An Incentive Budget

There is widespread agreement on the need for what is called an “incentive budget”. An “incentive budget” implies a general easing of the burden of taxation or, at the very least, a redistribution of the burden so that it weighs less oppressively on enterprise and on the savings necessary to finance enterprise. The obstacle in the way of such a budget is the massive scale of government expenditure which has so far defied all attempts to curb it. On the contrary, like Topsy, it grows and grows and continues to consume an ever larger part of the national income.

Many of those who urge drastic cuts in government expenditure do so in obstinate disregard of present-day political realities. The public pressure on governments for more and more cash hand-outs and for a constantly widening scope of government services of all kinds has, in recent years, been well-nigh irresistible, and it has been one which no political party could afford to ignore except at the cost of tens of thousands of votes at the polls.

But, while the large-scale slashing of expenditure envisaged by these people is beyond the realm of political reality, there is ample scope for worthwhile economies which, in sum, would prove to be not insignificant. If the use of the axe is out of question, the pruning knife is still a practicable instrument of trade.
Moreover, the realisation seems to be dawning at last that all these government benefits have to be paid for, and that there are practical limits to which you can expect the other fellow to foot the bill. Far from providing steadier jobs and better living standards, excessive government spending, because of the heavy taxes necessary to finance it, saps the spirit of adventure and achievement on which employment and economic progress largely depend. Hence the public pressure for increased government services is now accompanied by the opposite pressure for lower taxes.

The present Commonwealth government is caught unhappily between these conflicting forces. The path of economic wisdom is fairly plain. It calls for the restoration of enterprise and the encouragement of initiative through the modification and adjustment of tax scales. We have reached the point where it would be wise for the government to sacrifice, if necessary, politics for economics, to risk courting a small degree of political unpopularity—which may, in the event, fail to materialise—in order to satisfy the demands of a realistic and progressive economic policy.

Great Increase in Expenditure Since 1947-8.

In 1938/9 Australia spent about £218 million, or about 28% of the national income, on government services—federal, state, semi-governmental and municipal. During the war government expenditure rose to a peak of £750 million in 1942/3, thereafter hovering around £700 million—about 60% of the national income. With the tapering off of defence expenditure to the low figure of £23 million in 1947/8, government outlays were brought back to £505 million representing 29% of the national income—about the same as before the war. But, from this point on, government expenditure has risen by leaps and bounds because of soaring administrative costs, the growth of social services, public works programmes of unprecedented magnitude, and the mounting threat of “the cold war”.

The comparative trend is shown in the following table:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Government Expenditure*</th>
<th>Percentage of National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947/8</td>
<td>£505 m.</td>
<td>28.8%</td>
</tr>
<tr>
<td>1948/9</td>
<td>576</td>
<td>29.7</td>
</tr>
<tr>
<td>1949/50</td>
<td>700</td>
<td>30.5</td>
</tr>
<tr>
<td>1950/51</td>
<td>966</td>
<td>31.0</td>
</tr>
<tr>
<td>1951/52</td>
<td>1,139</td>
<td>35.2</td>
</tr>
<tr>
<td>1952/3 est.</td>
<td>1,210</td>
<td>35.0</td>
</tr>
</tbody>
</table>

In six years government expenditure in money terms has more than doubled. Allowing for price changes, real expenditure has increased by about 40%.

What are the prospects of cutting down this immense outlay by governments? This question can be conveniently discussed under four main heads of government expenditure—administration, social services, defence and public works.

Administration.

Administration costs consist in the main of the costs of government departments, such as the Federal or State Treasuries which are not run as business undertakings like the Railways or Post Office. The increase in the administrative cost of governments is largely a reflection of the greatly extended range of activities now carried on by the Commonwealth Government. Most of the increase in staff employed by all governments—from 42,000 before the war to 108,000 in 1947 to 127,000 in June, 1952—took place in Commonwealth Government departments. The number of public servants coming under the jurisdiction of the Commonwealth Public Service Board, excluding postal officials, has risen from about 12,000 in 1939 to 78,000 in 1952. New departments...
have been created—such as Immigration (3,500 employees), Social Services (1,000), Civil Aviation (5,000), Labour and National Service (2,000), National Development (500), Works (16,000)—to deal with new post-war responsibilities. Existing departments, such as Repatriation, Taxation, External Affairs and the Prime Minister's Department, have also been greatly enlarged to cope with growing functions.

It must be reluctantly conceded that the prospect of any spectacular reductions in the size of these staffs is remote. The existing strength of public servants alone is sufficient to make any Government tread warily in the matter of drastic economies in the public service.

Social Services.

This is the most intractable part of Government expenditure. In fact the cost of social services is far more likely to increase than diminish.

This year the cost of social services will amount to over 10% of the national income, compared with 7% in 1938/9 and 6% in 1947/8. The ageing of the population and extensions to health and medical schemes will in the near future involve further additions to cash benefits, while the need for better educational and health facilities and other civic requirements may add to the cost of social services in the future.

Defence.

Defence is budgeted to absorb £200 million in the current year. Before the war just over 1/- in every £ of government revenue was devoted to defence. In 1947/8 defence outlay fell below 1/- in every £, but this year it will probably take over 3/-.

The biggest items consist of new defence equipment, such as ships and aircraft, which accounted for nearly half the total defence bill for 1951/2. Service costs—permanent forces, national service in ceees and citizen military forces—costs nearly £50 million. The Korean War to date has cost £13 million—an average of £6 million per annum—and the total outlay on the Rocket Range since its inception has been £24 million.

If Australia is to shoulder its fair share of responsibility for the defence of the free world, any substantial reduction in defence expenditure cannot be entered into lightly. Moreover, the critic of heavy defence expenditure must still face up to the fact that in 1951 Britain spent 13.4% of national income on defence, while U.S.A. (17.0%) and Canada (10%) are all bearing defence commitments in excess of the Australian outlay (5.1%).

Public Works.

Apart from defence, public works account for most of the substantial increase in expenditure since 1947/8. Public works took 7.8% of the national income before the war, and 5.6% in 1947/8. Now they are absorbing over 10%. Australia's public works programme in the post-war years has been lamentably planned and managed. The general design was over-ambitious and too many projects were attempted at once, setting up an absurd competition for technicians, labour and materials which has added greatly to costs, and led to extravagant squandering of public monies. The lack of coordination is largely the product of State and Federal political rivalries. Individual items showing the greatest rises in expenditure compared with pre-war are power schemes, civil aviation, the railways and public buildings. On the other hand, expenditure on roads and harbours has not kept pace with national income. Expenditure on water schemes does not seem excessive compared with pre-war.

Although the International Bank has commented adversely on the planning of public works in Australia, and the matter was again raised at the recent Sterling Area Conference, the cynic may be
pardoned for wondering whether the States will abandon their "parish pump" politics for a logical national programme of priorities.

To sum up, reductions in government expenditure of the really spectacular variety are outside the realm of practicability. The public demand for social services and benefits seems to be insatiable. A careful watch should be maintained on the costs of proposed health schemes; such palpably vote-catching measures as marriage loans should be resisted; but no drastic policy changes can be anticipated in the field of social services. The trend will in all probability be toward expansion rather than restriction. Even were the planning functions of the Commonwealth Government reduced, and some of the newer government departments scrapped, the economies achieved—while important in themselves—would be Lilliputian when measured against the giant proportions of the total government budget.

Any great curtailment of defence expenditure cannot be expected while international tension continues. Public works, it is true, offer real scope for the economies to be achieved through better planning and management. But governments have come to regard large-scale expenditures on public works as essential to full employment, and there are also the new aspirations for national development which command almost universal support.

Since the political obstacles in the way of dramatic cuts in government expenditure appear almost insurmountable, the conclusion must be that an "incentive budget" will have to concentrate mainly on revising tax policies and on redistributing the tax burden. The guiding consideration must be to reduce the burden of taxation at the points where it presses most severely on enterprise and savings—the two vital lubricants of the economy—mechanism at present in short supply. The chief offenders in this regard are the excessive rates of personal income tax and company tax. But, if relief is to be afforded at these points, the impossibility of wholesale reductions in indirect taxation must be frankly confronted. Those who argue most vociferously about the need for slashing indirect taxes would quickly lower their voices if they were told that the consequences of this would be an increase in their personal tax. It is difficult to see how we can have both. If income tax—both personal and company—is to be reduced on any worthwhile scale, then the revenue from indirect tax must be at least maintained, and probably increased. Since indirect taxes have a comparatively small influence on the willingness to work and on enterprise, the conclusion is inescapable that, in general, an "incentive budget" should concentrate mainly on reducing the burden of income tax. There is also the important consideration that indirect taxes today comprise only a slightly higher proportion of total national income than before the war, and that other countries, notably Canada (with an unrivalled record in post-war development) place much greater reliance on this form of taxation than Australia.

