COSTS are the “weak spot” of the Australian economy.

On practically every other count, the economy looks fairly robust. Employment is high. Company balance sheets are satisfactory. Supplies of basic materials are ample. Taxes are lower than for some years. Money is plentiful; the major financial institutions are highly liquid, interest rates are tending downward, the loan market is much stronger. Overseas financial reserves are at reasonably healthy levels. The seasonal outlook is good and, above all, the wool market retains its amazing buoyancy.

Because of the possibility of a recession in America, the future of overseas prices is, it is true, hedged about with some uncertainty. (The article on page 126 by an eminent economist, Professor J. B. Condliffe, suggests the need for caution on this score.)

If costs were lower it would be possible to face even a drop in export prices without undue misgiving. But the cold winds set in motion by a slump in these prices could be turned icy-cold on the Australian continent by the alpine peaks of our cost structure.
In view of the crucial importance of costs we have felt justified in devoting two articles in this "Review" to the subject.

The first article "Do Costs Matter?" is concerned with basic economic theory. We feel that a re-statement of the theory of the matter is called for because, since the war, there has been a noticeable tendency among some professional economists to disregard the importance of costs. This tendency has expressed itself, either more or less strongly, in political policies, in the decisions of industrial tribunals and in the general climate of popular thought. A conjuncture of fortunate circumstances has so far enabled Australia to "get away with" this attitude to costs without any disastrous economic consequences. But economic truths cannot be flouted indefinitely with impunity. Our first article endeavours to demonstrate the fallacies and the perils of this line of thought.

The second article is concerned with the facts of the problem. Through collecting together a considerable body of the most authoritative data, it aims to show the menacing levels to which costs have risen. It is designed to be an answer to those people who still refuse to recognise that the level of costs is proving in any way damaging to the economy, and to those who are still disposed to argue that Australian costs are not yet out of line with those overseas.
DO COSTS MATTER?

OVER the post-war years there seems to have been a widespread feeling that costs don't matter very much.

Now this is something entirely new in economic thought. With the old classical economists costs were all-important. And in the days when international trade was regulated by the stern discipline of the gold standard, costs did matter—a very great deal. If incomes (and consequently costs) in a particular country rose sharply out of line with incomes and costs in other countries, the disparity led to an outflow of gold. In order to check this movement and to preserve the gold basis of its currency the country in question was forced to resort to deflationary measures such as credit restriction, higher interest rates and sometimes straight-out cuts in incomes. In the environment of the gold standard, costs mattered so much that any rapid increase was looked at askance.

The gold standard thus possessed one great advantage that has been lost to the modern world. It kept the cost structures of the various countries engaged in international trade reasonably in step, and, to that extent, it promoted the classical economists' ideal of maximising trade between the nations. But it had the disadvantage of tying the economy of one country too tightly to those of the countries with which it traded. If, for example, there were a recession in business activity in the United States, the full effects were transmitted to the rest of the world by an automatic process. Other countries were virtually compelled to follow the path of deflation in order to preserve their external balance and thus their stocks of gold.

Under these conditions of trade, individual countries had little control over their own domestic economies. The level of employment was determined largely by the ebb and flow of external economic forces rather than by internal financial policy. It is not surprising that expert and popular opinion rebelled against the tight tyranny of the gold standard and the severe limitations which it imposed on the freedom of countries to manage their own economic and financial affairs.

But now we have jumped to the other extreme. The economic experience of Australia (and other countries) since the end of the war seems to suggest that we believe it to be right and possible to go our own way, and to pursue internal policies regardless almost of their effect on our trading and financial relationships with other countries. Under this philosophy, and now that there is no longer the automatic check on incomes and costs imposed by the gold standard, there has developed a reckless, irresponsible attitude to costs, a feeling that costs can be permitted to go on rising almost indefinitely without any seriously adverse economic effects. It is the philosophy of "costs don't matter"—or, at least, not very much.

Of course there have been a few heretics. Many business men have protested vigorously against the rapid increase in post-war costs in Australia, although, perhaps, more from fears of the effect of rising costs on their competitive position than from any reasoned economic argument. A few economists have registered their forebodings—but only a few. The great majority of modern economists belong to the
neo-Keynesian school of thought with its one-sided emphasis on expansionist financial policies and its insistence that any reduction in money incomes under any circumstances will bring about unemployment. It is undoubtedly the influence of this school of thought that is responsible for the blithe indifference to soaring costs in Australia displayed by governments, industrial tribunals and popular opinion since the end of the war.

Now the question which this article is primarily concerned to answer is just how far this attitude of indifference to costs is tenable. Is it true that costs don’t matter? Is it possible for money costs to snowball year after year without any serious consequences for the economy? And if it is not possible, then at what point do rising costs become a menace to economic stability and better living standards? Has that point yet been reached in Australia?

A BRIEF digression is necessary to forestall any misunderstanding. The level of money incomes is only one of the two main influences which determine costs of production. The other is the efficiency with which production is carried out, popularly expressed as output per man-hour or man-year. If output per man-hour increases without any changes in wages and other incomes, costs will fall. If productivity increases at the same rate as incomes are increasing, costs will remain constant. But, if wages and other incomes are increasing at a faster rate than improvements in output per man-hour, costs will rise. The last-mentioned case largely explains what has been happening in Australia since the end of the war. The growth in productivity has been far exceeded by the expansion in money incomes with consequent increases in costs.

Those who argue that the way to reduce costs (and selling prices) is to improve efficiency often overlook that productive efficiency can only be raised gradually. Admittedly it is true that spectacular advances in productive efficiency are frequently achieved in particular industries. But, over the whole economy, technical and psychological limitations preclude any major forward jumps in output per man-hour. Even in the dynamic economy of the United States increases in man-hour output average only around 2% to 3% a year.

