overall budget, a number of representational offices abroad diffusing information about Australia as a place to invest. In recent years particular attention has been given to attracting regional headquarters of foreign companies which are planning to set them up in the Western Pacific rim. In addition to information and promotion the central government offers certain limited tax concessions to companies which start operating in Australia, in particular related to sales taxes on their office equipment and taxation of dividends from abroad. Noting that around half of the companies which invest in Australia claim that the IPFP has played "some" or "a major" role in their investment decisions, a recent report estimates that the programme induces an average net inward foreign investment of A$ 230 million per year.[110] On top of the Commonwealth efforts, state authorities have been particularly active in supporting investment into their area. The incentives used to persuade foreign companies include exemptions from payroll taxes and other forms of state taxation for the years following the initial investment. According to a Queensland estimate, tax concessions corresponding to up to A$ 7 000 per employee per year for the first 3 to 4 years are involved. A recent report found that the states engage in competitive bidding for major investment which, while quite costly to the public purse, produce no net gains on the national level (Industry Commission, forthcoming).

Regional support. State governments and agencies are running numerous programmes to support new and small enterprises. It is difficult to get a comprehensive picture of these programmes, but they seem to be extremely dispersed and narrowly focused. One reason for this is that many services are provided jointly with the Commonwealth government. States' financial contributions are, however, typically very small; *e.g.* Victorian Small Business has a yearly budget of A$ 2 million. The number of small firms using these support services seems to be low – less than 5 per cent according to the 1995 Business Longitudinal Study.

Inspired by the obvious success of such American high-tech environments as Silicon Valley which is seen to depend, partly, on their ability to draw on technological spin-offs from large nearby universities,[111] much attention has been given to establishing science and technology parks close to most of the larger tertiary education institutions. So far 16 such parks have been established and a further four are under construction, most of them funded either by state authorities or the universities themselves.[112] Thus far around A$ 100 million of public money have been invested in science and technology parks. However, while the impact of such parks is notoriously difficult to assess, the anecdotal evidence is that they have so far not generated many new high-tech companies – the only success story frequently cited being West Australia's science park in Perth. One of the main reasons for this seems to be unwillingness on the part of universities and other institutions to transfer the value of intellectual property to potential entrepreneurs among their staff. Another is that Australian academics are, reportedly, much less willing to engage in commercial activities than their American counterparts.

A review of support programmes. In 1996 the Minister for Industry, Science and Tourism announced a comprehensive Review of Business Programs, the purpose of which is to decide on the optimal mix of business programmes "to assist industry meet the challenges of an increasingly competitive global market". The outcome of this work, the so-called *Mortimer Report*, is currently much debated in Australia. The report found that the number of Commonwealth industry programmes is too large and too unfocused – and, to some extent, dictated by tradition rather than current relevance – so that businesses intended to benefit from them have to incur an unreasonable burden in terms of time and costs. Moreover, it concluded that the delivery of programmes was not efficient and that monitoring and follow-up on individual programmes was lacking. Its main recommendation was, therefore, that programmes should be fewer, have a large individual budget and be focused towards areas which are likely to improve the international position of the Australian business sector, namely: boosting investment; encouraging innovation; promoting exports; improving business competitiveness; and making for sustainable resource management. The most controversial suggestion from the Mortimer Report is the proposed establishment of a new agency "Invest Australia" intended to devise financial incentives to attract foreign direct investment. The formal justification for the proposal is twofold: *i)* other countries in the region tend to support foreign investment even more generously; and *ii)* many disincentives to investment in Australia seem to relate to the negative impact of higher taxes and stricter Government regulation. Therefore, it is argued, the Government should offer would-be investors offsetting compensation.

Assessment

The overall finding of this chapter is that, while conditions for enhanced entrepreneurship have improved over the last decade, there have been only scattered signs of a strengthened entrepreneurial endeavour. These include emerging small companies which have built their success on export sales from an early stage and a strong performance of venture-capital-backed companies. The government has contributed to stimulating the entrepreneurial spirit by exposing Australian companies to international competition, raising labour market flexibility, fostering the functioning of financial markets and stepping up efforts to encourage domestic competition. It has also tried to facilitate company creation and growth through various programmes, often in collaboration with the states. Problems remain, however. The costs of tax and regulatory compliance remain particularly onerous for small companies, intermediation of risk capital is still insufficient, and researchers are lacking receptiveness to commercialisation of their inventions some of which are world-class.

It is important to continue improving the climate favouring entrepreneurship through the on-going process of strengthening market mechanisms and reducing the burden of government regulation and taxation. In this context, it would be particularly beneficial to make further efforts to simplify the tax code, improve labour market flexibility, encourage product market competition and submit a large part of the public sector to market test.

As to specific public support schemes, the key recommendation of the recent Mortimer Report to limit their number is well taken. However, a policy of selectively supporting activities perceived as particularly important for the external competitiveness is not well founded. Rather, a good policy should sharpen the current focus on dealing with market failures, compensating for a disadvantage of small scales and facilitating companies' effort to seize new opportunities. The suggested increase in subsidies to attract foreign companies to operate in Australia would be unwise, and so is competition among the States and Territories to attract companies by offering tax concessions and subsidies.

List of acronyms

AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumes Commission
ACCI	Australian Chamber of Commerce and Industry
ACTU	Australian Council of Trade Unions
AFIC	Australian Financial Institutions Commission
AIMA	Australian Investment Managers’ Association
AIRC	Australian Industrial Relations Commission
AN	Australian National Railways Commission
ANTA	Australian National Training Authority
APEC	Asia Pacific Economic Co-operation
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASX	Australian Stock Exchange
AWAs	Australian Workplace Agreements
AWOTE	Average Weekly Oridinary Time Earnings
BNP	Business Networks Program
BSC	Business Skill Class
CAs	Certified Agreements
CAB	Cyclically-adjusted budget balance
CAPEX	Capital expenditure survey
CFSC	Australian Corporations and Financial Services Commission
CLERP	Corporate Law Economic Reform Program
COAG	Council of Australian Governments
CPI	Consumer Price Index
CRCs	Cooperative Research Centres
CSIRO	Commonwealth Scientific and Industrial Research Organisation

EFAs	Enterprise Flexibility Agreements
EFTA	European Free Trade Association
EPAC	Economic Planning Advisory Commission
FBT	Fringe benefit tax
FI	Financial Institutions scheme
FLEX	Flexible labour exchange services
GP	General Practitioner
GST	Goods and Services Tax
IASC	International Accounting Standards Committee
IIF	Innovation Investment Fund
ILO	International Labour Organisation
IPFP	Investment Promotion and Facilitation Program
ISC	Insurance and Superannuation Commission
MCI	Monetary conditions indicator
MTAWE	Male Total Average Weekly Earnings
NAWRU	Non-accelerating wage rate of unemployment
NCC	National Competition Council
NCP	National Competition Policy
PBS	Pharmaceutical Benefits Scheme
PDFs	The Pooled Development Funds
PSB	Payments System Board
PRRT	Petroleum Resource Rent Tax
RBA	Reserve Bank of Australia
SDRs	Standard Drawing Rights
SMEs	Small and Medium-sized Enterprises
SSAs	State Supervisory Agencies
TCF	Textiles, clothing and footwear
TPA	Trade Practices Act
VAT	Value Added Tax
VET	Vocational Education and Training
WST	Wholesale Sales Tax

Notes

1. If not indicated otherwise, all references to GDP are to GDP(A), which is the average of the expenditure, income and production measures of GDP. At times, these different measures provide rather diverse results. In calendar year 1996, for example, the expenditure-based GDP(E) is for an acceleration of real GDP growth, while the income-based GDP(I) suggests a slowdown.
2. Fiscal years begin 1st July.
3. Trend data indicate an annualised growth rate of 2.8 per cent instead of 3.0 per cent in the first half of 1997.
4. In the second quarter of 1997, hence in FY 1996/97, gold sales of the Reserve Bank of Australia (A$ 1.8 billion) and the sale of a frigate to New Zealand (A$ 0.5 billion) have boosted exports. These transactions amount to $2^1/_4$ per cent of exports of goods and services in FY 1996/97. The construction of the frigate took several years to complete and the value of this construction activity has been counted as an increase in public authority stocks in the periods when it took place. In the domestic production account, the contribution to GDP from the value of the frigate exported to New Zealand and the gold sales are exactly offset by a reduction in public authority stocks, which underlay the recorded sharp fall in inventory accumulation.
5. For example, the Citylink road project in Victoria.
6. Other incomes comprising income of other unincorporated enterprises, income from dwellings, interest and dividends, and current grants to non-profit institutions fell by an annualised rate of 12.5 per cent in the third quarter of 1996.
7. Housing affordability is measured by the ratio of average household disposable income to the ("qualifying") income required to meet payments on a typical dwelling (expressed as an index). In calculating qualifying income a deposit of 20 per cent with repayments equal to 30 per cent of income is assumed using a conventional 25 year loan. An increase in the Index represents an improvement in affordability.
8. Employment data for the second half of 1996 may be biased downward due to a change in the employment survey technique from face-to-face to telephone interviewing. This seems to have induced some interviewees to report that they were not in the labour force, when previously they would have reported that they were employed. Had the change in survey procedures not taken place, the ABS estimates that employment may have grown by an annualised rate of around $2^1/_2$ per cent (instead of the recorded 1.5 per cent) in the second half of 1996. The effect was, however, only temporary and has not affected employment levels in 1997.