Taxation of Companies.

Company taxes, as a percentage of the national income, rose from 2% in 1938 to 4% in 1947/8. They are now at about 5%. Of each £ of profit, companies must now pay over to the Government about 9/- compared with less than 4/- before the war. When departmental disallowances of deductions are taken into account, the impost is in many cases over 10/- of the £ of real as distinct from taxable profit. In turn, shareholders must pay taxes on their dividends ranging from about 5/- in the £ for the typical income earner with a modest portfolio of share
over 15/- in the £ for the large investor with income from other sources which puts him in the heavy tax range. Before the war dividends were not doubly taxed*.

The argument against taxes of these proportions is that they reduce the incentive to industrial expansion, and what is equally important they starve industry of the financial resources which will enable it to expand. In particular they bear heavily on the young company with prospects of rapid growth, but in which the element of risk is greater. There is less profit to plough back into the business, whilst the investor, subject to heavy tax on his earnings, is likely to invest diminished savings with greater caution in well-established enterprises. The economic argument against heavy company taxation has always been strong; today, when there is an acute scarcity of savings, it becomes stronger than ever.

Inadequate depreciation allowances are also a sore point with companies, and indeed any business today. Existing allowances for depreciation have become unreal in view of current costs of replacing buildings, plant and equipment. More liberal depreciation provisions and a reduction in taxes on profits would do much to rejuvenate the risk capital market, for companies and their shareholders are by far the largest source of savings for new investment.

Individual Income Taxes.

Personal income taxes have increased from 3.3% of the national income in 1938/9 to about 11% for the current financial year. Most of this very steep rise has fallen on the middle and upper income earners. In the latest year for which figures are available, the top 15% of taxpayers provided about three-quarters of the total revenue from income tax collections.

Both the present Federal Government and its predecessor have emphasised that the burden of tax on the ordinary wage-earner with a family compares more than favourably with other English-speaking countries. A wage earner on £15 per week (approximate average weekly wage of male factory worker) with a wife and child pays less than 1/- per week tax or about 1/- in the £. On the other hand, taxes on each extra £ of income earned by the higher income earners range from 8/6 at £2,000 to 15/- at £10,000. This may be effective in the matter of winning votes, but it imposes a deadening burden on enterprise.

Carried beyond a certain point, steeply progressive taxation defeats its own ends by reducing the total pool of wealth available to improve the lot of the under-dog and the low income earner. By weakening incentives high taxation cuts into pioneering investment that makes more jobs—and makes them more productive. The wage-earner has much to gain from lower taxes on those who open up new avenues of employment. If the taxes paid by most farmers are so high that they prefer to sit on the front porch rather than to grow more wheat or wool or employ migrants to develop their holdings, then the community is clearly worse off as a result of its high tax policy. Powerful motives are needed to encourage men to change from a secure position to one with chances of brilliant success or total failure, or to induce an investor to risk his savings in the development of new products, processes or services. Very high marginal taxes reduce the force of these motives.

There is no way of telling at what rate of marginal tax (i.e., the tax on each extra

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* Pre-war, dividends were exempt from State income tax and for Federal tax a rebate (at the shareholders' rate of tax on property incomes, or at the company rate, whichever was the less) was allowed to shareholders in respect of dividends distributed by companies.
£ of income) the danger point is reached, but a practical commonsense assumption might place it at around 10/- in the £. Under the present rates of tax, this point is reached at about an income of £2,800. At £10,000 the marginal tax becomes 15/-. The latest income year for which statistics are available, 1949/50, reveals that 34,000 people earned over £3,000 per annum and paid £70 million in taxes. This figure today might be well over £100 million. If the rate of marginal tax were limited to 10/-, the tonic effect on farm production and business enterprise would far outweigh any direct embarrassment that might be caused to the national finances. Actually, in the long run, the increase in incomes might yield a large part of the tax forgone, even at the lower rates levied.

At the time of the introduction of the last Federal Budget, revenue from personal income tax and company tax was estimated at £550 million. It seems now that actual collections will be somewhat higher. An "incentive budget" that means anything would have to contemplate a reduction in revenue from these sources of, say, £100 million. This figure is, of course, no more than a rough guess, but it can be taken in order to indicate with some definitly the broad proportions of the problem. Possibly well over half this loss in revenue would be incurred by smoothing out the income tax scale so that the marginal rate of tax of 10/- was reached at £10,000 instead of at £2,800 as at present. The remainder would arise from reductions in public company tax to an average of, say, 7/- in the £, an equivalent cut in taxes on private companies, and a liberalised system of depreciation allowances.

In the first place any economies in government expenditure should be applied to reduce the need for Treasury Bill finance, which, in the current year, will be uncomfortably high. This would mean that extra revenue from other sources would have to be found to compensate for the loss by reason of income and company tax concessions.

The reduction of income tax would leave members of the public and industrial companies with additional funds and it is reasonable to expect that some of this money will find its way into the government bond market. This, combined with the prospect of improving economic conditions and greater financial liquidity, should mean a much stronger market for loan monies than in the current year. There is no doubt that one of the main reasons for the weakness of the market over the past twelve months has been the heavy exactions on the public imposed by income taxes.

What other sources of additional funds can be tapped?

An increase in revenue from custom duty will undoubtedly follow the easing of import restrictions, recently announced. The great part of the balance would have to be found in the field of sales tax. A present less than one-third of sales are subject to sales tax. An important addition to revenue would be obtained by reducing the number of exempt items and imposing a nominal rate of, say, 5%. This admittedly, would be politically unpopular and would have certain undesirable features. But if there is to be any worthwhile while cuts in the income tax field—and any "incentive budget" demands that cut be made and that they be worthwhile—there seems no escape from obtaining more revenue from indirect taxation.

The U.S. Committee for Economic Development, a group of progressively minded American business men possessing direct links with the new Eisen
hower administration, in a report on Tax and Expenditure Policy prepared last year for the guidance of the American Government, recommended a wider spread of sales tax as less inflationary and less injurious to production than any other alternative.

Of course, no doubt most of us would like to see all taxes reduced—direct and indirect. But we are faced with the dilemma that if decisive reductions are to be made in income taxes, then revenue from indirect taxation will have to be maintained—possibly even increased. Token concessions over the field would achieve no effective economic purpose and would please no one.

* * * *

**TABLE I.—COMBINED EXPENDITURES OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3.**

<table>
<thead>
<tr>
<th></th>
<th>1938/9</th>
<th>1947/8</th>
<th>1948/9</th>
<th>1949/50</th>
<th>1950/1</th>
<th>1951/2</th>
<th>1952/3</th>
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<tr>
<td></td>
<td>£m.</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Benefits</td>
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<td>87</td>
<td>104</td>
<td>116</td>
<td>143</td>
<td>172</td>
<td>200</td>
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<td>Education, Health, etc.</td>
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<td>68</td>
<td>73</td>
<td>89</td>
<td>105</td>
<td>126</td>
<td>140</td>
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<td>54</td>
<td>155</td>
<td>177</td>
<td>205</td>
<td>248</td>
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<td>340</td>
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<td>57</td>
<td>64</td>
<td>75</td>
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<td>23</td>
<td>40</td>
<td>53</td>
<td>98</td>
<td>165</td>
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<td>99</td>
<td>136</td>
<td>204</td>
<td>293</td>
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<td>All Other</td>
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<td>48</td>
<td>40</td>
<td>104</td>
<td>38</td>
<td>35</td>
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<tr>
<td></td>
<td>218</td>
<td>505</td>
<td>576</td>
<td>700</td>
<td>966</td>
<td>1139</td>
<td>1210</td>
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**TABLE II.—COMBINED RECEIPTS OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3 AS A PERCENTAGE OF NATIONAL INCOME.**

<table>
<thead>
<tr>
<th></th>
<th>1938/9</th>
<th>1947/8</th>
<th>1948/9</th>
<th>1949/50</th>
<th>1950/1</th>
<th>1951/2</th>
<th>1952/3</th>
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<tbody>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Indirect Taxes</td>
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<td>12.8</td>
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<td>Direct Taxes</td>
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<tr>
<td>Income Tax on Companies</td>
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<td>Death Duties, etc</td>
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<td>0.7</td>
<td>0.6</td>
<td>0.9</td>
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<td>Total Direct Taxes</td>
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<td>12.9</td>
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<td>1.3</td>
<td>1.0</td>
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<td>Increased Debt</td>
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<td>0.3</td>
<td>4.0</td>
<td>4.1</td>
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<tr>
<td>TOTAL</td>
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<td>28.8</td>
<td>29.7</td>
<td>30.5</td>
<td>31.0</td>
<td>35.2</td>
<td>35.0</td>
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</table>