WITH the classical economists it was taken for granted that costs of production in a given country could not be permitted to get seriously out of step with cost levels in other countries. If that occurred, other countries would concentrate their purchases on cheaper sources of supply and would undersell the high-cost-of-production country in its own domestic markets. In other words, the exports of the high-cost country would decline and its imports would increase. If this situation remained uncorrected, sooner or later the offending country would be unable to pay for its essential requirements from abroad, its standards of living would be drastically reduced and unemployment would appear.

To meet a situation of this kind the remedy prescribed by the classical economists was simple: reduce costs, expand exports and restore the competitive position of domestic industries producing for the home.
market. The remedy of the neo-Keynesians is precisely the reverse; cut back imports by quantitative restrictions to the levels which the reduced income from exports will stand, and compensate for any unemployment resulting from the falling off in external demand by expanding demand at home through a policy of credit expansion. In other words, in a situation for which the classical economists prescribed lower costs, the neo-Keynesians prescribe still higher costs.

Now clearly there must be limits to which the neo-Keynesian policy can be carried. For if domestic costs go on increasing regardless of the level of world costs there must come a time when production for export becomes completely unprofitable. Before that point is reached, a government following neo-Keynesian ideas would no doubt endeavour to bolster export production by paying subsidies to export producers. But that device could have only a limited application; for if costs are not restrained, or if export prices fall, the government would eventually be faced with an impossible bill for subsidies. There is no escape from the logic that a country whose costs are far above the level of world costs must face the possibility of a collapse in export production and if that should occur there will be no money to pay for imports. Imports will therefore dwindle to a trickle and the high-cost country will be forced into complete self-sufficiency. The road of high costs is the road to economic autarchy.

Now it may be claimed that this is a theoretical reductio ad absurdum and that, in practice, no country, with the possible exception of the United States, could become self-sufficient or near self-sufficient in the modern world without a catastrophic reduction in its standard of living. And long before that reduction had been achieved, public opinion, if not economic horse-sense, would compel a reversal of policy.

The fact that this is true, that is, that no country could embark upon a policy of near self-sufficiency, only goes to prove that there must be limits to the distance to which the doctrine of "costs don't matter" can be pushed.

We are speaking now, of course, of costs in the relative sense. So long as the costs of all countries are rising in roughly the same ratio, the position of one country vis-à-vis the countries with which it trades will remain unaltered. The trouble arises when the costs of one country or a number of countries become much higher than costs in other countries. When this occurs, the normal flow of international trade will be upset. The high-cost countries will resort to various devices to restore their external balance of payments position. These devices may take a variety of forms, such as exchange controls, subsidies, protective tariffs to bolster up those industries feeling the pinch most acutely, and straight-out quantity restrictions on imports. But all these devices have the effect of reducing the volume of international trade. They are therefore highly unfair to those countries that have been behaving themselves by keeping their costs on a tight rein.

* In its latest Annual Report the Tariff Board rightly points out that "the Tariff can only provide temporary protection. In contributing to the cost-price spiral the Tariff would be hastening the day when it would be sheltering a cost-price structure so high that trade with the rest of the world would be impossible. The Board in framing its recommendations is faced with the choice between an immediate local and temporary dislocation (by refusal to grant tariff protection) or a delayed but widespread and more permanent unemployment."
The plain truth is that any nation that allows its costs to get grossly out of line with overseas cost levels is falling down on its responsibilities to the rest of the world. The various economic and financial institutions set up since the war to promote the maximum of stable trade have no hope of working successfully whilst there are wide disparities between the cost structures of the various nations.

One of the most eminent of British economists, Professor Lionel Robbins, has argued that the intractability of "the dollar gap" is traceable to this cause. While, in the post-war period, prices and incomes in the United States have greatly increased, prices and incomes in the non-dollar countries have in most instances increased a great deal more. The cost divergence on this account has been further aggravated by the much more rapid advance in technical productivity in the United States. Under these circumstances the persistence of the dollar shortage was inevitable. The crux of the dollar problem is thus to be found in the excessive expansion of incomes since the war in the non-dollar countries.

In course of propounding this argument, Professor Robbins states: "It should be clear that the essential condition for balanced trade is an appropriate relation between incomes in the different areas concerned, so that when the value of the product in one country increases relatively to the value of the product elsewhere there is a shift in relative incomes." This simply means that if the nations of the world are to draw the maximum benefit from trading with one another, and if trade is not to be constantly dislocated by restrictive expedients, costs in the different countries must be kept reasonably in line. This is the essential condition of a balanced and expanding world trading system.

What is the alternative? If nations insist on pursuing their own domestic policies without regard to their external implications there must result a vicious spiral of contraction in international trade. In order to preserve their financial solvency, the high-cost countries are forced to resort to the use of defensive mechanisms. Those countries for which they previously provided a large market suffer a reduction in their exports. With a declining income from exports they, in turn, are compelled to limit their purchases from abroad. The position of the high-cost countries thus tends to worsen still further leading them to intensify their policy of import restriction. The original unbalance caused by the failure of a few countries to restrain their costs sets in motion an all-along-the-line retreat to economic isolation.

Countries, such as the United Kingdom, which are very highly dependent on international trade, would of course suffer most in a trading climate of this kind. As Professor Robbins pregnantly remarks: "A generalization and perpetuation of recent Australian policy would knock us off our perch entirely and keep us permanently from climbing back."†

Keynes, of course, insisted that individual countries, should retain control over their own financial policies and thus over the level of

† This is not quoted to imply criticism of the Australian policy of import cuts. Under the conditions which arose there was no alternative. The criticism should not be directed at the import cuts, but at the policies which made them unavoidable.
employment. The neo-Keynesians remember this. But they forget, or are unaware, that Keynes also argued that autonomy in domestic economic affairs would only work successfully in an international environment that observed the basic principles of the classical doctrine. In his last article, published after his death, he declared: "I find myself moved, not for the first time, to remind contemporary economists that the classical teaching embodied some permanent truths of great importance. There are in these matters deep undercurrents at work, natural forces one can call them, or even the invisible hand, which are operating toward equilibrium."