9. Industry Commission (1997a), September.
10. AWOTE seems conceptually the best of the available published indicators of short-term wage developments and is therefore the RBA's preferred measure of wage inflation. For a discussion see the December 1996 Reserve Bank of Australia Bulletin.
11. The bias stems from the trend increase in standard ordinary-time hours which tends to raise the increase in weekly ordinary-time earnings above that of hourly wage rates.
12. The Treasury underlying inflation series excludes from the CPI mortgage and consumer debt charges along with volatile items including the prices of fresh fruits and vegetables, meat and seafood, tobacco and alcohol, petrol, items with a marked seasonal pattern, such as holiday travel, accommodation and clothing, and goods and services provided mostly by the public sector. The Treasury measure thus retains about 50 per cent of the CPI basket.
13. This measure is, however, biased downward by the trend increase of the share of part-time workers in employment as part-time workers typically earn lower wages than full-time workers.
14. According to the Cullen Egan Dell survey of skilled employees.
15. As noted previously, a substantial part of the boost to manufacturing exports in the second quarter of 1997 was of a one-off nature due to the sale of the frigate.
16. The ratio of outcomes to expectations.
17. As measured by the consumption deflator.
18. Treasury definition.
19. See the Statement on the Conduct of Monetary Policy issued jointly by the Treasurer and the Governor in August 1996.
20. Italy, the United Kingdom, Canada, Finland, New Zealand, Spain and Sweden.
21. Through its open-market operations, the RBA controls the cash rate – the overnight interest rate in the money market – and thereby the short end of the yield curve with a high degree of precision. Since January 1990, the RBA has announced every change in the cash rate target and has commented upon it in order to make monetary policy more transparent and to avoid the potential for confusion with the earlier practice.
22. For the measurement of conventional, ex-post real interest rates it appears most obvious to use as deflator the Treasury measure of the underlying rate of inflation. For example, in 1997, the headline rate of inflation was depressed by the effect of falling mortgage interest rates on the CPI, which would make it a downward biased indicator of expected inflation.
23. Although theoretically attractive, indexed bond yields may provide a distorted measure of real interest rates in practice for a variety of reasons, the most important being the relative illiquidity of the Australian market for indexed bonds.
24. Latest econometric research by Gruen, D., J. Romalis and N. Chandra (1997) on the basis of single equation analysis suggests that the effects of the recent cash rate cuts on activity may become visible in terms of higher output growth after a mean lag of about 1½ years, hence in 1998 and 1999. According to these estimates the effect of the cumulated cash rate cut could amount to extra growth of ½ percentage point in 1998 and of ¾ percentage point in 1999. These estimates are, however, subject to considerable uncertainty.

25. For ease of interpretation, the weights are usually expressed as the long-run effect on output of a real effective exchange rate relative to the long-run effect of a real short-term interest rate. Hence, the weight on the latter must equal unity. The Bank of Canada's MCI uses the weight of one-third on the real exchange rate. This is based on the observation that on average in Canada a change in the real short-term interest rate by one percentage point exerts three times the effect on real output growth as a change in the real exchange rate by 1 per cent.

26. See, for example, D. Gruen and T. Kortian (1996).

27. The MCI used here is defined as $MCI = (r - r^*) + 0.31(e/e^* - 1)\times 100 - 0.37(t/t^* - 1)\times 100$, where r is the real 90-day bill yield (using the Treasury underlying rate of inflation as deflator), r* the long-term trend value of r, e the real effective exchange rate expressed as real unit labour cost in common currency, e* the long-term trend value of e, t the terms of trade as ratio of implicit deflators of exports and imports of goods and services, and t* the long-term trend of t. As long-term trend values for r, e and t the non-stationary component of a Hodrick-Prescott filter has been used, with a smoothing factor of 1 600. The weights on the exchange rate and terms of trade components are based on model simulations. A positive MCI implies tight monetary conditions (relative to long-term averages).

28. See Taylor, J.B. (1993), "Discretion versus policy rules in practice", Carnegie-Rochester Conference Series on Public Policy, No. 39.

29. The normative short-term interest rate r′ ("Taylor rule") is defined as $r' = r^* + p + (p-p^*)/2 + GAP/2$. This makes r′ the sum of the long-term (Hodrick-Prescott) trend value r* of the real short-term interest rate, the actual underlying inflation rate p, one-half of the difference between actual underlying inflation p and the inflation objective p* and one-half of the output gap, defined as the difference between actual and potential output as a percentage of the latter.

30. All references to the "budget balance" and to "outlays" are in underlying terms, as defined by the Government, unless otherwise stated. This means that "net advances", which consist primarily of asset sales and net repayments of debt by the States to the Commonwealth, are excluded.

31. Fiscal years begin 1 July.

32. The one-off receipt of PRRT arose from the settlement of a dispute between the Victorian gas utilities and their suppliers. Most of this money was transferred to the Victorian Government in conformity with the deed for the Return of Tax Payments between Victoria and the Commonwealth Government.

33. So called because the former government legislated for personal income tax cuts which were to take effect from FY 1998/99. Subsequently, the promise of tax cuts was converted to an undertaking to subsidise employee superannuation contributions on a means-tested basis.

34 As revenue was greater than forecast in FY 1996/97, the fall in revenue may be greater than estimated at budget time.

35 The personal benefit payments category includes many outlays indexed to the CPI, but also the age pension which, in addition to being linked to the CPI, is now subject to supplementary indexation (if required) to maintain it at 25 per cent of Male Total Average Weekly Earnings (MTAWE). This results in some increase in such outlays over the projection period beyond that indicated by movements in the CPI.

36. See OECD (1996a), *Economic Surveys, Australia*, Chapter III.

37. In Australia, industrial awards generally specify minimum wages and conditions of work for most categories of labour. It is thus illegal to employ a worker at a wage or on terms which are less favourable than the relevant award, irrespective of whether a worker is a union member or not. The terms of awards may be reached by a settlement imposed by the Australian Industrial Relations Commission, by a combination of conciliation and arbitration, or by conciliation alone.

38. A more detailed account of the new Act is given by Commonwealth Department of Industrial Relations (1996), Changes in federal workplace relations law – legislation guide, mimeo.

39. The "allowable matters" set out in the Workplace Relations Act are the following: classifications of employees and skill-based career paths; ordinary time hours of work, rest breaks, notice periods and variations to working hours; rates of pay (such as hourly rates and annual salaries), rates of pay for juniors, trainees or apprentices, and rates of pay for employees under the supported wage system; piece rates, tallies and bonuses; annual leave and leave loadings; long service leave; personal/carer's leave, including sick leave, family leave, bereavement leave, compassionate leave, cultural leave and other like forms of leave; cover parental leave, including maternity and adoption leave; public holidays; allowances; loadings for working overtime or for casual or shift work; penalty rates; redundancy pay and notice of termination; stand-down provisions; dispute settling procedures; jury service; type of employment, such as full-time employment, casual employment, regular part-time employment and shift work; superannuation; pay and conditions for outworkers; provisions incidental to the allowable matters and necessary for the effective operation of the award.

40. The new Government thereby also honours its election commitment that workers entering formalised agreements would not be worse off as a result of the reform.

41. Under the old Industrial Relations Act employees could not register new unions if they could "conveniently belong" to an existing one. This is likely to have contributed to the practice of pattern bargaining under which unions first negotiate agreements with key employers and then use these as the model for all firms in the sector, regardless of the individual circumstances. To remedy this, the new Act requires an existing organisation opposing the registration of a new organisation to demonstrate that the applicant's members could "more conveniently" be members of the objecting organisation, and would be more effectively represented by that organisation. However, even if the specified grounds for objection are satisfied, it will be possible to register an applicant association with appropriate undertakings or alterations to its rules. The effectiveness of the new "more conveniently belong" provision will largely depend on the interpretation of the new legislation by the courts.

42. Reitano, R. (1994), "Legislative changes in 1993", Journal of Industrial Relations.

43. The proposed exclusion will not affect the rights of apprentices, or any employees engaged before the commencement of the exclusion. New small business employees will retain the protections envisaged by Articles 5, 6 and 11 of ILO C158, that is protection against dismissal for discriminatory reasons (*e.g.* on the basis of race, sex, union membership or non-membership, complaints against the employer, etc.) and protection against dismissal without minimum notice or pay in lieu, except in cases of serious misconduct.

44. In Rimmer's (1997) view the new Act leaves the unfair dismissal jurisdiction largely intact (p. 73).

45. See also Dawkins (1997) on this point.

46 From 12 March 1997, when the Employment Advocate began operations, to the end of September, 2095 Australian Workplace Agreements (AWAs) covering 113 employers have been approved. A further 194 AWAs covering 6 employers have been referred to the AIRC. With regard to non-union CAs, in the nine and a half months to mid-October 185 applications had been heard by the Commission, with 160 agreements having been approved. This compares with a total of only 251 Enterprise Feasibility Agreements (EFAs) approved under the Industrial Relations Act over a three year period.

47. Costa (1997), p. 51. Costa also points out that views about the desirability of competitive unionism are not unanimous; for example, some employer groups appear to share the view of the ACTU that competitive unions are not in the interest of the consumers of union services.

48. For a brief overview of major elements of the Working Nation programme see OECD (1995a), *Economic Surveys, Australia*, Chapter III, especially Box 1.

49. When Working Nation was established, the former Government required an interim evaluation for consideration in the FY 1996/97 budget. See Department of Employment, Education, Training and Youth Affairs (1996).

50. Brokered programmes are contracted out to various organisations – the brokers – and provide participants with both training and work experience for at least six months. In effect, they are mainly job creation projects with some training provided. For more details see OECD (1996a), Annex I.

51. The reforms are outlined in OECD (1996a), Chapter III.

52. Casemix funding involves payment for a treatment episode on the basis of average expected costs. As a method of funding public hospitals, it means that they receive funding on the basis of their prospective output of episodes of care valued in this way. Those hospitals which have lower costs get to keep the surplus while those with higher costs have less money in the following year. These arrangements encourage managers to increase productivity so as to avoid future funding cuts or possible dismissal.