### TABLE III.—COMBINED RECEIPTS OF AUSTRALIAN GOVERNMENTS 1938/9 TO 1952/3.

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<th>1938/9</th>
<th>1947/8</th>
<th>1948/9</th>
<th>1949/50</th>
<th>1950/1</th>
<th>1951/2 (Estimate)</th>
<th>1952/3</th>
<th>£m.</th>
<th>£m.</th>
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<tbody>
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<td>Customs</td>
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<tr>
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<td>12</td>
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<td><strong>Total Indirect Taxes</strong></td>
<td>93</td>
<td>225</td>
<td>248</td>
<td>282</td>
<td>335</td>
<td>448</td>
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<td><strong>Direct Taxes</strong></td>
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<tr>
<td>Company Income Taxes</td>
<td>16</td>
<td>71</td>
<td>74</td>
<td>85</td>
<td>101</td>
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<td>Personal Income Taxes</td>
<td>26</td>
<td>163</td>
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<tr>
<td>Death Duties, etc.</td>
<td>7</td>
<td>13</td>
<td>15</td>
<td>17</td>
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<tr>
<td><strong>Total Direct Taxes</strong></td>
<td>49</td>
<td>247</td>
<td>288</td>
<td>297</td>
<td>472</td>
<td>575</td>
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<tr>
<td>Interest, Business</td>
<td>44</td>
<td>42</td>
<td>33</td>
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<tr>
<td>Profits, etc.</td>
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<td><strong>Increased Debt</strong></td>
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<td>16</td>
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<tr>
<td>Loans, Local*</td>
<td>3</td>
<td>-10</td>
<td>-14</td>
<td>-30</td>
<td>-16</td>
<td>21</td>
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<tr>
<td>Treasury Bills</td>
<td>32</td>
<td>-9</td>
<td>7</td>
<td>91</td>
<td>128</td>
<td>80</td>
<td>109†</td>
<td></td>
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<tr>
<td><strong>Total Increased Debt</strong></td>
<td>218</td>
<td>505</td>
<td>576</td>
<td>700</td>
<td>966</td>
<td>1139</td>
<td>1210</td>
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Source: National Income Estimates and other publications by the Commonwealth Statistician.

*Proceeds of loan raisings less purchases of bonds, etc., on the open market and debt redeemed.

†Of this amount the Commonwealth Government has agreed to advance up to £135m. from Central Bank credit and its own resources towards the State Governments' loan works programmes.
APPENDIX

ONCE upon a time, economists used to devote a great deal of attention to the basic principles that should govern a good tax system—the comparative merits of particular taxes, the taxable capacity of a nation, the final incidence (i.e. who really pays the taxes) and so on. We had Sir Josiah Stamp’s classic: “Principles of Taxation” and studies of such outstanding merit as Hugh Dalton’s: “Public Finance.” It is paradoxical that, today, when taxes have reached unexampled heights, and when the application of sound principles has assumed infinitely greater importance, the problems of taxation receive so little fundamental thought.

Just before the close of World War II, the I.P.A., realising that in the post-war period taxation would become a major influence on the health of the economy, carried out a careful study of this problem with the help of tax experts, accountants, and businessmen. This study was published in August, 1945, under the title of “Taxation in the Post-War Years”. We believe that many of the conclusions reached as a result of that work are especially relevant to the present high tax conditions, and are worth repetition:

Pre-War a Mouse!
“We are forced to recognise that the magnitude of taxation in the future will be vastly greater than ever before in our peacetime economic history. So will its spread. Taxation will extend to every corner of the economic structure; it will influence directly every business decision and enterprise; it will enter into practically every economic calculation as a factor of major importance. From being a comparative mouse in the pre-war economy, it will be, if not a giant after the war—and that is possible—at least something to be reckoned with at every step. The very size of post-war taxation calls for a new approach and a more intensive examination of its relation to the whole economic problem.”

There is a crucial limit!
“Taxation above a certain limit must inevitably tend to dry up the source from which it is drawn. The crucial problem of post-war taxation policy in Australia will be to find this limit, and for economic statesmanship to see that it is not exceeded. Nothing could be more disastrous to the economy of the country and the standards of the people than a diminution of the total national production. With taxation at pre-war levels, the effects on production were possibly negligible; but with taxation at the high mark which is probable after the war, the most rigorous attention will need to be paid to economic incentives and to the financial resources left in the hands of industry for expanding and improving the efficiency of its plant and equipment.”

A Nation can tax itself out of Prosperity!
“The ultimate source of all taxation and of all state-sponsored services is personal endeavour. High taxation must inevitably tend to weaken this endeavour and therefore to destroy the source of its own creation. It is impossible for a nation to tax itself into prosperity. It is entirely possible for a nation to tax itself out of prosperity. To the wealthy, vigorous, producing country, all things concerned with the material, and indeed spiritual, welfare of its people are possible. To a poor country, struggling under a load of tax exaction too heavy for it to bear, social welfare must remain at a standstill.”

Goal is High Production!
“Taxation is itself one of those factors which affect the level of production and the degree of efficiency attained in the use of resources. Even
though government commitments may make un-
avoidable the raising of a definite sum of money
by taxation, it is still important to ask how the
necessary taxes can best be distributed and
levied in the light of the goal of high produc-
tion."

Stagnation or High Ambition!

"An equalitarian society, that is one in which
men are rewarded primarily according to their
needs, and not according to their skill and efforts
and achievements, will be a stagnant, dormant
society with death at the heart. The tremendous
industrial and scientific gains of the past cen-
tury will be dwarfed by those of the next so
long as we keep the pathways to the satisfaction
of high ambition clear and broad.

Guardian of the Public Interest!

"Whether the business man will decide on a
high, or a low, level of activity in his particular
enterprise will be determined by a complexity of
factors, of which the magnitude and kind of
the taxes the business will be called upon to
bear are by no means the least important. Here
Australian governments have a clear responsi-
bility. In their capacity as guardians of the
public interest, they must endeavour to create
conditions which will stimulate the business man
to the utmost enterprise and efficiency. In the
past governments have paid comparatively little
attention to the effects of company taxation on
business enterprise. They have looked at it
more as a convenient means of amassing revenue
to meet their own expenditure. This approach
will not be good enough for the future—more
especially in view of the higher peacetime taxes
to which company income will almost certainly
be subjected."

Inroads on Resources!

"There is no question that heavy taxation of
company income must exercise some restraining
influence on business and tend to slow up the
rate of economic expansion. This is due less
to the loss of incentive because of the smaller
prospective profit—although in the case of the
riskier forms of investment this is a material
factor—than to the inroads made on the financial
resources of the business, and thus on its capac-
ity to expand and to keep its plant and equip-
ment up-to-date."
THE BANKING LEGISLATION

The banking legislation introduced to Parliament by the Prime Minister on the 19th February, represents another episode in the controversial story of the evolution of the structure of the Commonwealth Bank and of the relationships between the Central Bank and the trading banks—a story that may not yet be complete. To appreciate the meaning of the legislation it must be viewed in the perspective of recent history.

Since the early years of World War II, the legal changes have been bewilderingly rapid. The impact of the war brought about far-reaching alterations to Australian banking methods. The need for controlling the inflationary potential of war finance and of directing financial resources into channels concerned with the effective prosecution of the war led the Commonwealth Government to invest the Central Bank (by means of National Security Regulations) with extensive powers of control over trading bank finances. The most important of these powers was the system of Special Accounts introduced in 1941. This system provided that increases in the assets of the trading banks above a stipulated base date would be deposited with the Commonwealth Bank. These assets could not be used by the trading banks for expanding their advances and thus adding to the inevitable inflationary pressure associated with huge government spending for war purposes. Other important features of the regulations were the direct control by the Central Bank over the purposes for which trading bank advances could be made and over all foreign exchange transactions, and the strict limitation of the extent of trading bank investments in government securities.

In August, 1945, the Labour Government introduced the 1945 Banking Act to give more or less permanent legislative validity to the war-time banking controls. For example, in the case of the Special Accounts, the Act empowered the Commonwealth Bank to require a trading bank to lodge to Special Account the whole of the increase in its assets since the 28th August, 1945. It also required the trading banks to lodge in Special Account the amount standing to the credit of that account at the time of the commencement of the Act.
At the same time the Government introduced the Commonwealth Bank Act 1945 which involved radical changes in the structure of the Central Bank itself. The Bank Board established in 1924 was abolished, the Bank was placed under the sole immediate authority of the Governor of the Bank, and the Governor himself was made subject to the Commonwealth Treasurer in the event of a difference of opinion on policy. Both the Acts were hotly contested by the Opposition parties and the then leader of the Opposition, Mr. R. G. Menzies, pledged that on return to office he would restore board control of the Commonwealth Bank, free from political interference. *This he proceeded to do in the Commonwealth Bank Act of 1951.*

**BUT**, in the meantime, the historic attempt to nationalise the trading banks had been made by the Chifley Government through the Banking Act of 1947 amid circumstances of violent controversy. The Constitution saved the banks. The Act was declared invalid in August, 1948, and the Menzies Government was returned to office in December, 1949, a result undoubtedly strongly influenced by the public’s fear and distaste of a nationalised banking system.