In spite of all the efforts to promote trade in the post-war period, the volume of international trade has failed to respond. While world trade in 1951 was as great as in 1929, the best pre-war year, this was only made possible by the staggering financial assistance provided by the United States, including military aid. It was not the result of a normal and natural flow of trade between the nations. World production has advanced enormously in the last two decades so that the proportion of world trade to production has fallen correspondingly. Only 16% of manufacturing output entered international trade in 1951, compared with 26% in 1929. And in that period substantial reductions in tariffs have been made in the dollar countries.

UNTIL late in 1951 Australia did not feel any ill-effects from its high cost structure. This was partly because costs in Australia did not begin to rise much more rapidly than overseas costs until about 1948. But it was also due to the combination of two circumstances, fortuitous and temporary in character. The first was the immediate post-war condition of world shortage brought about by the economic dislocation and physical destruction caused by the war. Under these circumstances competition in the home market with the locally produced product was limited. The second was the persistence of extraordinarily favourable export prices. This meant that despite the rising costs of export production, there was a more than profitable margin between costs and selling prices.

The first of these conditions has now vanished. When ample supplies of imports became available, Australia suddenly found itself flooded with imported products which even the buoyant level of export income was insufficient to finance. The drastic import restrictions of early 1952 were the outcome.

The second condition—favourable export prices which have masked the consequences of excessively high costs—continues, but the gap between prices and costs has become much narrower, even in the major export industries, and has disappeared entirely in exports such as canned vegetables and jams and some processed foods.

The prop to high internal costs of abnormally good export prices continues to stand, although it is beginning to look a little shaky. But what if export price levels should recede sharply and the prop be removed entirely? Would anyone seriously suggest that the problem could be met by a wholesale intensification of import restrictions, in other words by a retreat into economic isolation?
Import restriction is not a policy that can be applied year in, year out, or whenever a crisis appears in the external finances. With export prices high and a superfluity of accumulated stocks of goods, it can be introduced without any noticeable ill-effects. But with low export returns and the availability of only normal stocks it would soon occasion acute distress. A sharp fall in export prices would expose the futility of the “costs don’t matter” doctrine in all its short-sighted stupidity.

There is, of course, always that weapon of last resort, much beloved of the neo-Keynesians—exchange depreciation. But how effective would this be?

Exchange depreciation is a legitimate weapon for countering an adverse trade balance brought about largely by causes outside of a country's own control such as a more or less permanent worsening of its terms of trade. But it is a device of highly doubtful value where the external deficit is traceable primarily to the over-exuberant pursuit of internal expansionist policies and thus to a fundamental disparity in costs. In such a case depreciation would be a beggar-my-neighbour policy giving temporary relief at the expense of greater trouble later on.

Exchange devaluation is itself an inflationary force. It stimulates spending and adds to the cost structure both through loading the price of imported goods and materials and through the protection it provides for high-cost home production. Where the trouble arises primarily from internal inflation, depreciation relieves the external sore only to aggravate the internal seat of the disease.

Those who advocate depreciation as a cure for present economic ills in Australia should sit down and consider where the action they propose is likely to lead. They should ask themselves whether they will not be purchasing a little temporary relief at the cost of further unbalance in the Australian economy.

Under existing conditions of high employment depreciation should be ruled out of court. And even should there occur a serious decline in export prices, while exchange depreciation might prove unavoidable, as an isolated measure it would not correct the basic unbalance caused by an over-loaded internal cost structure. All in all, the prospective advantages to be derived from devaluation have been grossly over-estimated.

SINCE the war, Australia has hitched its waggon to the star of high wool prices. If the star should plummet to the ground it will take Australia with it.

The only sound and honest path for Australia to follow is to manage its internal finances so that its costs are maintained broadly around overseas levels. The other route is the route of economic isolation, irresponsibility and selfishness, and can eventually lead only to disaster.
THE preceding article attempted to show the fallacy of the
notion that costs are of minor importance in the world
of today where the prime concern of all countries is with
domestic full employment. It was argued that no community
could confine the effects of its economic and financial policies
within its own national boundaries; and that failure by a
country such as Australia to keep its costs in line with the
broad world march of costs must eventually lead to the eco-
nomic embarrassment of other countries and to the disloca-
tion of international trade. A country that pursues its own
domestic policies in selfish disregard of their impact on other
nations must expect to attract retaliatory measures to its own
serious disadvantage.

The experience of the inter-war years should have taught
us that there is no future in a world where nations either con-
sciously strive after economic self-sufficiency or are uncon-
sciously forced into self-sufficiency because of neglect to keep
their costs under control. What chance would there be of
real co-operation at the political level in a world where nations
were waging economic warfare on one another?

Since the war Australia has experienced the greatest cost
inflation in its history. The rise in costs was attributable
partly to causes outside of our own control but also to de-
liberate decisions of policy which might have been avoided.

But, even in face of the unprecedented increase in costs
that has occurred, there is a disposition in some circles to argue
that Australian prices are, in the main, still competitive with
world prices. In evidence put forward on behalf of the unions
in the recent Standard Hours and Wages Case, a leading au-
thority on Australian statistics asserted that despite the de-
terioration in our relative position over the last few years,
Australian manufacturers still possessed a 10% cost advantage
over overseas suppliers compared with pre-war. This view
was re-iterated at an academic forum by a prominent eco-
nomist who has been close to successive Commonwealth
Governments in an advisory capacity. It is perhaps no coin-
cidence that the very people who have suddenly found that
Australian costs are not so high after all are often the same
people whose expansionist financial ideas contributed to the
creation of a climate of opinion which was able to view with
so little concern the extraordinary cost increases of the past
few years.
The argument that Australian costs still compare favourably with overseas cost levels is derived from statistical averages. The movement in Australian costs, as indicated by the Commonwealth Statistician's index of nominal hourly wages and the Wholesale Price Index of raw materials, is compared with changes in the average level of import prices as measured by the Import Price Index produced by the Commonwealth Bank.