53. Casemix funding for public hospital out-patient departments only applies to (Group A) teaching hospitals in Victoria.

54. The interest earnings and administration charge on the accommodation bonds will henceforth be the principal funding source for the construction, extension and upgrading of nursing homes.

55. See Hilmer, F.G. *et al.* (1993).

56. According to estimates of the Industry Commission (1995), the full implementation of the Hilmer proposals (and of related reforms) will raise the level (not growth) of annual real GDP in the long run, once all adjustments have taken place, by $5^1/_2$ per cent, or A$ 23 billion per year (in 1993-94 dollars). Half of the gains are attributable to reforms improving the performance of Government Business Enterprises, with major contributions from the electricity, gas, telecommunications and rail sectors.

57. For more details see OECD (1996a), Chapter III.

58. The competitive neutrality principle specifies that government businesses should not enjoy any net competitive advantage merely as a result of public sector ownership. This involves subjecting government businesses to the same tax and regulatory regimes applicable to private business and requiring them to eam similar returns on debt and equity.

59. National Competition Council (1997).

60. In spite of substantial improvements in productivity in recent years, following corporatisation and privatisation of electricity businesses, productivity remains below international best practice. The Industry Commission (1995) estimates that implementation of a range of reforms in this industry could deliver an eventual gain in GDP of up to 1¼ per cent, reflecting the great importance of electricity to downstream industries.

61. See Report of the Shipping Reform Group (1997).

62 The Australian National Railways Commission is a Commonwealth authority which, until the sale, had operated intrastate freight operations in South Australia and Tasmania, interstate passenger services, mechanical engineering workshops, interstate mainline network and track maintenance business units. AN continues to operate the Commonwealth's interstate track.

63 The National Rail Corporation operates an interstate rail freight business in Australia. Its shareholders are the Commonwealth, New South Wales and Victoria.

64. The study of EPAC (Economic Planning Advisory Commission) also concludes that Australia's per capita income was around 8 per cent lower in 1990 than would have been in case of "matching" policies. An interesting case is Finland, which had similar tariff levels to Australia in 1965, but cut its tariffs to negligible levels by 1985. Finland's productivity growth between 1970 and 1990 was five times that of Australia.

65. Passenger motor vehicles, textiles, clothing and footwear currently account for nearly one-third of manufacturing production and some 4½ per cent of GDP.

66. The estimates are derived from using the MONASH model. See Dixon, P. *et al.* (1997).

67. It is estimated that the retail prices of imported cars and parts could decrease by 3 to 4 per cent relative to the prices of Australian made cars by 2009-10, which at first glance seems small, given a tariff cut by 10 percentage points. However, the competitive advantage given to imports by reductions in the tariff is much smaller at the retail level because the tariff is applied to prices overseas (fob). Further, the Australian industry also enjoys a reduction in costs of production from cutting the tariff on imported components, after adjustment for by-law exemptions. After these adjustments (costs of freight and insurance, wholesale and retail margins) are accounted for, the 10 per cent reduction is more like a 3-4 per cent reduction in the retail price of imported cars relative to Australian made cars.

68. The estimated employment losses in South Australia and Victoria are small inter alia because the competitive disadvantage to the cars and parts industry is expected to be only 3 to 4 per cent in Australian markets, the industry accounts for only 2 per cent of employment in South Australia and 1½ per cent in Victoria, and because export-oriented industries in these two States benefit from tariff cuts in the same way as industries in the rest of Australia.

69. The Commission contracted the Centre of Policy Studies at Monash University to undertake the work on the basis of the MONASH model of the Australian economy, which is a computable general equilibrium model.

70. The Inquiry considered introducing compulsory deposit insurance, as exists in most other OECD countries, but concluded that its disadvantages outweighed its advantages. In particular, while deposit insurance may identify more clearly the limit of regulatory assurance, overseas experience suggests that in the long run it may raise the probability and cost of instability by weakening the incentive structure (Garcia, 1996).

71. The result, as a Parliamentary Committee noted, was: "... a mammoth piece of legislation contained in two (now three) volumes and containing more than 1 300 provisions." (House of Representatives Standing Committee on Legal and Constitutional Affairs, 1991, p. 15).

72. This paragraph is based on OECD (1995b), pp. 13-14.

73. These apply to companies listed on the Australian Stock Exchange. To become listed, companies must enter into an agreement with the ASX to comply with the Listing Rules.

74. ASX Listing Rule 4.10.3, effective June 30, 1996.

75. An important consideration in this regard is that appropriate corporate governance arrangements differ between large and small firms. The large number of small listed companies in Australia (there are 1 100 listed entities, the 7th greatest number in the world, in a market which ranks only 14th by capitalisation) was a factor in the ASX's decision to adopt an indicative rather than a prescriptive approach to disclosure of corporate governance practices. The ASX was also concerned to avoid a check list approach being adopted by companies.

76. Remuneration disclosure is, nevertheless, much more limited than in the United States or the United Kingdom. Few Australian companies go beyond the statutory requirement to disclose the number of executives falling into a number of wide remuneration bands.

77. The rest of this paragraph is based on AIMA (1997), pp. 51-53.

78. If the creditors at issue have been misled into making loans, other remedies are available to them under the Corporations Law and under the Trade Practices Act.

79. Continuous disclosure also reduces the scope for insider trading, one of the practices in the late 1980s which undermined confidence in Australian financial markets.

80. Foreign portfolio investors hold 25-30 per cent of the market value of shares in listed companies. This proportion has doubled in the last five years.

81. Criminal charges brought by the ASC since its inception in 1991, have led to prison sentences for 101 people (ASC Annual Report, 1996-97, p 18).

82. This point was made by the American Law Institute, which noted that "... absent private enforcement, the State holds a monopoly on the access to remedies and it can determine, sometimes arbitrarily or for political reasons, not to enforce rights or duties it had previously guarded. Thus, private enforcement serves a fail-safe function and ensures greater stability in the application of the law." (American Law Institute, 1982, pp. 220-21).

83. These are actions in which a shareholder sues in the name of the company.

84. Practice in EU countries, EFTA countries and the United States is discussed in Skog (1995), pp. 27-36.

85. They are Maine, where the bid applies at 25 per cent of voting rights, and Pennsylvania, where it applies at 20 per cent (*ibid*, p. 37).

86. This results from requiring the purchaser to share the "control premium" with all shareholders.

87. Revesz and Lattimore (1997).

88. It should be noted that this comparison does not allow any inference to be made about the evolution over time of each of the enterprises.

89. *Op. cit.*, p. 264.

90. The rule is: persons who have been directors of two companies which have both been placed in liquidation and defaulted on more than half their debts may be disqualified from working as a company directors for a period of up to five years.

91. OECD (1990) estimates that the burden of compliance is, on average, four times heavier than average in small enterprises. This study notes that, according to surveys of small business in six industrialised countries, the burdens of compliance and regulation was the single most important factor discouraging economic activity.

92. ACCI Review (1996) lists compliance as an issue of particular concern to employers.

93. For an example, see Australian Taxation Office (1993).

94. Bickerdyke and Lattimore (1997).

95. OECD (1990).

96. Responding to the detailed proposals by a Deregulation Task Force of business leaders, the government issued the report "More Time for Business": Statement by the Prime Minister (1997).

97. Business Skills Section (1997).

98. Australian Business Chamber (1996).

99. National Investment Council (1995).

100. Coopers and Lybrand (1997). There is an element of double counting in these figures. Of companies which expect to list, 53 per cent nominated the ASX as their sole choice of listing market, while a further 14 per cent nominated the ASX as one of two possible listing markets. In addition, 21 per cent of companies that nominated a listing market made NASDAQ their sole choice. It was a possible choice for a further 9 per cent of companies.

101. Prudential regulation requires banks to limit equity investments in non-financial businesses to an aggregate amount not exceeding 5 per cent of Tier 1 capital without prior reference to the Reserve Bank. Individual investments are generally subject to a limit of 0.25 per cent of Tier 1 capital. A ban on banks' investment in SME equity was lifted in 1995.

102. Some examples of a "mismatch" between supply and demand are quoted in the so-called Investment Readiness Study (Ernest & Young, 1997).

103. *Op. cit.*

104. On the other hand, it may be argued that a high proportion of home-ownership and relatively low mortgage debt work in the opposite direction.

105. Productivity Commission (1997).

106. Entrepreneurs who choose to invite "business angels" to invest in their companies and accepted by the investors are likely to be those who are faced with a particularly favourable prospect.

107. Australian Business Foundation (1997).

108 Current spending is deductible at 125 per cent up front. Capital spending is deductible at 125 per cent over three years. The reduction in the tax concession to 125% was associated with an increase in non-tax based assistance for R&D. This reduction in the level of the tax concession was designed to improve the efficiency of R&D assistance and produce fiscal savings.

109. Bureau of Industry Economics (1995) and (1996).
110. Bureau of Industry Economics (1996).
111. For a discussion of the factors behind this success, see OECD (1997).
112. Private science parks also exist, but they typically have a more narrow focus.

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Annex

Calendar of main economic events

1996

November

The *Workplace Relations and Other Legislation Amendment Act 1996* became law on 25 November 1996.

December

On 11 December 1996, the Reserve Bank announced a reduction of $^1/_2$ percentage point in the officially targeted cash rate to 6 per cent.

An issues paper on the Taxation of Financial Arrangements was publicly released.

1997

January

The Treasurer released a Mid-Year Economic and Fiscal Outlook (MYEFO), as required by the Government's Charter of Budget Honesty. The MYEFO indicated a deterioration in the budget and forward estimates, with the expected FY 1996/97 underlying budget deficit rising from the budget-time estimate of A$ 5.6 billion (1.1 per cent of GDP) to A$ 8.5 billion (1.7 per cent of GDP).