The verdict of the Privy Council and the restoration of the principle of board control of the Commonwealth Bank did not, however, set at rest the fears of financial institutions and of important sections of the public regarding the framework of banking legislation. It was still felt that certain provisions, especially those relating to the Special Accounts System, constituted a severe encroachment on the principle of free enterprise in the banking field and went far further than was necessary to secure effective control of monetary policy by the Commonwealth Bank. There was the danger that the legislation, so far as the control provisions were concerned and also that relating to the structure of the Commonwealth Bank, could be used to promote and to expand the trading bank section of the Central Bank at the expense of the private banks, and in the long term to bring about virtual nationalisation of the banking system. *It was pointed out that the Commonwealth Bank was able to compete for ordinary banking business under conditions grossly unfair to the private*
banks since the trading section of the Commonwealth Bank was not subject to the same Central Bank controls, such as the Special Accounts System, as applied to the private banks.

THE new legislation attempts to remove the grounds of these criticisms and at the same time to maintain effective control of national monetary policy through the Central Bank.

It consists of two Bills, one to amend the existing Commonwealth Bank Act; the other to amend the 1945 Banking Act. The main feature of the first is that it establishes the trading section of the Commonwealth Bank as a separate corporate entity (the Commonwealth Trading Bank of Australia) with its own management, subject, however, to the direction of the Board and Governor of the Commonwealth Bank. The present statutory obligation of the Commonwealth Bank to expand the business of the General Banking Division is retained, but applied to the new Commonwealth Trading Bank. However, the new bank is obliged to conform with the main control provisions applicable to the private banks; such as the lodgment to Special Account, advance policy, and so on.

In the new Banking Bill, the Special Accounts procedure for the quantitative control of bank trading is retained but defined limits are placed on the amounts which can be called up by the Central Bank—the maximum amount is placed at the balances in Special Account existing at October 10, 1952 (totalling £171 million) plus 75% of any increase in deposits from September, 1952. This contrasts with the existing provision whereby the banks can be required to lodge the whole of their increase in assets since the 28th August, 1945, in Special Account. This has meant that the banks have had hanging over their heads a virtual Sword of Damocles, in that at any time they have a huge uncalled liability (amounting at the time of writing to around £500,000,000), which could conceivably be used to their grave financial embarrassment should the Government or the Commonwealth Bank feel disposed to apply the law in arbitrary fashion. This liability is specifically wiped out under the new legislation. The un-
called liability of each bank would under the new Act be adjusted each year so as not to exceed 10% of its average deposits. There are other provisions designed to provide additional protection for the trading banks in the matter of their prospective liabilities on Special Account.

* * * * *

WHAT can be said in praise or criticism of this legislation?

This is not the place to weigh minutely the merits and demerits of the various provisions it embodies. But a few general observations may be of interest.

The broad intention of the Bills is to give effective protection to the Trading Banks against arbitrary and hostile misuse of powers resident in the existing statutes, and at the same time to ensure that the Central Bank is maintained in a position where it is able to control monetary policy in the best national interest. It has been pointed out that it would be relatively simple for another Government to revert to the old arrangements, and that this might have been much more difficult had the General Banking Division of the Commonwealth Bank been established as an entirely separate institution outside the jurisdiction of the Board and Governor of the Central Bank.

APART from that, there is strong precedent in the practice of other English-speaking nations for a central banking institution divorced entirely from any trading activities. This is the position in the United States, Canada, and New Zealand, while the Bank of England engages in trading activities only to a very limited extent. This practice has clear-cut technical and psychological advantages. It allows the Central Bank authorities to concentrate wholly on the all-important problems of central banking, free from other distractions. Moreover it is calculated to produce a degree of confidence and co-operation between the Central Bank and the private banks greater than that which is feasible where the Central Bank authorities are also concerned with the business of trading. Political and historical, as well as technical considerations, however must be brought into account. Whether the
present moment is politically expedient for such a major break with tradition is a matter on which opinions will differ. Certainly, eighteen months ago the Government might have felt more disposed to embark on the bolder course.

From the strict technical point of view the proposed Special Account procedure may also be open to criticism. For instance, it has been claimed that a general overall control of bank resources would be fairer and automatically more impartial in application than control on an individual bank basis. While the possibility of discrimination between different banks is retained in the new legislation, the legislation would nevertheless seem to make possible the treatment of all banks on a broadly uniform basis, and it is to be hoped that the Act will be administered with this in mind. The general form of control is customary in most other central banking systems. For instance, those of the United States, Canada, and New Zealand operate on the principle of compulsory minimum deposits (representing a defined percentage of total deposits common to each bank) lodged with the central institution. The Australian economy, however, is peculiarly subject to wide fluctuations because of its close dependence on a notoriously unstable export income, and a case might be made out for somewhat stronger methods of control.

* * * *

WHATEVER might be said in criticism, the new legislation represents a step in the right direction. Despite differences from time to time with the trading banks, the Commonwealth Bank appears to have applied the powers provided under the old legislation with reasonable moderation and fairness. Nevertheless these powers are so wide as to be capable of serious abuse and misuse by a government hostile to the trading banks. There is, therefore, no good reason why they should be permitted to remain. The new legislation is an honest, if not in every respect satisfactory, attempt to bring about (in the Prime Minister's words), "... a just and proper reconciliation between the powers and functions of the Commonwealth Bank and an appropriate measure of protection to the trading banks".
SOCIALISM — WHAT NOW?

The meaning of socialism has never been perfectly clear. Certainly the attempts at precise definition—framed of necessity in abstract jargon—have usually concealed more than they have revealed. To different people socialism has conveyed different things. To the popular mind it seems to have meant little more than virtual overall nationalisation; to the intellectual it probably meant, in the main, the deliberate planning of economic processes, of supply, demand, employment and prices, by the state; to the social moralist, the equalising of wealth, income and opportunity; to the businessman, the annihilation of free enterprise. Even socialist thinkers themselves have embraced widely diverse brands of the common faith.

But, at the present time, the meaning and ultimate purpose have become more obscure than ever. For traditional socialism seems to have reached the end of the road and nothing concrete has yet been constructed to take its place. The intellectuals of the movement are busily engaged in searching for a new middle-20th century expression of socialist doctrine. Even the socialist practitioners—politicians, for instance, of the Labour Parties in Britain and Australia—are in complete confusion about their aims. Having run dry of constructive ideas, their role has become destructively critical. Only the extreme left-wingers—the Bevanites in Britain and the "Eddie Wards" in Australia—still cling obstinately to the old dogmas of the class war and public ownership. And while it would be dangerous to discount the influence of these sections on the policies of their parties, particularly if the economic weather should become stormy, they are in a minority at the moment.

In the socialist camp all is confusion.* Uncertainty and disillusionment prevail where, not long ago, everything was apparently divinely and comfortably simple and straight-forward. Socialism no longer offers to its adherents a clear-cut political programme, a definite set of objectives, and an unquestioning faith.

What accounts for the transformation?

The socialist forces are now confronted with a position which all political parties based on a more or less rigid philosophy reach at some time or other. The traditional ideas outlive their usefulness. They cease to be relevant. The facts of the political world pass them by. The old familiar catchcries no longer arouse any enthusiasm among the voting masses. Their political programmes, in the words of the popular song, become pushed just about as far as they can go, and the lines of the next advance cannot be clearly discerned. Something new and fresh in political doctrine and policy is needed. What shall it be? A lot of hard, fundamental thought and a great deal of painful soul-searching is unavoidable. The socialists today seem to be in the same unenviable plight as were the anti-socialists ten years earlier, in the closing years of World War II.

Nationalisation, once a central socialist idea, and the one that aroused the most enthusiasm, has been tried on a large scale in England and Australia and found wanting. The early socialists believed that the substitution of public ownership for private profit-making would solve all problems. It would lead to greater efficiency; it would solve the problems of labour relations; it would give the workers a real sense of participation in in-

*We are referring, of course, to long-run doctrine.
The socialist aim of equalising incomes has been realised in both Britain and Australia. Indeed it is impossible for any fair-minded person to see how it can be pursued further without entirely destroying the inadequate incentives to progressive enterprise that are all that now remain in Britain and Australia.

Experience has shown that it does none of these things. The large experiments in nationalisation introduced by the British Labour Government since 1945 have been anything but an unqualified success. They have created a whole host of difficulties that were not foreseen at the time of their introduction. They have not been notably efficient. In fact, a recent article in "The Economist" stated that: "The lesson of the past six years is that, in itself, it (i.e., nationalisation) promotes inefficiency." The labour relations of the nationalised industries have stubbornly refused to comply with the happy state predicted in the socialist textbooks. (In Australia most of the big strikes since the end of the war have occurred in the publicly-owned utilities.) Top management has proved to be even more inaccessible and remote and unknown to the large body of workers than in the big private concern. Large-scale, indiscriminate nationalisation no longer commands strong support among the voting public; nor, indeed, does it light the fires of enthusiasm in the socialist camp itself.