This method has glaring weaknesses, both statistical and other. For instance, the Import Price Index of the Commonwealth Bank includes the prices of imports from the hard currency areas which are not competitive with Australian products and which show a much greater rise than the prices of U.K. imports which form the chief source of competition with Australian production. Moreover the price index of U.K. imports includes essential capital equipment and semi-processed materials which are vital to Australian industry and are uncompetitive with it. These, among many other considerations, make it clear that the only meaningful and realistic basis of comparison is that of relative costs in particular industries. An analysis of these costs gives an entirely different impression to that which one might gain from a cursory survey of overall price indices.

Latest available data on the trend of wages and prices in Australia and United Kingdom is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hourly Earnings—June, '53</td>
<td>380</td>
<td>278</td>
</tr>
<tr>
<td>(1938/9 = 100)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale Prices—Sept., '53</td>
<td>333</td>
<td>318</td>
</tr>
<tr>
<td>(1936/7—1938/9 = 100)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

COMPARATIVE IMPORT PRICE INDICES AS AT JUNE, 1953.  (1936/7-1938/9 = 100).

BY SOURCE OF ORIGIN OF GOODS.

<table>
<thead>
<tr>
<th>Source of Origin of Goods</th>
<th>United Kingdom</th>
<th>U.S.A. &amp; Canada</th>
<th>All Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>354*</td>
<td>464</td>
<td>380</td>
</tr>
</tbody>
</table>

* Note: Evidence published in the Tariff Board's 1953 Annual Report indicates that prices of British goods competitive on the Australian market have risen much less than is indicated by this over-all index which includes raw materials and capital goods which are not competitive. A direction from the British Board of Trade is quoted to the effect "that they like to see industry get as much for its exports as the traffic will bear."

Sources: Hourly Earnings: Male factory workers and including over-time, overaward payments, piece rates, etc. U.K.: Labour Gazette and relate to April, Australia: Based on a formula, originally devised by the Tariff Board for transforming the Commonwealth Statistician's figure of average weekly manufacturing earnings per male unit into average hourly earnings.


The effect of high costs is of course not confined to the manufacturing industries. The profitability of primary production depends largely on the margin between world prices and costs of production. There are also industries whose output, although not subject to the rigours of competition, has been seriously affected by a level of costs which has become uneconomic. The key building industry is a striking case in point.

SECONDARY INDUSTRY

We should at the outset realise that a large part of manufacturing output does not compete at all. The horror spectacle sometimes painted of the great proportion of Australian manufacturing being priced out of business because of high costs is an entirely misleading one. Possibly one-half of manufacturing production caters for an essentially local demand which could not be met from overseas sources. Typical examples are gas and electrical undertakings, brickworks, ice cream factories, repair workshops and newspapers and printing. Another section is able to anticipate immunity or partial immunity from competition because production is mainly in the hands of associates and subsidiaries of overseas concerns. And a third section is so vital to the national welfare that no government could afford to stand by and see it seriously threatened.

All this however does not imply that an uncompetitive cost structure is of no great significance in the whole manufacturing complex. It is difficult to estimate the magnitude of the section of manufacturing that is highly vulnerable to overseas competition. Some authorities have suggested that it might employ up to 200,000 people. Others have placed the figure around 100,000. The vulnerable industries would consist mainly of textiles and clothing, many engineering products, paper, electrical and household goods. Moreover any serious recession in this section of manufacturing would have unfavourable repercussions on other secondary industries which may not be competitive with overseas production.

Industries already feeling the effects of overseas competition, or feeling themselves to be in an exposed position, are deluging the Tariff Board with applications for increased protection. A study of recent reports made by the Board and of evidence submitted in inquiries provide a significant commentary on the level of Australian costs.
Internal Combustion Engines—Report dated 27th October, 1952:

In 1950, hourly earnings in both United Kingdom and Australian factories were, on an average, practically equal. At the present inquiry, evidence showed that average hourly earnings in the Australian industry were approximately 27½% higher than the average hourly earnings in the United Kingdom. Hourly earnings under incentives in the United Kingdom could be expected to result in greater output per hour than hourly earnings under time work in Australia and the disparity in labour cost, when related to the unit of output, would therefore be probably greater than 27½%.

Tractors—28th October and 19th December, 1952:

Like other Australian industries the tractor industry has been severely hit by the very great increases in labour costs during the last two or three years (between 60% and 70%) and with the consequent increases in costs of raw materials. There have of course, been rises in costs overseas during the same period, but increases in Australia have been steeper. Bounty rates of 12½% were recommended in 1950. Bounty rates equivalent to an ad valorem duty of 25% are now necessary to afford adequate assistance.

Textiles—Cotton, Meat Wraps—13th May, 1953:

A comparison of the average hourly cost of direct labour revealed that the cost to the Australian manufacturers was more than 100% higher than that experienced in the United Kingdom industry.

Carpets, Carpeting and Floor Rugs—Report, 18th May, 1953:

Compared with the average cost of production of carpet made by ten United Kingdom manufacturers, Australian costs of production of similar carpet at the time of the inquiry were approximately from 20% to 35% higher. Weighted average earnings for all classes of labour were 80% higher in Australia. Holiday and sick leave payments in Australia are shown to be on a much more generous scale than in the United Kingdom.