The *Workplace Relations Act 1996* came into operation. The Act encourages the spread of enterprise bargaining by: providing greater choice in the way agreements are negotiated; reducing the prescribed role of unions in the bargaining process and introducing more effective limits on industrial action; and simplifying awards.

March

The Prime Minister issued a statement entitled *More Time for Business* containing a range of measures, including tax measures, designed to reduce the burden of regulation and red tape on small business.

The Treasurer announced the Corporate Law Economic Reform Program (CLERP). It entails a fundamental review of key areas of regulation affecting business and investment activity and is intended to give Australia's Corporations Law an economic focus. The CLERP will also respond to the Financial System Inquiry recommendations for reform of corporate and market regulation.

The Government announced a pilot of the Work for the Dole initiative.

At the 1997 Premiers' Conference it was agreed that financial assistance grants to the States and Territories would be maintained in real per capita terms through to FY 1999/2000, with this guarantee in FY 1998/99 and FY 1999/2000 being conditional on the States complying with their obligations under the Agreement to Implement the National Competition Policy and Related Reforms. It was agreed that the States and Territories would make payments of A$ 627 million in FY 1997/98 as a contribution to the Commonwealth's deficit reduction programme.

The Loan Council agreed Loan Council Allocations nominated by the Commonwealth and each State and Territory for FY 1997/98. It also agreed a revised framework for the presentation of uniform financial information by Commonwealth, State and Territory governments, including three-year forward estimates for the general government sector and the publication of a mid-year report by each jurisdiction.

April

The Australian Industrial Relations Commission (AIRC) granted a flat A$ 10 per week wage increase for those on awards. The increase is absorbable into over award payments and is estimated to be received by around 23 per cent of the workforce. The AIRC also introduced a federal minimum wage whereby all employees earning below A$ 359.40 per week will have their wages increased to this level – this will affect about 2 per cent of employees.

The Treasurer released the Final Report of the Financial System Inquiry and announced the Government's response to the Inquiry's recommendations concerning mergers policy, namely:

- the abolition of the "six pillars" policy which has involved a blanket ban on any mergers among the major banks and the largest life insurance companies;
- mergers among the four major banks will not be permitted until there is significantly more competition in the financial industry; and
- the removal of the blanket prohibition on a foreign take-over of any of the major banks.

Amendments to Part IIIA (access to services) of the *Trade Practices Act 1974* were made to facilitate reforms in network industries (e.g. electricity) being used to implement pro-competitive market structures. The changes permit a co-regulatory approach to be used as an alternative to direct regulation.

The Government announced that it would invest A$ 300 million over five years in a new programme of assistance for the pharmaceutical industry to follow the existing Factor (f) scheme, which is due to terminate in mid-1999.

May

On 23 May 1997, the Reserve Bank announced a reduction of ½ percentage point in the officially targeted cash rate to 5.5 per cent.

The 1997-98 Budget was delivered by the Treasurer. It built upon the programme of fiscal consolidation undertaken in the 1996-97 Budget and ensured that fiscal policy remained on a path consistent with the Government's medium term fiscal strategy of maintaining underlying budget balance, on average, over the course of the economic cycle. Consistent with the Government's commitment to return the underlying budget to balance over the term of the current Parliament, the 1997-98 Budget foreshadowed a surplus of A$ 1.6 billion (0.3 per cent of GDP) in FY 1998/99.

The first stage of the National Electricity Market commenced on 4 May, with the harmonisation, or alignment, of the existing Victorian and combined New South Wales/Australian Capital Territory electricity markets.

June

The Government announced that the tariff on motor vehicles would fall to 15 per cent by 1 January 2000, as presently scheduled, but that it would remain at this level for the next five years. The tariff is then to fall to 10 per cent on 1 January 2005. A WTO-consistent programme will be introduced to replace the Export Facilitation Scheme when it expires in 2000 and will run until 2005.

July

On 30 July 1997, the Reserve Bank announced a reduction of ½ percentage point in the officially targeted cash rate to 5 per cent.

Based on advice from the National Competition Council, the Commonwealth made payment for the first year of the first tranche of Competition Payments and the per capita element of the Financial Assistance Grants to the States and Territories. This first "competition policy payment" was made in recognition of the progress that all States and Territories have made in implementing National Competition Policy and Related Reforms. In FY 1997/98 these payments will total A$ 406 million.

On 1 July a new regulatory regime for the telecommunications industry came into operation. The *Telecommunications Act 1997* establishes open market access for both telecommunications infrastructure providers and service providers.

Three Commonwealth-owned airports (Melbourne, Brisbane and Perth) were privatised through the sale of 50-year leases.

August

The Prime Minister announced that he had instructed a Taxation Task Force to prepare options for reform of the taxation system.

The Commonwealth agreed to introduce measures to protect State and Territory revenue following the High Court's decision that State business franchise fees (BFF) were unconstitutional. In order to replace lost BFF revenues, Commonwealth tax rates applying to similar products as previously covered by BFF were increased and the moneys raised forwarded to States and Territories.

The Treasurer announced the Government's intention to revamp the arrangements for the regulatory supervision of managed investments by implementing the single responsible entity structure for the industry, which will clarify responsibility for the operation of schemes.

The Corporate Law Amendment (ASX) Bill 1997 was exposed for public comment. The Bill seeks to facilitate the decision by members of the Australian Stock Exchange to demutualise, while maintaining and enhancing the existing arrangements for the regulation of Australia's stock markets.

The Treasurer announced that building societies and credit unions would be able to issue cheques in their own name, rather than having to use a bank as an intermediary.

The Commonwealth Government announced that the businesses of the Australian National Railways Commission (AN) based in South Australia and Tasmania are to be sold to three consortia for a total of A$ 95.4 million, with the consortia contracted to spend a further A$ 97 million on capital expenditure for the businesses over the next four to six years. The sale excludes AN's interstate track.

September

The final outcome for the Commonwealth budget in FY 1996/97 was an underlying deficit of A$ 4.9 billion (1 per cent of GDP), compared with an estimated deficit of A$ 6.9 billion (1.3 per cent of GDP) at the time of the 1997-98 Budget. The better-than-expected outcome reflected both stronger-than-expected revenue collections and lower-than-expected underlying outlays.

On 2 September 1997 the Treasurer announced the Government's comprehensive response to the Final Report of the Financial System Inquiry. The Government has agreed in-principle to the Inquiry's recommendations for a new regulatory structure. Subject in part to the agreement of the States, this would involve replacing the present institutional regulators with three agencies established along regulatory-objective (or functional) lines – the Reserve Bank of Australia, the Australian

Prudential Regulation Authority (APRA), and the Australian Corporations and Financial Services Commission (ACFSC).

The Government announced that the current schedule of tariff reductions for the textiles, clothing, leather and footwear (TCF) industries would continue through to 2000 after which tariff levels would remain unchanged until 2005. The tariffs are then to be cut by about one-third. The TCF Import Credit Scheme will terminate, as scheduled, on 30 June 2000, and a TCF Investment Program designed to encourage TCF companies to become more internationally competitive will be introduced.

The Government announced a range of measures to help small business in the areas of unfair conduct, retail tenancy, franchising, misuse of market power, financing and access to justice. The Trade Practices Act is to be amended so that small businesses are entitled to essentially the same legal protection against unfair business practices as consumers now enjoy.

The Prime Minister announced a package of policies to assist the rural sector costing around A$ 520 million.

The first CLERP position paper, on how the accounting standard setting process in Australia should be reformed, was released. Key proposals include Australia adopting accepted international standards by the start of 1999 and improved institutional arrangements for setting standards.

The Federal Government announced Commonwealth assistance to State and Territory Governments as part of an Inter-Jurisdictional Taxation Agreement (IJTA) between the Commonwealth and State and Territory Governments. The other major element of the IJTA is a review of reciprocal taxation (*i.e.* each government applying its taxes to other levels of government).

Expressions of interest were called for the sale, by 50-year leases, of a further fifteen Commonwealth-owned airports, including the airports of Adelaide, Canberra, Coolangatta, Darwin, and Hobart. Completion of the sale process is expected by 30 June 1998.

The Government announced that it had reached agreement with the mainland States on interstate rail reform. As a first step, the Commonwealth and Victoria will place their interstate track under single management by 1 July 1998 and a plan will be considered in November 1997 for the extension of this network to Perth.

Centrelink, the one-stop shop for a range of Government services, was officially opened. These services include social security and Commonwealth employment services, as well as child care payments and the delivery of rural assistance programmes. A key role for Centrelink is the referral of unemployed people to employment service providers (both private and public) in the new Employment Services Market set to come into operation in May 1998.

October

The second CLERP position paper was released. It sets out proposals for reforms designed to reduce the cost of fund-raising by Australian companies. Key proposals include reducing the legal requirements for information disclosure necessary for small and larger businesses to raise capital, rationalising liability rules by removing overlaps between the Corporations Law and the Trade Practices Act, and facilitating the use of shorter prospectuses and profile statements.