Traditional socialism stood for the "planned economy". But the economies of England and Australia and of free enterprise America are now consciously guided by governments towards the objectives of economic stability, full employment and "fair shares".

The socialist aim of equalising incomes has been realised in both Britain and Australia. Indeed it is impossible for any fair-minded person to see how it can be pursued further without entirely destroying the inadequate incentives to progressive enterprise that are all that now remain in Britain and Australia.

Traditional socialism called for the establishment of a National Minimum—a basic standard of living to which all citizens were entitled as a right. Through the large-scale extension of social benefits and services in the postwar years (by no means all of which were the products of socialist governments—for instance, child endowment in Australia), a practicable minimum has now been secured.

In short, many of the key objectives of socialism are now part and parcel of the modern economic and social order. Others, such as nationalisation, have brought doubts and often disillusionment and no longer command wide public support. On the face of it there is not much left for traditional socialism to do.

Much of this is recognised in a remarkable book, "Socialism: A New Statement of Principles", recently published in London. The book is the joint product of leading socialist thinkers, and its basic ideas receive the endorsement of Labour politicians of the standing of Mr. Attlee and Mr. Jim Griffiths, and of Mr. Morgan Phillips, the Secretary of the National Executive Committee of the Labour Party. Gone is the old uncompromising certainty and dogmatism and much of the fervour of the early, and even of some of the postwar, socialist textbooks. "Reforms which were once a vision are now reality. Measures once advocated only on propaganda platforms ... are now proud features of our national life. But despite our successes—or perhaps because of them—we are conscious that the society we hoped to build still eludes us." (Perhaps it was always an illusion!) "The easy confidence of the past is gone and our way forward is beset with uncertainty. It is not only that we hesitate whether this or that measure should feature in the next election pro-
gramme. We are reconsidering the very fundamentals of our faith."

Here the uncertainty and the doubts—one might almost say the wavering faith—of the modern socialist in his own, once passionately-held, creed are frankly admitted. Nationalisation, as a central article of faith, is repudiated and its limitations recognised. "It does not, by itself, remove from those employed as manual workers the feeling of being on 'the other side'. . . . Many of the benefits which were expected naturally to flow are not attained unless further action is taken. The recognition of this new problem has called forth a new slogan: 'Nationalisation is not socialisation'. This slogan is as good an indication as any of the mood of our times. It expresses the uncertainty that reigns concerning the form of organisation really desired."

And what of the socialist's traditional belief in state control and planning? Again there follows something which comes perilously close to the toppling of another key pillar of the socialist faith. "Their earlier beliefs usually led socialists to struggle for an increase in the powers of the state. Today we are less certain. Do we want more or less state action in the social services? . . . . we are all becoming aware that the concentration of economic and political power in the same hands may be a threat to the freedom and independence of the individual." The socialist has taken an uncommonly long time to wake up to this danger. It has been apparent to, and feared by, the non-socialist for some decades. "His (i.e., the individual's) very existence becomes more and more dependent upon forces which, by their nature, are inclined to sacrifice him for the sake of the 'collective good'." No! this is not Professor Hayek or some other apostle of the Right.

Not the least astonishing part of this book is its deep concern with the threat of "the centralisation of power, the spreading intervention of the state" to the integrity of the individual. These new tendencies, it affirms, are "as much a challenge in their own way as capitalist exploitation". Apparently the bureaucrat, the expert, the state controller, once much beloved of the socialist, is replacing the old-time capitalist as the "big bad wolf" in socialist doctrine. A transformation indeed!

The inescapable need, under today's circumstances, for higher productivity calls for a further drastic realignment in socialist thought. "In the past socialists were concerned mainly with the distribution of income. . . . Since 1945 they have been compelled to preach the need for greater output. . . . The leadership has had to wage a battle against the conservative elements in the ranks who still find it difficult to grasp that it is no longer sufficient to 'soak the rich'."

Cold water is thrown on the doctrine of the class struggle. (Over goes another pillar of the faith.) The book recognises that there are good and bad in all classes and members of the privileged classes have played an important part in the struggle for a better society. "Classes cannot be divided into sheep and goats. Even if they could, to pit class against class in the end leads to a naked struggle for power and advantage, destroying the very values which socialists most wish to uphold."

But the most surprising thing of all is yet to come. There is really, we are told, no final state of society which can be labelled "socialism." "There is no accepted institutional blueprint called 'socialism'." The socialist system is a myth. The essence of socialism lies in ideals, and these ideals cannot be realised by changes in institutions, but only by changes in human attitudes and relationships.
ONE would never have thought to have seen the day when a group of influential socialists would virtually demolish one by one the main articles of their traditional faith—the dogma of the class struggle, the panacea of nationalisation, the centralisation of power in the state, the establishment of the ultimate, inevitable Socialist Commonwealth.

All this must have been exceedingly hard for socialists to think, and harder still to proclaim. It is to the strong credit, therefore, of the authors of the booklet that they have been able to break the fetters of the old ways of thought and to state in frank and courageous terms, for the edification of politicians and the rank-and-file supporters of the movement, the need for a completely fresh approach.

This is a profoundly important book. It does not solve the problem confronting the socialist political parties for a new political platform relevant to the requirements imposed by modern social and economic conditions. But it does accomplish the necessary preliminary task of preparing the ground. It clears away a lot of the useless mumbo-jumbo, many of the outworn prejudices and dogmas which have cluttered up and befogged the minds of dyed-in-the-wool socialists and prevented them from seeing clearly the real problems with which the modern economy has to contend. The recent conferences of the Labour parties in Britain and Australia and recent utterances of their leaders reveal that they are almost bankrupt in the matter of realistic policy. Perhaps this book will be a first step towards making them solvent. Certainly all true democrats will hope so.

BUT, in the meantime, the now discredited dogmas of traditional socialism—discredited, as we have seen, even among leading intellectuals of the movement itself—may continue to offer a threat to economic sanity and to efficiency, enterprise and freedom in economic affairs. For the present therefore, it would be dangerous to regard old-time socialism as a spent force.
REE ENTERPRISE FILMS

The Institute is building up a small collection of 16 mm. sound films, which will be made available free-of-charge to interested people on request.

The following films are available at present:

"Can We Be Rich?"—The basic theme of this excellent British film is productivity, the commentary being provided by Mr. Geoffrey Crowther, Editor of the renowned English journal "The Economist".

"Money at Work"—The story of millions of American investors whose savings built U.S. Industry and made possible the world’s highest standard of living. (A gift of the New York Stock Exchange)

"Over to You"—An account of a recent visit to U.S.A. of a Productivity Team representing the British Hosiery industry.

"Productivity — Key to Plenty"—This film shows that rising output per man-hour in U.S.A. has been largely achieved by increased use of mechanical power and that productivity accounts for the high standard of living in U.S.A.

"The Eternal Forest"—The story of the wise use of forestry resources. The film shows how Australian Paper Manufacturers Ltd. are conserving a national asset and are also planting for the future. (A gift of Australian Paper Manufacturers Ltd)

"The Tree of Life"—An account of Unilever’s achievements in the field of native administration and in the production of palm oil and soap in the Belgian Congo. (A gift of Lever Associated Enterprises Pty. Ltd)

"What Makes Us Tick"—This is a colour film in cartoon form. It is designed to show the average American, in a simple way, how the New York Stock Exchange operates. (On long term loan from the New York Stock Exchange)

The I.P.A. intends to add other suitable films which tell a story of industrial achievement, make some contribution towards the wider understanding of the part played by free enterprise in the economy, or contribute in some other way towards better economic knowledge. The Institute would be pleased to hear from companies which have films of this kind that might be included in our film library.

The Institute desires to advise readers that the firm of Moviesound, Motion Picture Engineers and Exhibitors, have been appointed official film projectionists for the I.P.A. Moviesound is fully equipped for the projection of all 16 mm. films. Its facilities include a mobile screening unit and a range of entertainment films which are available for staff amenity screenings, etc.

Further particulars regarding these services may be had on application to—

MOVIESOUND
43 Hardware Street, MELBOURNE, C.1
Telephone: MU 1100
A CHANGING FEDERALISM

(By A Correspondent)

The Constitution bequeathed to us in 1900 owed much to the example of other federal states, and at this time when its framework is creaking ominously it may again be expedient to see what other countries have done in the interval. The three countries which, along with Australia, are treated by students of government as typical federations are the United States of America, Canada, and Switzerland, all with an experience of federalism considerably longer than our own. Although there is no universal recipe for good government, and political institutions cannot be transplanted holus-bolus from one country to another, federal systems face similar problems everywhere, and developments in these three countries may stimulate ideas for improving our own governmental structure.