Engineering—Chains—3rd August, 1953:

Per unit of production, labour cost in the Australian factory is over five times the average in United Kingdom factories where payment by results operates extensively.

Extracts from Evidence Presented—Reports not Finalised.

Paper—Hearing—12th November, 1952:

In June, 1947, Australia had a 30% advantage over imported wrapping paper. Local costs of paper manufacture have risen so quickly that today the landed cost of imported wrapping paper is nearly 50% below that locally produced.

Vitreous Enamels—6th October, 1953:

The local company have been producing in Australia since 1936/7 and their activities were successful, even without protective duties, right up until 1950. From then onwards the effects of Australia's high cost position reflected themselves in excessive importations from overseas to the serious detriment of the local company.

Rayon Yarn—21st October, 1953:

The request for protection is based on a level of efficiency at least equal to that of our competitors and is necessitated solely by the higher materials, labour and plant costs inseparable from the Australian economy.

Chemicals—Soda Ash—22nd October, 1953:

In 1947 Australian soda ash without duties of any kind sold for £16/15/− a ton compared with a landed cost for U.K. soda ash of £17/2/−.
Since then the Australian price has risen to £35/-/- per ton, whereas the English landed cost has only risen to £21/14/10 per ton. Unless the local product is granted a 95% duty it will be unable to compete with the overseas product once import restrictions are lifted. Costs have risen by 124% between 1947 and 1953 made up as follows: labour 66%, packages 163%, interstate freights 212%, depreciation 120% (due to excess costs of new plant installed—actual cost was £3.4m. compared with £1m. estimated in 1947). Since 1947 the cost of transporting soda ash from U.K. to Australia has risen from £5/5/- to £7/1/-, a rise of about 37%. Over the same period the cost of transporting a ton of soda ash from the Osborne works in South Australia to other Australian ports has risen from £2/-/- to £8/5/-, a rise of 212%.

The problem of high manufacturing costs does not of course merely affect manufacturing products competing on the home market. In the early post-war years a promising export market had been built up in certain manufactured goods. Many of these markets have been lost.

Export outlets for piece goods, jams, processed vegetables and certain milk products, motor accessories, electrical and engineering products, paper pulp and a host of miscellaneous items have been lost because of high costs and General Motors-Holden have had to abandon their plans to export the Australian car for the time being.

Australia is looking to overseas markets to take its surplus production of pig iron and steel. But whereas before the war Australian pig iron f.o.b. commanded an 80% advantage over British pig iron, today this advantage has been whittled down to 15%. Apart from the greater increase in wage rates, the price of coal—the main cost ingredient in manufacturing pig iron—has since 1938 increased by 420% in Australia compared with 250% in United Kingdom.

Primary Industry

Because of a remarkable succession of bountiful seasons and record prices it is easy to lose sight of the fact that the main export industries—wool and wheat—are now in a much weaker position to cope with any decline in prices.

Because of their inability to pass on costs, farmers’ real incomes have slumped since 1947/8 despite higher wool prices and a wonderful season in 1952/3. After allowing for the reduction in the value of money, real farm incomes in 1952/3 were £312m. as compared with £359m. in 1947/8.
It is admittedly difficult to calculate with any precision the average costs of growing a pound of wool or a bushel of wheat. However surveys carried out by the Bureau of Agricultural Economics, the Rural Bank of N.S.W. and other authorities in recent years throw valuable light on this subject and give a significant indication of cost trends in relation to selling prices.

**WOOL COSTS**

In 1938 a Queensland Royal Commission on the Wool Industry estimated the cost of producing wool at about 11d. per lb. compared with average selling prices of 12.5d. in 1937/8 and 10.4d. in 1938/9. These conditions seem like a nightmare compared with average selling prices of 81d. per lb. in 1952/3 and an average of 82d. over the last five years. However, recent surveys suggest that costs of producing wool have soared almost as precipitously as selling prices.

After warning against placing too much reliance on average cost of production figures, the Rural Bank of N.S.W. has published data for typical N.S.W. properties grouped under various categories, showing costs per lb. of wool in 1952/3 ranging from 41.65 pence to 62.11 pence (see Appendix—Table 1).

It should be borne in mind that this data was collected during the most favourable growing season on record with top quality fleeces. Granting that any significant and sustained change in wool prices would probably be accompanied by compensating changes in certain costs, particularly an appropriate return on lower capital values, a sharp decline in wool prices could still lead to serious difficulties in the industry. Cost of production now appears to be at or above the average level of wool prices ruling in 1948/9. In the following table the data collected by the Rural Bank survey is combined with an analysis of costs for an earlier period conducted by the Bureau of Agricultural Economics:

<table>
<thead>
<tr>
<th></th>
<th>Pence per lb.</th>
<th>Pence per lb.</th>
<th>Australian Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>B.A.E. 1947/8</td>
<td>34</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>B.A.E. 1948/9</td>
<td>38</td>
<td>48</td>
<td></td>
</tr>
<tr>
<td>B.A.E. 1950/1</td>
<td>n.a.</td>
<td>144</td>
<td></td>
</tr>
<tr>
<td>Rural Bank 1952/3</td>
<td>58</td>
<td>81</td>
<td></td>
</tr>
</tbody>
</table>
WHEAT COSTS

At the outbreak of World War II wheat prices had fallen to 2/1 per bushel compared with 3/1 in August, 1938, and 5/1 in August, 1937. The lowest monthly quotation during the depression was 2/2 in August, 1931. Farmers had to be assisted by government bounties and other relief during most of the 30's, because wheat was being sold at less than cost of production. No one wishes to see the financial despair of those days (when practically every wheat-grower was hopelessly in debt and dependent on the charity of the State) return again.