STATISTICAL ANNEX AND STRUCTURAL INDICATORS

Table A. **Selected background statistics**

	Average 1987-96	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
A. Percentage changes from previous year at constant 1989/90 prices											
Private consumption	3.4	2.1	3.6	5.2	2.7	0.9	3.6	2.7	4.5	4.6	3.0
Gross fixed capital formation	2.3	3.6	7.5	9.4	–8.3	–9.5	1.9	3.3	11.7	1.6	5.1
Public	–0.1	–3.5	–12.3	8.4	1.2	4.9	–1.6	0.2	1.9	–2.5	–0.2
Private	2.6	4.6	9.9	9.5	–9.2	–11.1	2.4	3.7	12.9	2.0	5.7
Residential	2.2	1.3	22.0	2.4	–11.5	–4.1	10.7	11.0	10.6	–9.2	–7.3
Non-residential construction	2.1	15.2	17.0	11.1	–8.5	–20.4	–12.3	–3.4	6.7	20.3	17.1
Machinery and equipment	5.2	4.9	11.2	12.9	–14.2	–11.8	7.7	5.9	20.0	5.3	15.6
Public enterprises	–2.8	–0.1	–19.0	15.8	7.4	–10.7	–8.0	–10.8	6.6	4.9	–6.4
GDP[1]	3.0	4.5	3.8	4.2	1.2	–1.3	2.6	3.9	5.4	3.9	3.4
GDP price deflator	3.4	7.8	8.6	7.5	4.5	2.3	1.3	1.3	1.1	2.5	2.1
Employment	1.8	2.2	3.7	4.7	1.5	–2.1	–0.7	0.4	3.1	4.1	1.3
Compensation of employees (current prices)	6.7	8.4	10.7	12.5	8.7	1.4	3.3	3.6	6.1	7.6	6.3
Productivity (GDP / employment)	1.2	2.3	0.1	–0.5	–0.2	0.8	3.3	3.5	2.2	–0.2	2.1
Unit labour costs (compensation / GDP)	3.6	3.7	6.6	8.0	7.4	2.8	0.7	–0.3	0.7	3.6	2.8
B. Percentage ratios											
Gross fixed capital formation as % of GDP at constant prices	22.4	23.3	24.1	25.3	22.9	21.1	20.9	20.8	22.1	21.6	21.9
Stockbuilding as % of GDP at constant prices	0.4	0.0	0.8	1.5	0.4	–0.9	–0.3	0.6	0.4	0.8	0.6
Foreign balance as % of GDP at constant prices	0.7	2.0	0.1	–2.5	–0.5	2.3	1.9	2.3	1.2	0.2	0.5
Compensation of employees as % of GDP at current prices	49.4	49.3	48.4	48.6	50.0	50.3	50.0	49.2	49.0	49.5	49.8
Direct taxes as per cent of household income	21.1	24.0	23.7	23.1	21.6	20.5	19.1	19.5	19.3	20.0	20.5
Unemployment as per cent of total labour force	8.6	8.0	7.1	6.1	7.0	9.5	10.7	10.9	9.7	8.6	8.5
C. Other indicator											
Current balance (US$ billion)	–12.7	–8.0	–9.7	–17.0	–14.3	–9.3	–9.9	–9.5	–16.2	–18.6	–15.0

1. Income-based measure.

Source: Australian Bureau of Statistics and OECD Secretariat.

Table B. **Gross domestic product**

A$ million

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
	Current prices									
Private consumption[1]	165 587	184 350	206 936	225 143	235 556	248 740	260 465	274 723	293 870	308 815
Government current expenditure[1]	50 358	54 683	59 055	64 994	69 493	72 677	74 932	78 474	81 776	85 701
Gross fixed capital formation[2]	68 115	77 564	90 462	85 775	77 949	79 569	84 275	94 423	96 419	100 463
Private	49 155	61 003	70 643	64 182	57 098	59 805	65 585	75 182	76 735	81 499
Public enterprises	11 139	9 415	11 687	13 052	11 812	10 941	9 798	10 322	10 831	10 165
Government	7 821	7 146	8 132	8 541	9 039	8 823	8 892	8 919	8 853	8 799
Change in stocks	726	3 026	5 332	518	–2 669	–1 089	1 824	2 797	4 157	2 578
Exports of goods and services	47 248	53 134	57 908	63 457	67 942	72 960	79 714	83 430	92 725	99 758
Imports of goods and services	49 443	55 621	66 185	66 096	65 184	72 791	80 559	88 084	98 324	99 552
Statistical discrepancy	95	1 629	3 306	3 534	–2 306	–4 236	–4 087	–1 840	2 461	1 785
Gross domestic product at purchasers' values[3]	282 686	318 765	356 814	377 325	380 781	395 830	416 564	443 923	473 084	499 548
Indirect taxes less subsidies	34 780	38 793	42 581	44 816	44 603	44 837	47 827	54 921	584 06	62 163
Gross domestic product at factor cost	247 906	279 972	314 233	332 509	336 178	350 993	368 737	389 002	414 678	437 385
	Average 1989/90 prices									
Private consumption[1]	195 521	202 580	213 180	218 942	220 958	228 981	235 207	245 802	257 032	264 816
Government current expenditure[1]	57 253	59 000	60 453	62 958	64 519	65 524	65 687	69 156	71 088	72 888
Gross fixed capital formation[2]	78 774	84 653	92 632	84 982	76 927	78 421	81 015	90 483	91 923	96 616
Private	57 252	66 639	72 338	63 700	56 609	59 163	62 876	71 557	72 731	78 110
Public enterprises	12 757	10 329	11 963	12 847	11 466	10 552	9 412	10 034	10 522	9 852
Government	8 765	7 685	8 331	8 435	8 852	8 706	8 727	8 892	8 670	8 654
Change in stocks	6	2 917	5 455	1 658	–3113	–1 173	2 237	1 663	3 436	2 853
Exports of goods and services	55 001	56 792	58 603	63 489	71 815	75 634	81 324	88 455	92 311	101 747
Imports of goods and services	48 384	56 413	67 864	65 195	63 534	68 502	72 293	83 553	91 539	99 417
Statistical discrepancy	123	1 777	3 433	3 484	–2 199	–4 013	–3 830	–1 693	2 259	1 595
Gross domestic product at purchasers' values[3]	338 294	351 306	365 892	370 318	365 373	374 872	389 347	410 313	426 510	441 098

1. Not adjusted for the impact of the introduction of Medicare from 1 February 1986, which had the effect of transferring certain expenditures on healthcare, formely included as private in consumption expenditure, to public consumption expenditure.
2. Not adjusted to remove the impact of the sale to the private sector of public sector assets under leaseback and similar arrangements.
3. Income-based measure.

Source: Australian Bureau of Statistics.

Table C. **Income and expenditure of households (including unincorporated enterprises)**

A$ million, current prices

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Compensation of employees	139 345	154 209	173 551	188 722	191 475	198 017	205 056	217 600	234 175	248 975
Income from property and entrepreneurship	50 497	58 240	66 853	68 441	64 391	62 985	62 396	65 923	72 161	77 249
Farm	2 903	5 067	4 470	2 020	917	2 411	3 693	3 068	3 925	5 159
Non-farm	47 594	53 173	62 383	66 421	63 474	60 574	58 703	62 855	68 236	72 090
Current transfers from government	26 303	28 480	30 651	35 223	39 969	44 520	47 874	50 200	53 444	57 808
Grants to non-profit institutions	3 263	3 801	4 120	4 750	5 252	5 768	6 324	7 004	8 279	8 474
Third party insurance transfers	1 429	1 303	1 207	1 324	1 370	1 137	1 146	1 502	1 752	1 834
Unrequited transfers from overseas	2 443	2 929	3 488	3 358	3 549	2 926	1 930	2 061	2 559	2 915
Income	223 280	248 962	279 870	301 818	306 006	315 353	324 726	344 290	372 370	397 255
less: Income taxes	40 551	44 767	48 773	49 754	48 421	47 071	49 228	51 681	57 594	62 928
of which: Direct taxes paid on income	1 672	1 902	2 181	2 384	2 498	2 658	2 988	3 389	3 556	3721
Consumer debt interest	4 549	4 961	7 300	7 723	6 199	4 312	3 496	3 310	4 116	4 499
Transfers paid by households	747	796	863	949	988	1 006	1 010	1 063	1 151	1 220
Disposable income	175 761	196 536	220 753	241 008	247 900	260 306	268 004	284 847	305 953	324 887
Consumption expenditure	165 587	184 350	206 936	225 143	235 556	248 740	260 465	274 723	293 870	308 815
Saving	10 174	12 186	13 817	15 865	12 344	11 566	7 539	10 124	12 083	16 072
as per cent of disposable income	5.8	6.2	6.3	6.6	5.0	4.4	2.8	3.6	3.9	4.9

Source: Australian Bureau of Statistics.

Table D. **Prices and wages**

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
	Index FY 1989/90 = 100									
Price deflators										
Gross domestic product	83.6	90.7	97.5	101.9	104.2	105.6	107.0	108.2	110.9	113.3
Private consumption	84.6	90.9	97.0	102.8	106.5	108.6	110.7	111.7	114.3	116.5
Gross fixed capital formation	86.4	91.6	97.6	100.9	101.3	101.4	104.0	104.3	104.9	103.9
Exports[1]	85.7	93.4	98.6	99.8	94.5	96.3	97.9	94.2	100.3	97.9
Imports[1]	102.1	98.7	97.4	101.3	102.5	106.1	111.3	105.4	107.3	100.1
Terms of trade[1]	84.0	94.8	101.3	98.5	92.2	90.8	87.9	89.4	93.5	97.8
Consumer price index[2]										
Total	83.3	89.4	96.2	103.2	106.5	107.5	109.5	111.5	116.4	119.6
Food	83.5	89.4	96.0	103.6	106.9	107.9	109.6	111.9	117.3	120.3
Award rates of pay, adult persons	86.5	91.5	97.2	103.1	106.9	109.6	110.6	112.1	113.8	115.6
Average weekly earnings, all employees	85.0	90.6	96.9	103.3	107.2	109.9	113.0	116.4	119.6	123.1

1. Goods and services.
2. Not adjusted for the effects of Medicare.

Source: Australian Bureau of Statistics, Reserve Bank, and OECD Secretariat.