In every modern state the balance of power has shifted decisively from local and regional authorities to the central government. In all federations, this takes the form of a weakening of the state or provincial governments in relation to the federal government. So it has been suggested that federations are obsolescent, and their conversion to unitary states inevitable. This view underrates the continuing importance of the reasons which were responsible for federal rather than unitary government in the first place. In Australia at least, the experience of a half-century suggests that we may expect to go on living under a federal system for many years.

Our basic political problem, then, is to find a more satisfactory set of relationships between the Commonwealth and State governments, that will bring the 19th-century Constitution into line with 20th-century realities, and yet do away with the present travesty of federalism whereby the States find themselves continually soliciting money from the Commonwealth while simultaneously snapping at the hand that feeds them.

Three principal courses of action suggest themselves for the readjustment of the federal framework. The first, and most radical, lies through the redistribution of functions between the Federal and State governments, entailing a transfer of legislative activities to the centre and the greatest possible decentralization of administration and executive responsibility with the States as component units. The second important change is the establishment of a satisfactory financial relationship, based on future as well as present needs, which will lift the States from their present financial morass. The third possibility is through the promotion of the greatest possible co-operation between the States, and between State and Federal bodies, on both the legislative and administrative levels.

REDISTRIBUTION OF FUNCTIONS

The necessity for revising the allocation of responsibilities between the central and regional governments has been recognized in the three federations of Switzerland, Canada and the United States. The best brains available have been employed to study the question, as in the United States Commission on the Organization of the Executive Branch (the Hoover Commission), and the 1937 Royal Commission on Dominion-Provincial Relations in Canada. As a result of the Commission's recommendations, (incorporated in a Report known as the Rowell-Sirois Report) responsibility for unemployment was taken over by the Canadian government in 1940.

Of the three countries, Switzerland has done most to transfer constitutional responsibilities to the central government.
The Federal Legislature consists of 2 chambers—the National Council and the Council of States. The National Council consists of 194 members—one for every 22,000 inhabitants, and is elected by proportional representation. The Council of States has only 44 members—two for every canton—and thus is more representative of the cantons. Both chambers have identical powers and duties and the consent of both is necessary before legislation can be enacted. In addition, there is the Federal Council of seven members responsible for the initiation and administration of government business in the same way as a cabinet, but unlike a cabinet, its members cannot be forced to resign. The seven members of the Federal Council constitute the seven heads of the seven State Departments, and are appointed by the two legislative bodies in light of their particular technical qualifications for their posts and not because of their attachment to any political party. They cannot be members of either of the two chambers.

The referendum is an essential part of the Swiss constitution. It prevents domination by any political party or by the legislature.

Between 1848 and 1952 there were ninety-two constitutional referenda, of which fifty were passed. In 1898, railways were nationalized. In 1908, water resources were transferred to the federal government. In 1921, all internal transport was placed under federal regulation. In 1912, a complete national civil code was approved by the Federal Assembly. The Confederation (as the federal authority is described in Swiss official documents) can order public works of national importance to be undertaken by cantons, or encourage them by subsidy, or prohibit them on the ground of security. It is entitled to expropriate land, with fair compensation, for this purpose. The constitution also fixes subsidies for cantons with international Alpine highways through them; these may be withheld if the Confederation is not satisfied with the canton's performance. Other roads and bridges of national importance are subject to federal control.

Constitutional changes have also enabled the establishment of a comprehensive system of social services, including compulsory insurance against old age. The federal government is empowered to enact uniform laws on child labour, working hours, and industrial health. It is expressly instructed by the constitution to grant subsidies to the cantons for education; it may create institutions of higher learning and subsidize others. (To date the only institution so established—in 1855—is the world-famous Technical Institute at Zurich.) The Confederation is also empowered to enact uniform standards for the profession.

In spite of the never-ceasing expansion of central government functions, the status and independence of the cantons remain unchanged, and they continue to be responsible for practically everything that takes place within their boundaries. The federal government and the Federal Assembly content themselves, on the whole, with enacting general standards for the whole country and with subsidizing the cantonal governments towards the execution of various phases of their work. In the sphere of education, for instance, the federal government is both obliged by the constitution to grant financial aid to the cantons and to observe their autonomy in the matter. Even where no such specific guarantee exists, the Confederation generally prefers to leave executive action to the cantons. All social service payments are made through the cantonal administration; in the case of unemployment relief, rates are fixed by the Confederation, and the final payment includes a contribution from the canton. Civil and criminal laws are enacted by the Federal Assembly,
be the administration of justice and penal institutions belongs to the cantons.

OBVIOUSLY, Switzerland is a very special case from which conclusions may be drawn only with great caution; but at least it suggests that this kind of relationship between federal and state governments is a practical possibility. In spite of centralization, a recognized division of functions has steadily grown by which the Confederation is responsible for all matters of genuinely national importance, whether in the fields of economic life, education, transport, public finance, social security, health, or justice. The cantons, on the other hand, have remained responsible even in these spheres for executive action within their own borders, leaving legislation as the major responsibility of the federal government.

INTERGOVERNMENTAL CO-OPERATION

Canada and the United States, especially the latter, provide illustrations of how much can be done to resolve the difficulties of divided jurisdiction inherent in any federal structure.

In the U.S.A., much attention has been given to co-operation between state governments. The central body which exists for this purpose is the Council of State Governments, set up in 1934. The Council acts as a clearing house for research and information on governmental problems; as a medium for improving legislative and administrative practices; and as a means for improving and facilitating federal-state and state-local relations. It provides the secretariat for a number of other bodies, most of them older than the Council itself, for example, the American Legislators' Association; the Governors' Conference; the Conference of Chief Justices; the National Associations of State Attorneys-General, of State Budget Officers, of State Purchasing Officers, etc.

The Council provides various forms of expert assistance for all officials of the forty-eight states. These include research projects referred to it by the state governments—for example, on conflicting taxation, financial policy, school systems, water resources, unemployment relief, federal-state relations, and state-local relations. Other activities are a general inquiry and information service; advice on the drafting of uniform state laws; assistance in drawing up interstate compacts; and increasingly in recent years, the organization of co-operation between the states and the Federal government. The Council publishes a monthly journal called "State Government," which is the only one of its kind in the world, a biennial volume "The Book of the States" covering all state matters, and books such as "Federal Grants-in-Aid" and "The 48 State School Systems."

The American Constitution permits the negotiation of interstate compacts with the approval of the U.S. Congress. About ninety of these compacts had been ratified up to 1950. Since 1934, compacts have generally been made through the Commissions on Interstate Co-operation which exist in each state, and which act as the liaison between the state government and the Council. A typical Commission is composed of ten members of the state legislature and five state officials. The Commissions have been active in negotiating agreements on interstate trade barriers; crime; oil conservation; wild life and fisheries; control of rivers and catchment areas; sewage disposal; road safety; marriage; uniform legislation; state boundaries; bridge and road construction; and education. In some cases permanent Commissions are set up to administer the agreement.
Since 1932, the Federal Government has played a steadily growing role in the field of intergovernmental co-operation. It was chiefly responsible for uniform laws on road safety, on narcotics, labour conditions, education, crime and parole.

The Social Security Board induced nearly all states to pass uniform legislation on unemployment insurance, by providing that so long as certain essential clauses were embodied in the state Act, residents of the state would be eligible for unemployment benefits. This was connected with the levying of state inheritance taxes; provided the state enacted unemployment, 80% of the state tax would be credited against Federal estate tax. Old age pensions, pensions for the blind, and aid for orphans were treated in a similar manner. By this means the Federal government was able to bring practically all states into line without rigid centralization or dictation. In 1950, the total of Federal grants-in-aid reached 2,500,000,000 dollars, covering health, housing, transport, conservation, agriculture, education, social security, and veterans’ benefits.

FINANCIAL RELATIONS

The crucial problem of every federal country today is that raised by the ever-growing disparity between the financial resources of the federal government and those of the regional governments. In every federation, the central government now provides a substantial part of state revenues. The country whose financial problems are closest to Australia’s is Canada, from whose experience we may learn much.

The 1937 Royal Commission recommended, first, the transfer of income tax, company tax and inheritance tax from the provinces to the Dominion Government; secondly, the taking over of provincial public debts; thirdly, the payment of subsidies (‘national adjustment grants’) to provinces in financial need; and finally, the taking over of responsibility for unemployment by the Dominion. Payment of subsidies was to be administered by a permanent Finance Commission.

Most of the recommendations sound familiar to an Australian ear, and the Report acknowledged the Royal Commission’s debt to the work of the Commonwealth Grants Commission.