Since the war-time marketing arrangements were instituted all Australian wheat has been marketed by the Australian Wheat Board. From June, 1942 to December, 1947, the price of wheat for gristing into flour for home consumption averaged 3/11½ per bushel. All proceeds, including export sales at various prices, were paid into “Wheat Pools” from which advances were periodically made to growers. With the expiration of the war-time controls, the States and the Commonwealth agreed in July, 1948 to continue a wheat stabilization plan until June, 1953. The Commonwealth Government guaranteed a return to growers based on costs of production. This increased from 6/3 per bushel in 1948 to 11/11 in December, 1952. The home consumption price (kept down by subsidy) was also closely related to it.

Export prices ranged as follows:
1946/7—12/6.
1947/8—19/5.
1948/9—15/8.

<table>
<thead>
<tr>
<th>Wheat Sold Under International Wheat Agreement</th>
<th>Wheat Sold in Excess of I.W.A. Quota</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949/50 ..................................................</td>
<td>15/5 .................................</td>
</tr>
<tr>
<td>1950/51 ..................................................</td>
<td>16/1 .................................</td>
</tr>
<tr>
<td>1951/52 ..................................................</td>
<td>16/4 .................................</td>
</tr>
<tr>
<td>1952/53 ..................................................</td>
<td>16/6 .................................</td>
</tr>
</tbody>
</table>

For the ensuing season, the home consumption price (without government subsidy) will be 14/- per bushel for wheat for flour-making and the I.W.A. price should continue around 16/- per bushel. However, the “free” market price for wheat has dropped back to about 17/- per bushel, so that wheat in excess of the I.W.A. quota will no longer command
a substantial premium. As about half Australia's wheat must be exported any weakening of overseas prices must be viewed with concern. Production costs are now estimated at 12/8 per bushel, over double the base year 1947/8.

According to the Bureau of Agricultural Economics, the profit per bushel in wheat growing has more than halved between 1947/8 and 1952/3. Here are the figures:

<table>
<thead>
<tr>
<th></th>
<th>1947/8</th>
<th>1952/3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total &quot;pool&quot; returns</td>
<td>14/4</td>
<td>15/5</td>
</tr>
<tr>
<td>Cost of production</td>
<td>6/3</td>
<td>11/11</td>
</tr>
<tr>
<td>Profit per bushel</td>
<td>8/1</td>
<td>3/6*</td>
</tr>
</tbody>
</table>

* 1/10 in 1947/8 values.

The capacity of the wheat industry to cope with a drought cycle or the unloading of surpluses building up in other wheat-growing countries has already been greatly weakened since 1947/8.

OTHER PRIMARY INDUSTRIES

DAIRYING in Australia has always been recognised as a high-cost industry and the home consumer has been expected to subsidise the export price in order to enable producers to compete on world markets. The present home consumption price is causing consumer resistance and a reduction in the per-head consumption of butter. Cost of production has risen from 2/- per lb. in 1947/8 to 4/1 in 1951/2 and Governments are naturally reluctant to further subsidise the industry or permit any additional rises in costs to be passed on to the consumer.

The Bureau of Agricultural Economics estimates that costs of producing meat rose by over 50% between 1948/49 and 1951/52 and costs of egg production by 90%. Dried fruit costs in 1952/53 were estimated at 87% above 1948/49 levels although the average price received by growers at the packing shed had only increased by 63%.

SERVICE INDUSTRIES

The unhappy consequences of a high cost structure are not confined to industries competitive with imports or those dependent upon export markets. Some industries completely
sheltered from overseas competition find that the rising level of costs builds up a price resistance which in some instances has dangerous national implications. The building industry is perhaps the best example of this.

Building costs have become so steep that very few people are willing to go ahead with new city buildings or extensions to premises not absolutely necessary. Building for investment purposes is a thing of the past. The lack of city building in Melbourne and other capital cities is partly traceable to the fact that rentals at the present level of building costs would become prohibitive to prospective tenants. There is also the fear on the part of prospective investors of serious losses of capital should costs decline.

With statutory additions, such as sick leave, holiday and wet weather pay, average award rates of building workers have jumped from 2/6 per hour in 1939 to over 10/- today—an increase of 300%. Prices of building materials which were 335% above pre-war levels at the peak in July, 1952, have dropped somewhat, but are still 265% higher. Tradesmen engaged on jobs carried out by builders of new buildings in Victoria have dropped from 34,000 in March, 1952, to 27,000 today.

Despite the pressing need for new city buildings for office and shop purposes, for hotel accommodation and civic development, the high level of costs has produced an almost complete standstill.

* * * * *

IN face of the evidence given in this article—all of which is taken either from official or well-informed sources—it is difficult to understand the complacency of those who find comfort in the beguiling simplicity of statistical averages. There seems little doubt that quite a significant section of the economy could no longer compete on the basis of present costs. While export prices, especially of wool, remain firm, serious trouble should be avoided. But a steep fall in these prices could render the basic export industries unprofitable and would spread something that might be little less than chaos through the Australian economy.
### APPENDIX

#### TABLE 1.

**WOOL GROWING COSTS**

<table>
<thead>
<tr>
<th>Pence per lb. of Wool</th>
<th>Pence per lb. of Wool</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lowest Group</strong></td>
<td><strong>Highest Group</strong></td>
</tr>
<tr>
<td>Direct costs—packs, shearing, cartage, freight, etc.</td>
<td>8.22</td>
</tr>
<tr>
<td>Maintenance and replacement plant and stock</td>
<td>8.14</td>
</tr>
<tr>
<td>Wages of employees</td>
<td>4.91</td>
</tr>
<tr>
<td>All other operating costs</td>
<td>5.25</td>
</tr>
<tr>
<td>Rates and insurance</td>
<td>2.45</td>
</tr>
<tr>
<td><strong>Owner’s wage allowance</strong></td>
<td>28.97</td>
</tr>
<tr>
<td><strong>Less “sideline” income</strong></td>
<td>5.04</td>
</tr>
<tr>
<td>Interest on owner’s capital</td>
<td>17.33</td>
</tr>
<tr>
<td><strong>Interest on owner’s capital</strong></td>
<td>16.68</td>
</tr>
<tr>
<td><strong>Interest on owner’s capital</strong></td>
<td>24.97</td>
</tr>
<tr>
<td><strong>Interest on owner’s capital</strong></td>
<td>41.65</td>
</tr>
<tr>
<td>Type of property</td>
<td>4,000 mixed sheep (Breeding own replacements)</td>
</tr>
</tbody>
</table>