Table E. **Balance of payments**

A$ million

	1990	1991	1992	1993	1994	1995	1996
Exports	50 351	53 919	57 753	62 103	64 094	71 129	76 126
Imports	49 867	49 416	55 689	62 350	68 612	76 835	77 298
Trade balance	484	4 503	2 064	–247	–4 518	–5 706	–1 172
Services, net	–20 975	–18 623	–16 923	–14 014	–17 769	–20 033	–19 249
Non-factor services, credit	13 106	14 023	15 207	17 611	19 336	21 596	23 632
Non-factor services, debit	16 229	15 768	17 102	18 209	19 472	21 489	22 254
Non-factor services, net	–3 123	–1 745	–1 895	–598	–136	107	1 378
Investment income, credit	4 565	4 230	5 139	6 200	6 047	7 294	7 836
Investment income, debit	22 417	21 108	20 167	19 616	23 680	27 434	28 463
Investment income, net	–17 852	–16 878	–15 028	–13 416	–17 633	–20 140	–20 627
Balance on goods and services	–20 491	–14 120	–14 859	–14 261	–22 287	–25 739	–20 421
Tranfers, credit	4 524	4 555	3 783	2 740	2 826	3 450	3 902
Transfers, debit	–2 326	–2 330	–2 372	–2 465	–2 678	–2 820	–2 634
Unrequited transfers, net	2 198	2 225	1 411	275	148	630	1 268
Balance on current account	–18 294	–11 895	–13 450	–13 986	–22 139	–25 111	–19 154
Net capital movements[1]	14 638	13 792	15 789	15 096	14 975	26 441	19 624
Net errors and omissions	3 649	–1 896	–2 184	–945	7 312	–1 281	–471
Changes in official reserves	–2 744	6 240	10 868	10 621	10 762	3 885	–798

1. Including changes in official reserves.

Source: Australian Bureau of Statistics, *Balance of Payments*, and OECD, *Main Economic Indicators*.

Table F. **Foreign trade by commodity**[1]

	1980	1985	1990	1995	1996	1980	1985	1990	1995	1996
	US$ million					Per cent of total				
SITC sections:										
Total exports, fob	22 072	22 675	39 753	53 121	60 539	100.0	100.0	100.0	100.0	100.0
Food and live animals	7 280	5 409	7 587	9 692	12 368	33.0	23.9	19.1	18.2	20.4
Beverages and tobacco	49	51	223	431	578	0.2	0.2	0.6	0.8	1.0
Crude materials, inedible, except fuels	6 571	6 275	10 509	10 844	11 759	29.8	27.7	26.4	20.4	19.4
Mineral fuels, lubricants and related materials	2 400	5 678	7 501	8 880	10 184	10.9	25.0	18.9	16.7	16.8
Animals and vegetable oils, fats and waxes	115	94	102	190	187	0.5	0.4	0.3	0.4	0.3
Chemicals and related products, n.e.s.	482	397	1 013	2 154	2 351	2.2	1.8	2.5	4.1	3.9
Manufactured goods classified chiefly by material	2 585	2 243	4 891	7 257	7 392	11.7	9.9	12.3	13.7	12.2
Machinery and transport equipment	1 170	1 086	3 220	6 788	7 812	5.3	4.8	8.1	12.8	12.9
Miscellaneous manufactured articles	384	443	1 020	1 849	2 205	1.7	2.0	2.6	3.5	3.6
Commodities and transactions not classified according to kind	1 035	998	3 686	5 037	5 703	4.7	4.4	9.3	9.5	9.4
Total imports, cif	20 194	23 316	38 918	57 425	61 406	100.0	100.0	100.0	100.0	100.0
Food and live animals	766	943	1 495	2 184	2 285	3.8	4.0	3.8	3.8	3.7
Beverages and tobacco	184	189	315	374	402	0.9	0.8	0.8	0.7	0.7
Crude materials, inedible, except fuels	876	690	1 096	1 297	1 183	4.3	3.0	2.8	2.3	1.9
Mineral fuels, lubricants and related materials	2 762	1 599	2 191	2 880	3 839	13.7	6.9	5.6	5.0	6.3
Animals and vegetable oils, fats and waxes	79	76	98	186	208	0.4	0.3	0.3	0.3	0.3
Chemicals and related products, n.e.s.	1 826	1 993	4 005	6 369	7 102	9.0	8.5	10.3	11.1	11.6
Manufactured goods classified chiefly by material	3 552	3 774	5 961	8 413	8 306	17.6	16.2	15.3	14.7	13.5
Machinery and transport equipment	7 259	9 928	17 491	26 975	28 840	35.9	42.6	44.9	47.0	47.0
Miscellaneous manufactured articles	2 447	3 099	5 410	8 130	8 653	12.1	13.3	13.9	14.2	14.1
Commodities and transactions not classified according to kind	442	1 027	854	615	589	2.2	4.4	2.2	1.1	1.0

1. General trade.

Source: OECD, *Foreign Trade Statistics*, Series A.

Table G. **Foreign trade by area**[1]

US$ million

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Exports, fob										
OECD Europe	4 895	5 438	5 941	6 277	5 972	6 218	5 541	5 624	6 478	74 95
of which: United Kingdom	1 140	1 166	1 323	1 400	1 330	1 665	1 910	1 711	1 829	2 124
OECD North America	3 465	4 137	4 469	5 011	4 901	4 474	4 335	4 265	4 296	4 923
Japan	6 790	8 882	9 761	10 206	11 538	10 714	10 441	11 613	12 182	12 080
New Zealand	1 512	1 630	1 891	1 956	2 043	2 241	2 466	3 152	3 841	4 283
Far East	5 194	6 936	7 937	8 476	10 439	11 941	12 034	14 103	16 415	18 492
Other non-OECD countries	3 168	3 652	4 335	3 826	3 570	3 374	3 603	3 950	4 163	5 874
Non-specified	405	464	763	957	841	835	1 058	1 300	1 120	1 370
Total	26 508	32 671	36 991	38 912	41 934	42 439	42 392	47 432	52 968	60 225
Imports, cif										
OECD Europe	7 741	9 449	10 885	10 681	9 639	9 986	10 065	12 644	15 600	16 265
of which: United Kingdom	1 951	2 467	2 785	2 701	2 401	2 413	2 410	2 979	3 451	3 921
OECD North America	6 381	8 043	10 320	10 309	10 180	9 993	9 896	11 934	13 809	15 628
Japan	5 321	6 713	8 320	7 307	6 808	7 373	8 073	8 867	8 878	8 000
New Zealand	1 110	1 463	1 662	1 716	1 768	1 876	2 065	2 482	2 673	2 882
Far East	4 110	5 067	6 231	5 773	6 748	7 636	7 948	9 624	11 101	12 710
Other non-OECD countries	1 618	1 680	2 370	2 355	2 524	2 722	3 040	3 033	3 653	4 010
Non-specified	32	55	92	63	70	67	71	71	79	158
Total	27 011	33 340	40 949	39 139	38 723	40 756	42 422	49 952	57 465	61 475

1. General trade.

Source: OECD, *Foreign Trade Statistics*, Series A.

Table H. **Production structure and performance indicators**

Fiscal years[1]

	1975	1980	1985	1990	1995	1975	1980	1985	1990	1995
	GDP share					Employment share				
A. Production structure (constant prices)										
Tradeables										
Agriculture	4.9	3.9	4.3	4.3	3.7	6.8	6.6	6.2	5.6	5.1
Mining and quarrying	3.7	3.5	4.2	4.5	4.3	1.4	1.4	1.5	1.2	1.0
Manufacturing	18.1	17.7	15.4	15.1	13.6	21.6	19.7	16.5	14.7	13.4
Non-tradeables										
Electricity, gas and water	2.8	3.0	3.2	3.4	3.2	1.8	2.1	2.1	1.3	1.0
Construction	7.9	7.8	7.1	6.8	6.3	8.7	7.7	7.0	7.4	7.2
Trade, restaurants and hotels	21.8	20.8	19.5	18.6	19.1	19.8	20.1	23.4	25.2	25.4
Transport, storage and communication	5.7	6.7	7.1	7.8	9.4	7.8	7.4	7.5	6.9	6.6
Finance, insurance, real estate and business services	19.2	20.6	21.4	23.0	21.6	7.4	8.5	10.9	12.4	13.4
Community, social and personal services	12.0	12.9	13.0	13.7	13.6	19.9	22.1	20.0	20.9	22.3
	Productivity growth[2]					Investment share				
B. Economic performance (constant prices)										
Agriculture	–	–2.3	4.2	2.6	0.6	10.6	8.8	6.3	3.8	4.9
Mining and quarrying	–	–0.5	2.8	6.6	4.9	5.5	8.9	7.5	10.1	10.7
Manufacturing	–	2.8	2.1	2.2	1.9	13.1	14.8	11.4	12.9	13.2
Electricity, gas and water	–	0.8	2.3	11.0	6.9	12.4	12.3	9.9	7.6	6.9
Construction	–	3.8	1.7	–1.7	0.6	3.4	3.4	4.1	3.4	4.2
Trade, restaurants and hotels	–	0.2	–2.9	–2.0	2.2	9.5	9.9	9.3	9.3	9.4
Transport, storage and communication	–	5.9	2.2	4.0	6.8	13.4	13.2	17.2	14.5	17.5
Finance, insurance, real estate and business services	–	0.0	–2.7	–0.9	–0.8	10.5	9.4	12.5	17.5	13.4
Community, social and personal services	–	0.8	3.6	0.4	0.6	4.9	5.4	8.2	9.0	10.3
	1980	1988	1989	1990	1991	1992	1993	1994	1995	1996
C. Other indicators (current prices)										
Effective rate of protection, manufacturing	23	17	15	14	13	12	10	9	8	6
R&D in per cent of GDP	1.0	1.3	. .	1.4	. .	1.6	. .	1.6	. .	. .
Levels of net foreign debt[3]/GDP	5.6	28.6	32.0	34.9	36.3	37.5	39.1	36.1	37.3	37.1
Levels of foreign direct investment[3]/GDP	17.1	19.7	23.3	25.5	26.0	26.2	26.4	27.2	26.7	29.0

1. Beginning 1st July of the year indicated.
2. Average rate of growth between periods.
3. At 30th June of the year indicated.