A conference between the Dominion and the Provinces met in January, 1941, to consider the Report, but no agreement could be reached. In April of the same year the Dominion Government proposed that for the duration of the war and one year afterwards, the provinces should vacate the income tax field (including company tax), in return for reimbursements. The latter could be either the revenue collected by the province from this source in 1940, or the province’s annual debt payment for the same year, minus its revenue from inheritance taxes. A special grant based on financial need would also be paid if shown necessary. The provinces all accepted and signed agreements, four of them taking the second option.

Together with the other subsidies and grants normally paid in peacetime, the provinces thus received about one-third of their annual income in payments from the Federal government. In 1943 these totalled 140 million Canadian dollars.

At the end of the war, negotiations were resumed in an attempt to find a permanent basis for the retention of income tax by the Canadian Government. The two largest provinces, Ontario and Quebec, refused to co-operate, but all the others entered into individual five-year agreements with the Federal government during 1947, after almost two years of negotiation. As a result the Canadian provinces were able to obtain favourable terms after the war, whereas the Australian States were constrained to accept
an amount determined solely by the Commonwealth Government. Secondly, the Canadian 'escalator clause' is more generous to the provinces, and more cognizant to their needs, than the comparable provision in the Australian scheme. Finally, the Canadian provinces are permitted under the agreements to tax the profits of mining and lumber companies, as these are exploiting wasting assets for which compensation should be allowed.

It is true that the financial position of Canadian provinces is better than that of the Australian States. They are entitled to levy taxes on gasoline, on liquor, and on retail purchases (that is, sales tax). Consequently, they levied lower income taxes than most of our States. Moreover, railways, which are not the responsibility of the provinces, account for the greatest part of State indebtedness in Australia. In spite of these advantages, there is no doubt that the political wisdom manifested in the Canadian taxation agreements has been sadly lacking among Australian politicians. Mr. K. J. Binns, who investigated the Canadian System for the Tasmanian Government in 1947, observes:

"One must be impressed by the statesmanlike approach of the Dominion Government and also of certain of the provinces to the problems of Dominion-Provincial financial relations. The scheme evolved in Canada . . . recognizes the financial requirements both of the Dominion Government and also of the provinces, not only at the present time, but also as far as the future is concerned."

LESSONS FOR AUSTRALIA

It is true that Australia has also made progress in the directions illustrated by these three countries, and in some respects—notably the work of the Commonwealth Grants Commission and the Loan Council—has produced unique achievements. In spite of this, government and administration are in a state of crisis, and will continue to be so until federalism in Australia can be made to work on a genuinely co-operative and voluntary basis. Many of the necessary measures—rational distribution of revenue sources, development of regional self-government, re-allocation of constitutional powers, Commonwealth subsidies towards railways, administrative decentralization, etc.—have already been explored both on the official and unofficial levels. Federalism in Australia, as in other countries, can only survive so long as it is realized that the relative functions of Commonwealth, State and local authorities have radically changed and that only an equally radical revision of the political structure, unobscured by party slogans and parochial considerations, will meet the case.
The author of this article has a distinguished record in education, government and business. At the age of 33, he was appointed President of Trinity College, Connecticut. During the war, he served as Special Assistant to Donald M. Nelson, Chairman of the War Production Board. He became President of the New York Stock Exchange in 1951 and, on taking up this appointment, relinquished directorates in seven important companies, including General Foods Corporation and B. F. Goodrich Company.

G. KEITH FUNSTON

MR. FUNSTON has led a campaign to make the work of the Stock Exchange, and its indispensable function of mobilising the savings of millions of investors for use by American industry, better known to the American people.

If industry in Britain and Australia is to be adequately nourished with new risk capital in these days of heavy taxation, it will be compelled more and more to draw upon the savings of millions of small investors. It is most important, therefore, that the activities of the stock exchanges here and in Britain should be understood and appreciated by the great mass of the general public. For this reason the article which Mr. Funston has kindly sent to "Review" is especially relevant at the present time.
THE NEW YORK STOCK EXCHANGE
IN THE U.S. ECONOMY

By G. KEITH FUNSTON
President of the New York Stock Exchange

THE New York Stock Exchange is a market place for securities. It is a vast trading floor in a building at the corner of Broad and Wall Streets, New York City. It is the nation's largest organised securities market, where hundreds of Exchange member brokers daily buy and sell, for thousands of people, millions of dollars worth of shares of stocks and bonds of America's leading corporations.

Wall Street once was the political capital of the United States, just as it is the financial centre of the world today. Here the New York State Chamber of Commerce pressed the fight on the Stamp Act and the tax on tea. Here Washington took the first Presidential Oath of Office and the first Congress gathered.

In 1792, a group of merchants decided to meet daily at regular hours to buy and sell securities under the wide branches of an old buttonwood tree on Wall Street, only a few blocks from the site of the present Exchange. These twenty-four men were the original members of the New York Stock Exchange. In 1793, the brokers moved indoors into the Tontine Coffee House. During the next 100 years, the Exchange moved a dozen times or so before it settled down at its present location, at the corner of Broad and Wall Streets.

Where Buyer Meets Seller.

In a fundamental sense, the New York Stock Exchange is more than a market place for securities. The following legend could well appear beneath its name: "Here is where people buy and sell ownerships in America's leading corporations."

For, after all, what is a share of stock? It's a share of a business. The man who owns shares in, say, General Motors or American Telephone and Telegraph has an ownership interest in that company, with his risk as a co-owner being limited.

Let's say you own stock in a chemical company listed on the New York Stock Exchange—twenty-five shares out of the five million the company has issued. This means you own that fractional interest in the company's plant, its laboratories, its raw materials, its inventories, its goodwill, its sales organisation, its patents and, last but not least, its management. In short, you own an interest in everything that company has or may have in the future.

The Stock Exchange is the place where share certificates—evidences of ownership interest—may be bought and sold.

The Exchange operates in a rather unique fashion. It is not like the conventional auction where only buyers compete and there is only one seller. On the Exchange there is a "two-way" auction market. Here is the way it works: Buyers compete with each other to purchase the shares they want at the lowest price available. Simultaneously, sellers compete with each other to get the highest price anyone will pay for the shares they want to sell. Finally, the buyer bidding the highest price and the seller offering at the lowest price make a transaction at a price that is acceptable to each.
The Exchange is a market place where prices reflect the basic law of supply and demand. It is a market place where shares in American industry can be bought and sold almost as readily as you can deposit money in the bank. By bringing buyers and sellers together in one open market the Exchange becomes an integral part of our American way of life, implementing the Founding Fathers' creed that we all have the right to hold property. It's natural that it should, for the New York Stock Exchange is just about as old as the United States.

Need for Marketability.

In a free country, capital as well as labour must be free to work at whatever it chooses; free to move easily from one enterprise to another—entitled to the profits when the venture succeeds, ready to stand the losses if it fails. An investor may buy shares of a company listed on the Stock Exchange in the hope of handing them down to his grandchildren. But the knowledge that he can sell the securities on a few minutes' notice plays a basic role in his investment decision.

Actually, the Exchange serves a dual purpose.

For the saver, as we have seen, it provides a medium by which he may convert his funds into securities which he hopes will bring him income, a gain of capital, or both. Without this invested capital America would not enjoy the products of modern industry which are taken for granted today.

Although the New York Stock Exchange is not in itself a source of new equity capital—of risk funds essential to developing new industries and enlarging productivity—the flow of new capital soon would halt without it. If there were no Stock Exchange, no national market place where people could turn their investments into cash at will, investors would soon become impotent to finance any new ventures, no matter how promising.

In a comparatively short span of years, the American industrial scene has enjoyed a growth unrivalled in world history. American capitalism has put money to work producing more goods for more people at less cost. Fuelling our 43,000,000 automobiles, for example, is the oil industry, with an investment of $25,000 in plant, tools and equipment for every workman employed. And when you flip the switch which releases electric energy, you are commanding machinery which costs millions of dollars and is supervised by relatively few men.

That's a lot of money for machinery. But it's worth it. For this heavy investment in tools and machines enables the American workman to turn out more oil and more automobiles and more electric power than any other workman in the world. And because he as a worker produces so much, he as a consumer enjoys more at less cost.

That is the basis of the American standard of living. That is American capitalism today and money at work. The Stock Exchange makes share owning in this system readily available to millions of people.

Wide Spread of Ownership.

Who owns American industry? Wall Street? A tight little group of economic royalists? That notorious character with the checkerboard waistcoat, egg-sized diamond stickpin, fat cigar and hog jowls—the "capitalist"?

The answers to these questions were given in a comprehensive 140-page report published last year by The Brookings Institution,* which was commissioned by the New York Exchange to ascertain all the facts concerning share ownership in U.S.A.

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The survey breaks down and analyzes shareholdings on the basis of voluminous data supplied by 2,991 corporations, as well as several hundred banks and sharebrokers.