**Source:** Surveys carried out by 15 valuers of the Rural Bank scattered over New South Wales’ sheep growing districts.

#### TABLE II.

**COSTS OF WHEAT GROWING**

<table>
<thead>
<tr>
<th>Fence Per Bushel</th>
<th>1947/48</th>
<th>1952/53</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintenance and depreciation of machinery and structures</td>
<td>15.62</td>
<td>28.14</td>
</tr>
<tr>
<td>Fuel</td>
<td>12.48</td>
<td>21.38</td>
</tr>
<tr>
<td>Fertilizer and seed</td>
<td>9.48</td>
<td>20.30</td>
</tr>
<tr>
<td>Hired labour</td>
<td>9.24</td>
<td>20.17</td>
</tr>
<tr>
<td>Cartage and corn sacks</td>
<td>3.30</td>
<td>7.22</td>
</tr>
<tr>
<td>Rates and taxes, interest, insurance, rent and sundries</td>
<td>12.96</td>
<td>15.02</td>
</tr>
<tr>
<td><strong>Total cash costs</strong></td>
<td>63.08</td>
<td>112.73</td>
</tr>
<tr>
<td>Interest on farmer’s equity</td>
<td>13.08</td>
<td>19.18</td>
</tr>
<tr>
<td>Allowance for farmer’s labour</td>
<td>22.80</td>
<td>48.37</td>
</tr>
<tr>
<td><strong>Total farm costs</strong></td>
<td>98.96</td>
<td>180.28</td>
</tr>
<tr>
<td>Less 1/3 for “sideline” income</td>
<td>33.96</td>
<td>61.89</td>
</tr>
<tr>
<td>Net cost of production at siding</td>
<td>65.00</td>
<td>118.39</td>
</tr>
<tr>
<td>Rail freight and handling</td>
<td>10.00</td>
<td>24.36</td>
</tr>
<tr>
<td>Total costs, bulk basis f.o.r. ports</td>
<td>75.00</td>
<td>142.75</td>
</tr>
</tbody>
</table>

**Source:** Bureau of Agricultural Economics.

**Notes:** These calculations are based on the following assumptions:

1. A fair average long term yield of 12 bushels per acre.
2. An average holding of 300 acres.
3. A wage allowance of $6/10/ per week to owner operators in 1947/8 adjusted upwards for 1952/3 in line with basic wage increases.
4. Interest on farmer’s equity—in 1952/3 at 3% on a most conservative valuation of properties and other assets.
TODAY circumstances are more favourable to free enterprise than for a long time. Controls have been eased, prices are more stable, taxes have been reduced, and the trade union movement has made an important change in its policy on the use of incentive systems in industry. Altogether we have moved closer to the type of economy for which the I.P.A. has been fighting since its inception.

Business is naturally appreciative of its new degree of freedom, but we must bear in mind that this enlarged freedom brings greater responsibilities to industrial and business leaders. A free economy can be successful and lasting in a democratic country only where its leaders and the business community generally display a high sense of responsibility for the national welfare.

It is the duty of businessmen, through their representative organizations, to advocate policies which conform with the real interests of the people as a whole.

We have very rightly opposed government interference with business through detailed controls, but we must recognize
that some broad forms of economic supervision by government are absolutely necessary in the modern economy; otherwise, in the event of a serious drought or a collapse in overseas prices, we could easily return to the days when there were wide and serious fluctuations in business activity and employment. These recessions in the past have caused heavy losses, and are certainly not in the financial interests of business. Nor are they in its long-term political interests.

The vulnerable part of Australia's economy at the moment is the high cost of production, and every producer, manufacturer or distributor, who contributes in any way to a reduction in these costs, will be helping to place this country on a sounder financial basis and will be assisting toward the goal of stability of employment for the Australian people.

The wisest businessmen will use the added financial resources available from Australia's increasing wealth and the recent reductions in taxation in a far-sighted manner. They will improve their plant and technical facilities to raise productivity and strengthen internal reserves to help protect the security of their employees and increase employment.

For ten years we have advocated that increasing productivity, combined with improved employer-employee relations, is the only way to increase the living standards of all the people. Some of these ideas are slowly but surely taking root and the influence which the Institute has exerted in these directions must at all costs be maintained.

There should be no need for me to warn you that the free economy in the form in which we believe is by no means yet firmly established.

The vigilance of this Institute must not be relaxed for a moment. The educational work we have undertaken by the continued circulation of our literature, giving fundamental economic truths, is having its effect on government policies and on public opinion.
THE future of the arbitration system and of the Australian wage structure have been thrown into confusion by events following on the decision of the Commonwealth Court in the recent Basic Wage and Standard Hours Case. The Court rejected the main body of the employers' claim for a reduction in wages and an increase in working hours, but decided to discontinue the system of quarterly cost-of-living adjustments.