Source: Australian Bureau of Statistics; Reserve Bank of Australia, *Bulletin*; OECD, *National Accounts* and *Main Science and Technology Indicators.*

Table I. **Labour market indicators**

	A. Evolution					
	Peak	Trough	1985	1990	1995	1996
Standardised unemployment rate	1993: 10.8	1981: 5.7	8.2	7.0	8.6	8.6
Unemployment rate						
Total	1993: 10.9	1981: 5.7	8.3	7.0	8.5	8.6
Male	1993: 11.5	1981: 4.8	7.9	6.8	8.8	8.8
Female	1983: 10.4	1990: 7.2	8.8	7.2	8.1	8.3
Youth[1]	1992: 19.5	1989: 10.4	14.3	13.2	14.4	14.8
Share of long-term unemployment[2]	1993: 36.7	1982: 19.0	30.9	21.6	30.8	28.4
Non-farm vacancies (thousand)	1989: 68.2	1983: 17.6	54.0	48.3	57.3	60.8
Average hours worked in manufacturing. weekly	1970: 39.5	1993: 35.6	37.0	38.2	38.8	38.7
Overtime hours per week, non-farm	1989: 1.5	1984: 1.1	1.2	1.3	1.2	1.1

	B. Structural of institutional characteristics					
	1970	1980	1985	1990	1995	1996
Labour force (percentage change)[3]	. .	2.0	1.7	3.0	1.3	1.4
Participation rate[4]						
Total	61.2	61.3	60.8	63.8	63.7	63.6
Male	83.0	78.3	75.8	75.6	73.9	73.7
Female	39.6	44.8	46.3	52.2	53.8	53.8
Employment by sector						
Per cent of total						
Agriculture	8.0	6.5	6.1	5.6	5.0	5.1
Industry	36.4	30.8	27.6	25.4	22.9	22.6
Services	55.6	62.7	66.2	69.0	72.1	72.3
Percentage change[3]						
Agriculture	. .	–0.6	0.4	1.2	–1.2	3.0
Industry	. .	–0.1	–1.2	1.5	–1.1	–0.3
Services	. .	2.8	2.4	4.2	1.8	1.7
Total	. .	1.5	1.2	3.2	0.9	1.4
Part-time employment, per cent of total employed	10.6	16.4	18.2	21.3	24.5	24.7
Non-wage labour cost[5]	3.4	5.7	7.5	7.2	9.0	9.1

1. People between 15 and 24 years as a percentage of the labour force of the same age group.
2. People looking for a job since one year or more as a percentage of total unemployment.
3. Average rate of growth between periods.
4. Labour force as a percentage of the corresponding population aged 15 and over.
5. Total social contributions as a percentage of total compensation.

Source: Australian Bureau of Statistics; OECD, Labour Force Statistics.

Table J. **The public sector**

	1973	1980	1985	1990	1995	1996
Budget indicators : General government accounts (per cent of GDP)						
Current receipts (excluding interests)	23.6	27.7	30.5	31.9	31.1	31.7
Non-interest expenditures	23.9	29.1	32.3	29.9	32.1	32.0
Primary budget balance	–0.3	–1.4	–1.8	2.0	–1.0	–0.3
Net interest (including net capital transfers)	–0.1	–0.4	–1.0	–1.4	–1.1	–0.9
General government budget balance	–0.4	–1.8	–2.8	0.6	–2.1	–1.2
Structure of expenditure and taxation (per cent of GDP)						
Government expenditure	24.1	30.7	35.2	33.9	35.9	35.6
Transfers	7.0	9.6	11.2	10.9	13.3	13.5
Subsidies	1.1	1.5	1.8	1.4	1.3	13.2
General expenditure[1]						
Education	3.6	4.5	4.3	3.8	3.6	. .
Transportation	1.5	1.6	1.6	1.6	1.3	. .
Health	2.0	3.1	3.2	3.2	3.1	. .
Tax receipts[1]	25.3	28.3	30.0	30.8	30.6	. .
Personal income tax	10.2	12.4	13.6	13.2	12.4	. .
Corporate tax	3.8	3.4	2.8	4.4	4.5	. .
Payroll tax	1.3	1.4	1.4	1.9	2.1	. .
Taxes on goods and services	7.5	8.8	9.9	8.6	8.9	. .
of which: Specific taxes on consumption	4.7	6.4	6.2	4.7	4.4	. .
Other indicators						
Income tax elasticity[1]	1.6[2]	1.2	1.2	0.1	1.4	. .
Income tax as a percentage of total tax[1]	40.5	44.0	45.2	43.0	40.6	. .
Net public debt as a percentage of GDP	. .	. .	. .	10.6	28.2	28.6

	Prior to		After
Tax rates (per cent)			
Top rate of income tax	49	1st January 1990	47
Lower rate of income tax	21	1st January 1991	20
Corporation tax rate	33	1st July 1996	36

1. Fiscal years beginning 1st July of indicated years.
2. 1974 figure.

Source: Australian Bureau of Statistics; OECD, *National Accounts*, *Revenue Statistics of OECD Member Countries* and Secretariat estimates.

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period[1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece
Population											
Total	Thousands	1994	17 840	8 031	10 124	29 251	5 206	5 088	57 960	81 407	10 430
Inhabitants per sq. km	Number	1994	2	96	332	3	121	15	106	228	79
Net average annual increase over previous 10 years	%	1994	1.4	0.6	0.3	1.6	0.2	0.4	0.5	2.9	0.5
Employment											
Total civilian employment (TCE)[2]	Thousands	1994	7 680 (93)	3 737	3 724 (92)	13 292	2 508	2 015	21 781 (93)	35 894	3 790
of which: Agriculture	% of TCE	1994	5.3 (93)	7.2	2.6 (92)	4.1	5.1	8.3	5.1 (93)	3.3	20.8
Industry	% of TCE	1994	23.7 (93)	33.2	27.7 (92)	22.6	26.8	26.8	27.7 (93)	37.6	23.6
Services	% of TCE	1994	71 (93)	59.6	69.7 (92)	73.3	68.1	64.9	67.2 (93)	59.1	55.5
Gross domestic product (GDP)											
At current prices and current exchange rates	Bill. US$	1994	331.6	198.1	227.9	544	146.7	97.2	1 328.5	1 832.3	73.1 (93)
Per capita	US$	1994	18 588	24 670	22 515	18 598	28 181	19 106	22 944	27 826	7 051 (93)
At current prices using current PPP's[3]	Bill. US$	1994	327.9	162.3	204.2	596.7	107	82.5	1 111.8	1 601.7	118
Per capita	US$	1994	18 382	20 210	20 166	20 401	20 546	16 208	19 201	24 325	1 450
Average annual volume growth over previous 5 years	%	1994	2.2	2.5	1.6	1.1	1.9	–1.6	1.1	2.6	1.4 (93)
Gross fixed capital formation (GFCF)	% of GDP	1994	21.4	24.8	17.4	18.7	14.8	14.3	18.1	18.5	17.4 (93)
of which: Machinery and equipment	% of GDP	1993	9.8	8.7	7.8	6.2	7.2	5.90	8.10	7.5	7.8
Residential construction	% of GDP	1993	5.2	6.3	4.6	6.1	2.9	3.7	4.9	6.5	3.6
Average annual volume growth over previous 5 years	%	1994	0.8	3.7	0.4	–0.1	–2.8	–12.9	–1	0.8	2.7 (93)
Gross saving ratio[4]	% of GDP	1994	16.8	25.3	22	16	17	16.6	19	21	15.5 (93)
General government											
Current expenditure on goods and services	% of GDP	1994	17.5	18.8	15	20.2	25.3	22.4	19.6	17.7	19.1 (93)
Current disbursements[5]	% of GDP	1993	36.9	48.4	55.3	49	61.1	58.9	51.5	45.6	51.2
Current receipts	% of GDP	1993	33.5	48.6	50.1	43	58.3	52.5	46.8	45.7	40.2
Net official development assistance	% of GNP	1993	0.34	0.31	0.41	0.46	1.03	0.76	0.66	0.44	..
Indicators of living standards											
Private consumption per capita using current PPP's[3]	US$	1993	10 803	10 546	12 090	11 863	10 042	8 814	11 395	10 733	6 367
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480[8]	169
Telephones, per 1 000 inhabitants	Number	1991	464	432	410	586	577	544	511	420[8]	413
Television sets, per 1 000 inhabitants	Number	1991	480	478	451	639	536	501	407	556[8]	197
Doctors, per 1 000 inhabitants	Number	1993	2.2 (91)	2.3	3.7	2.2	2.8 (92)	2.6 (92)	2.8	3.2 (92)	3.8 (92)
Infant mortality per 1 000 live births	Number		6.1	6.5	8	6.8	5.4	4.4	6.5	5.8	8.5
Wages and prices (average annual increase over previous 5 years)											
Wages (earnings or rates according to availability)	%	1994	3	5.5	3.7	3.3	3.5	4.8	3.5	5.2	14.6
Consumer prices	%	1994	3	3.4	2.8	2.8	2.1	3.3	2.5	3.3	16.2
Foreign trade											
Exports of goods, fob*	Mill. US$	1994	47 363	44 881	137 259[7]	165 358	41 850	29 514	235 337	422 243	8 958
As % of GDP	%	1994	14.3	22.7	60.2	30.4	28.5	30.4	17.7	23	11.5 (93)
Average annual increase over previous 5 years	%	1994	5	6.7	6.5	7.1	8.3	4.9	5.6	4.4	3.4
Imports of goods, cif*	Mill. US$	1994	49 731	55 071	126 006[7]	148 297	35 932	23 091	220 508	376 566	21 111
As % of GDP	%	1994	15	27.8	55.3	27.3	24.5	23.8	16.6	20.6	30.1 (93)
Average annual increase over previous 5 years	%	1994	4	7.2	5	5.4	6.1	–1.3	3.5	6.9	5.4
Total official reserves[6]	Mill. SDRs	1994	7 730	11 523	9 505[7]	8 416	6 203	7 304	17 986	52 994	9 924
As ratio of average monthly imports of goods	Ratio	1994	1.9	2.5	0.9	0.7	2.1	3.8	1	1.7	5.6