The data dealing with individual share owners were compiled from a field survey of 15,000 people representing a cross-section of the population. Share ownership by individuals is analyzed also by sex, age groups, education, income, occupation and type of employment. The percentage of share owners to the total population in each group, the number and kinds of different stocks which individuals own, and how long these people have been stockholders, were all carefully tabulated.

The principal findings of The Brookings Institution were:

- There are 6,490,000 individual Americans who own one or more shares in publicly-owned corporations in U.S.A., i.e., one in every sixteen adults is a share-owner and there are one or more shareholders in one-tenth of all families. It is estimated that there are a further 3 million owners of shares in non-listed companies.

- The gross number of stock holders—counting a share-owner once for each investment in one or more stock issue—is 30,300,000. The average number of issues per share-owner is estimated at 4.1. Only 8% of all share-owners hold ten or more stock issues.

- 76% of all stock holders have incomes of less than $10,000 a year after taxes.

- A family with an income of less than $2,000 has little money to spare in these days of high prices. Yet there are 200,000 such families who own shares of stock in American corporations.

- There are about 4.9 billion shares in our publicly-owned corporations.

- The number of shares in the names of men is 1,763 millions, or 36.3% of the total. The average number of shares for all shareholdings in the names of men is 160, which indicates the comparatively small number of large holdings. Women own 27% of the total shares, or about three-quarters as many shares as men. For women the average number of shares per shareholding is 115. Joint accounts hold 7.5% of all shares; Trustees, etc., 11.3%; Institutions and Foundations 2.5%.

- The Brookings Report disclosed that the occupations of shareholders were broadly as follows:

<table>
<thead>
<tr>
<th>Occupations</th>
<th>% of Total</th>
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<tbody>
<tr>
<td>Top Management</td>
<td>4.6</td>
</tr>
<tr>
<td>Middle management</td>
<td>9.6</td>
</tr>
<tr>
<td>Professions—doctors, etc.</td>
<td>10.3</td>
</tr>
<tr>
<td>Farmers</td>
<td>4.9</td>
</tr>
<tr>
<td>“White-Collar” workers</td>
<td>9.7</td>
</tr>
<tr>
<td>Salesmen, etc.</td>
<td>3.1</td>
</tr>
<tr>
<td>Skilled workers</td>
<td>6.3</td>
</tr>
<tr>
<td>Other workers</td>
<td>3.4</td>
</tr>
<tr>
<td>Housewives, etc.</td>
<td>32.8</td>
</tr>
<tr>
<td>Retired people</td>
<td>9.1</td>
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<tr>
<td>Others</td>
<td>2.3</td>
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The Brookings survey refutes many popular misconceptions about who owns industry. In particular, it undermines one of Pravda's most cherished propaganda notions that the American economy is owned and operated by a small group of "Wall Street Capitalists".

Need for Economic Education.

I sincerely hope that adequate resources will be made available to enable some organisation in your own country to make
The Board of Governors comprises thirty-three men, mostly members of the Exchange, but also including three representatives of the public, who have no direct connection with the securities business and who bring a broad non-professional character to the Board's deliberations. By this means, all sections of the country and many diverging viewpoints are represented.

Administration of policies established by the Board rests in the hands of a salaried president and staff. The Exchange has about 1,150 employees, of whom 430 work on the trading floor.

Operating the Exchange requires an annual budget of between eight and nine million dollars. This money comes principally from membership dues, direct charges to members and their firms, and from fees paid by corporations for listing their securities.

500,000 miles of telegraph and telephone wires connect the trading floor with 1,700 members' offices and many of those offices with 2,900 non-member correspondent firms.

Listed on the New York Stock Exchange.

There are nearly 2,500 issues of stocks and bonds listed on the New York Stock Exchange. They represent the ownership or the debt of nearly all the leading corporations in this country—American Telephone & Telegraph, du Pont, General Electric, General Motors, Montgomery Ward, Pennsylvania Railroad, Standard Oil of New Jersey, U.S. Steel—and on and on for a total of about 1,100 different enterprises.

How large do companies with stock listed on the Exchange bulk in the total American scene? These 1,100 companies earn about half of all the net profits after taxes reported by all U.S. companies, and they provide jobs for more than 11 million workers.

Organisation of the Stock Exchange.

The price of a Stock Exchange membership is determined by how much a candidate will pay and the amount the owner will accept. The Board of Governors maintains complete control over admissions. To become a member, one must be a citizen, be sponsored by two members or allied members and be able to present proof of financial responsibility and integrity.

The price of memberships has ranged in recent years from $35,000 to $68,000. The initiation fee is $4,000 and dues are $750 annually.

The policies of the Exchange and its rules and regulations governing the conduct of members and allied members are set by a Board of Governors elected by the members. The Board exercises broad disciplinary powers. Indicative of the national character of the New York Stock Exchange is the composition of its Board of Governors.

The price of a similar survey of the facts of share ownership in Australian public companies. For it is only by searching for the facts and then publicising them widely that we can banish fallacies and the misrepresentation of those who would destroy our way of life.

Already the free enterprise system in the United States is spending very considerable sums in educating the people in the simple facts of capitalism and stock-ownership. In addition to the constant efforts of the New York Stock Exchange in these directions, it is estimated that American industry is spending between $100,000,000 and $150,000,000 a year, not in advertising its products or the merits of any particular company, but simply in explaining how capitalism works; how competition benefits an economy; why widespread share-ownership is a good thing, how obsession with security can destroy security, and so on.
 Corporations listed on the New York Stock Exchange produce three-quarters of all the automobiles and trucks made in this country; ship about seven-eighths of all the finished steel; produce three-quarters of all the electric power generated; handle more than 90 per cent. of all the railroad traffic; refine 90 per cent. of all the oil produced, and fly 90 per cent. of domestic revenue passenger miles.

What is the significance of the phrase: "Listed on the New York Stock Exchange?"

At the time a company qualifies for listing on the Stock Exchange, it must be a going concern and must have substantial assets and demonstrated earning power. Great emphasis is placed by the Exchange on such considerations as degree of national interest in the company, its standing in its particular field, the character of the market for its products, and relative stability and position in its industry. The company's stock should have a sufficiently wide distribution to offer reasonable assurance that an adequate auction market in the securities would exist. The company should show earnings of at least a million dollars in the preceding year and should have a minimum of 1,500 stock holders, together holding at least 300,000 shares. Companies listing today agree to publish their financial condition quarterly. About 87% of the companies now listed publish earnings statements every three months, 9 per cent. publish every six months. Only 3 per cent. publish financial statements but once a year.

Failure of a company to disclose all information specified by the Exchange may result in its suspension from the list.

Corporations have found that raising new capital is facilitated when their securities are listed on the Exchange because investors are more attracted to a company that has met the requirements of the nation's largest organised securities market. And corporate management has found many concrete benefits, as well as prestige, in the broader market for their securities obtained on the Exchange, in a greater number of share-owners and in appearance of the company's name in the financial pages and stock tables of the nation's press.

Ownership Capital.

The growth of American industry, in the number of its owners, can be measured in terms of investors' willingness to share in the risks as well as the rewards of a free and enterprising business system. It was venture capital that financed the research which developed the automobile, plastics, the airplane, new metals and miracle drugs. The willingness to risk a loss in the hope of profit has supplied America with the venture capital which has opened new industrial frontiers and given us a standard of living unsurpassed in any place in the world.

Consider the last 75 years.

In 1875, there were only 163 stock issues on the New York Stock Exchange. In every year since the number has risen until today there are 1,500.

Fifty years ago there were sixty million shares. Today the total exceeds 4 billions!

Only twenty years ago there were 645 stockholders in American Telephone & Telegraph. Today there are more than 1,100,000! U.S. Steel then had 223,000; today it has 272,000. Standard Oil of New Jersey then had 127,000, today 254,000. General Motors in 1931 had 313,000 and today that company is owned by 482,000 stock holders.

The Stock Exchange offers the saver a broad selection for investment. He may buy shares in any of hundreds of distinguished corporations with long and
honourable business careers, corporations which have paid their share-owners dividends each year for decades—corporations engaged in producing everything from steel mills to toy trains. There are many yardsticks for a good investment. No one of them alone is sufficient. But the ability of a company to pay dividends through panic, depression and war is no minor factor.

There is a risk involved in the purchase of any kind of property, whether it's a house, a share of stock, or a bag of diamonds. The market price of shares in even our strongest companies moves up and down from time to time. Corporations may earn good profits in some years they may also run into periods when they operate at a loss. And even when most companies are prospering, some lag.

* * * * *

The Stock Exchange is the very heart of the American economic system. For it enables people to become partners in that system. Capitalism is a living philosophy which has grown up within our democratic form of government; it has survived minor wars and world war, secession, panics, depressions. Democracy is the hope of a free world today—and democracy's greatest ally is capitalism.