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period[1]	Iceland	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand
Population										
Total	Thousands	1994	267	3 571	57 190	124 960	398	93 010	15 382	3 526
Inhabitants per sq. km	Number	1994	3	51	190	331	153	47	377	13
Net average annual increase over previous 10 years	%	1994	1.1	0.1	0	0.4	0.8	2	0.6	0.8
Employment										
Total civilian employment (TCE)[2]	Thousands	1994	138	1 168 (93)	20 152 (93)	64 530	162 (91)	32 439	6 631	1 560
of which: Agriculture	% of TCE	1994	9.4	12.7 (93)	7.5 (93)	5.8	3.7 (91)	25.8	4	10.4
Industry	% of TCE	1994	26.1	27.7 (93)	33 (93)	34	31.5 (91)	22.2	23	25
Services	% of TCE	1994	65.2	59.7 (93)	59.6 (93)	60.2	64.8 (91)	52.1	73	64.6
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US$	1994	6.2	52	1 017.8	4 590	10.6 (92)	371.2	334.3	51.2
Per capita	US$	1994	23 199	14 550	17 796	36 732	27 073 (92)	3 991	21 733	14 513
At current prices using current PPP's[3]	Bill. US$	1994	5.1	54.3	1 068.4	2 593.7	11.7	673.3	285.9	57.3
Per capita	US$	1994	19 271	15 212	18 681	20 756	29 454	7 239	18 589	16 248
Average annual volume growth over previous 5 years	%	1994	0.6	4.7	1	2.1	4.1 (92)	3	2.3	2.5
Gross fixed capital formation (GFCF)	% of GDP	1994	15.2	15.1	16.4	28.6	20.4 (93)	20.7	19.3	20
of which: Machinery and equipment	% of GDP	1993	3.9	6.3	7.4	11.5	..	9.4	8.6	9.3
Residential construction	% of GDP	1993	4.4	4.1	5.3	5.4	..	4.9	5.1	4.9
Average annual volume growth over previous 5 years	%	1994	–4	1	–2.3	1.4	6.5 (92)	7.7	0.4	5.8
Gross saving ratio[4]	% of GDP	1994	16.9	19.5	18.8	31.2	60.2 (92)	15.1	24.4	20.7
General government										
Current expenditure on goods and services	% of GDP	1994	20.6	16	17.1	9.8	17.1 (92)	11.8[9]	14.2	14.7
Current disbursements[5]	% of GDP	1993	34.9	..	53.2	26.9	..	..	55.4	..
Current receipts	% of GDP	1993	35.9	..	47.1	32.9	..	..	54.5	..
Net official development assistance	% of GNP	1993	..	0.15	0.42	0.27	0.34 (92)	..	0.88	0.22
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1993	11 546	7 750	11 029	11 791	15 545	4 853	10 726	9 266
Passenger cars, per 1 000 inhabitants	Number	1990	464	228	478	282	470	85	356	440
Telephones, per 1 000 inhabitants	Number	1991	527	300	400	454	511	70	477	436
Television sets, per 1 000 inhabitants	Number	1991	319	276	421	613	267	148	485	443
Doctors, per 1 000 inhabitants	Number	1993	3	1.7 (92)	1.7 (91)	1.7 (92)	2.1 (92)	1	2.5 (90)	2
Infant mortality per 1 000 live births	Number		4.8	5.9	7.3	4.5 (92)	8.5 (92)	18	6.3	7.3
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	..	4.6	5.9	2.4	..	5.3	3.2	2.1
Consumer prices	%	1994	6.3	2.7	5.2	2	3.1	16.1	2.8	2.5
Foreign trade										
Exports of goods, fob*	Mill. US$	1994	1 628	34 125	189 802	396 149	..	60 882	155 084	12 169
As % of GDP	%	1994	26.3	65.7	18.6	8.6	..	16.4	46.4	23.8
Average annual increase over previous 5 years	%	1994	2.7	10.5	6.2	7.6	..	21.7	7.6	6.5
Imports of goods, cif*	Mill. US$	1994	1 464	25 812	167 690	274 916	..	79 346	139 800	11 859
As % of GDP	%	1994	23.6	49.7	16.5	6	..	21.4	41.8	23.2
Average annual increase over previous 5 years	%	1994	0.7	8.1	1.9	5.5	..	25.5	6.1	6.1
Total official reserves[6]	Mill. SDRs	1994	201	4 189	22 102	86 214	..	4 301	23 655	2 540
As ratio of average monthly imports of goods	Ratio	1994	1.6	1.9	1.6	3.8	..	0.7	2	2.6

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics.*
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics.*

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period[1]	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population										
Total	Thousands	1994	4 337	9 900	39 150	8 781	6 994	60 573	58 375	260 651
Inhabitants per sq. km	Number	1994	13	107	78	20	169	78	238	28
Net average annual increase over previous 10 years	%	1994	0.5	–0.1	0.2	0.5	0.7	2.1	0.3	1
Employment										
Total civilian employment (TCE)[2]	Thousands	1994	1970 (93)	4 372	11 760	3 926	3 772	19 664	25 044 (93)	123 060
of which: Agriculture	% of TCE	1994	5.6 (93)	11.5	9.8	3.4	4	44.8	2.2 (93)	2.9
Industry	% of TCE	1994	23.1 (93)	32.8	30.1	25	28.8	22.2	26.2 (93)	24
Services	% of TCE	1994	71.3 (93)	55.7	60.2	71.6	67.2	33	71.6 (93)	73.1
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US$	1994	103.4 (93)	87	482.4	196.6	257.3	130.7	1 019.5	6 649.8
Per capita	US$	1994	23 984 (93)	8 792	12 321	22 389	36 790	2 157	17 468	25 512
At current prices using current PPP's[3]	Bill. US$	1994	95.3	122	531.7	153	167.4	319.3	1 030.2	6 649.8
Per capita	US$	1994	21 968	12 335	13 581	17 422	23 942	5 271	17 650	25 512
Average annual volume growth over previous 5 years	%	1994	2.1 (93)	1.4	1.5	–0.3	0.5	3.6	0.8	2.1
Gross fixed capital formation (GFCF)	% of GDP	1994	22 (93)	25.7	19.8	13.7	22.8	24.5	15	17.2
of which: Machinery and equipment	% of GDP	1993	..	..	5.7	5.7	7.5	10.3	7.3	7.7
Residential construction	% of GDP	1993	..	..	4.1	4	14.9[10]	9.1	3.1	4
Average annual volume growth over previous 5 years	%	1994	–3.93	2.7	–1.2	–7.6	–0.4	5.1	–2.1	4.6
Gross saving ratio[4]	% of GDP	1994	21.9 (93)	24.2	18.8	13.7	29.3	22.5	13.5	16.2
General government										
Current expenditure on goods and services	% of GDP	1994	22.1 (93)	17.2	16.9	27.3	14.1	11.7	21.6	16.4
Current disbursements[5]	% of GDP	1993	..	..	43.7	67.3	36.7	..	42.7	35.8
Current disbursements[5]	% of GDP	1993	..	..	40.1	59	36	..	36.8	31.7
Current receipts	% of GDP	1993	1.23	0.36	0.32	1.33	0.49	..	0.34	0.19
Net official development assistance	% of GNP	1993	9 826	7 780	8 412	9 240	13 730	3 617	10 942	16 444
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1993	378	260	307	418	441	29	361	568
Passenger cars, per 1 000 inhabitants	Number	1990	515	273	340	687	603	143	445	553
Telephones, per 1 000 inhabitants	Number	1991	423	187	400	468	406	175	434	814
Television sets, per 1 000 inhabitants	Number	1991	3.2 (92)	2.9	4.1	3	3	0.9	1.5 (92)	2.3 (92)
Doctors, per 1 000 inhabitants	Number	1993	5	8.7	7.6	4.8	5.6	52.6	6.6	8.5 (92)
Infant mortality per 1 000 live births	Number		4	..	7.2	5.4	..	..	6.7	2.8
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	2.7	9	5.6	5.7	3.9	73	4.6	3.6
Consumer prices	%	1994	34 645	17 072	73 129	61 122	70 467	18 456	205 170	512 627
Foreign trade										
Exports of goods, fob*	Mill. US$	1994	30.9 (93)	19.6	15.2	31.1	27.4	14.1	20.1	7.7
As % of GDP	%	1994	5	6.1	10.5	3.4	6.4	9.5	6.1	7.1
Average annual increase over previous 5 years	%	1994	27 345	25 967	92 182	51 730	68 126	22 976	227 026	663 256
Imports of goods, cif*	Mill. US$	1994	23.3 (93)	29.9	19.1	26.3	26.5	17.6	22.3	10
As % of GDP	%	1994	2.9	6.6	5.2	1	3.2	37.9	2.8	7
Average annual increase over previous 5 years	%	1994	13 033	10 627	28 475	15 929	23 790	4 911	28 094	43 350
Total official reserves[6]	Mill. SDRs	1994	5.7	4.9	3.7	3.7	4.2	2.6	1.5	0.8

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics.*

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