Despite its limited constitutional authority and the fact that its determinations apply directly to less than half of Australian employees, the Commonwealth Court has held a position of unchallenged authority in the sphere of wage-fixing. The supremacy of the Court has been recognised by State governments and State industrial tribunals whose awards and determinations embrace nearly as many employees as the rulings of the Commonwealth Court itself. Under State laws it has been mandatory upon the N.S.W. Industrial Commission and the Victorian Wages Boards to incorporate in their determinations the wage rates contained in Federal awards to the extent to which they are applicable. The industrial authorities of the other States have also in the past followed fairly closely in the footsteps of the Commonwealth Court, although the more isolated States of Queensland and Western Australia have at times shown a disposition to pursue an independent course. Because of the dominance of Victoria and New South Wales in the industrial life of the Commonwealth, this show of independence, which might in any case be justified by special local circumstances, has not seriously threatened the broad uniformity of the Australian wage structure.

Thus, up to the present, despite divided jurisdiction and the existence of seven separate sovereign authorities in industrial matters, there has been maintained a remarkable degree of consistency in the national wages structure. This, of course, has been of inestimable benefit. The existence of wide disparities in wage levels in the different States and between State and Commonwealth awards would have wrought untold confusion in Australian economic life, and would have given rise to widespread industrial unrest and turmoil.
These advantages have now been threatened by the decisions of various State Governments and industrial authorities to disregard the ruling of the Commonwealth Court on the cost-of-living adjustment. In Victoria, for instance, the State Labour Government has continued to pay the latest adjustment to its own employees and, at the time of writing, is in the process of introducing legislation to amend the existing Shops and Factories Act to make it mandatory for State Wages Boards to continue to observe cost-of-living variations. The West Australian Government has introduced a bill to compel the State Court of Arbitration to continue quarterly adjustments in accordance with the Government Statistician's figures. The Queensland Industrial Court has also declined to observe the Commonwealth Court's ruling.

The long-recognised supremacy of the Commonwealth in the sphere of wage-fixing has thus been challenged. The refractory States have not offered one good or convincing reason for their refusal to abide by the Commonwealth Court's decision. Clearly the action of the Labor Governments of the States concerned is based upon a crude, self-righteous appeal to their political and possible political supporters rather than on any sound economic or industrial argument. The most serious aspect of their decision does not lie in the fact that it must tend to destroy the uniformity of the wage structure and to stimulate industrial dissatisfaction and unrest—although that is serious enough. The most disturbing feature of the whole matter is that it raises a vital issue of principle. It is this: Are wages to be determined by politicians on grounds of crude political expediency? Is the independence of wage-fixing authorities to be made subject to the dictates of governments? Or are wages to be settled by reference to the economic needs of the country and the capacity of the economy to pay after full enquiry by independent tribunals? Whether one thinks the Commonwealth Arbitration Court's decision was right or wrong, these are the real questions at stake.

* * * * *

Some opposition to the Court's judgment has arisen because of a fairly general belief that the basic wage represents a minimum "needs wage" and that any detraction from this, brought about through rising prices, reduces the basic wage-
earner below the standards acceptable in a civilised community. As the text of the Court's judgment is at pains to make clear this is a complete misapprehension. From 1913 the Court began to take cognizance of cost-of-living changes in fixing the minimum wage. In 1922 an amount of 3/- was added to the basic wage to compensate for the lag in adjusting wages to prices. In 1931 the "needs" basis for assessing the basic wage was dropped and the capacity of industry as a whole to pay became "the dominant principle in fixing the basic wage." In 1937 "prosperity loadings" averaging 5/- a week were granted on these grounds and were later incorporated in the basic wage. In 1946 the Court made an interim judgment adding a further 7/- to the basic wage and in 1950 the famous £1 increase was granted.

In its latest judgment, the Court points out that the real purchasing power of the basic wage has been raised over 25% since 1934. It might be added that when the "needs" basic wage was established there was no such thing as child endowment; nor were there social cash benefits and services on the scale that now exists. It should not be forgotten, too, that in these days the pure basic wage-earner is almost a legal fiction. There are few workers that have not been able, through their unions, to persuade the Court that they possess some skill or suffer some occupational disability and have thus obtained loadings substantially in excess of the basic wage.

In the light of present economic circumstances, the claim of State Labour Governments that in refusing to abide by the Court's ruling they are acting in the interests of the wage-earner looks so nonsensical that it comes perilously close to being hypocritical. It cannot be in the interests of the wage-earner or of anyone else that costs should continue to rise. All responsible opinion in Australia at the moment concurs in the view that costs are reaching dangerous levels. Although stressing this point in the case of the primary industries, the Court's judgment possibly does not give sufficient emphasis to it. But there is little doubt that the Court would agree that further increases in costs would be most undesirable and the Court does make clear that it considers the cost-of-living adjustment to have been an accelerating factor in the rapid inflation of prices in 1951 and 1952. It is indis-
putable that a continuance of the rising cost trend would constitute a threat to employment in important sections of industry. How, then, can it be in the interests of the wage-earners to take action which would tend to perpetuate this trend?

Should prices fall, the adherence of the States to the cost-of-living adjustment could prove to be seriously opposed to the immediate interests of the wage-earner.

* * * *

IT would seem an appropriate time to say a few words about the constitution of the Court. Whatever the relative merits and demerits of compulsory arbitration as compared with collective bargaining, the principle of arbitration is so deeply imbedded in Australian industrial thought and practice that it is difficult to conceive of any radical departure from it. And while the system of arbitration continues, it is the clear duty of employers and trade unions, and even more of governments, to uphold the authority and prestige of its major instrumentality—the Commonwealth Court. That is why the irresponsible actions of some State Governments since the Court's judgment was delivered is to be unreservedly condemned.

This, however, does not mean that some thought should not be given to the improvement of the system, and especially of the Commonwealth authority itself. A main point that must occur to any informed observer centres around the economic competence of the Court. Doubts on this score have been intensified rather than alleviated by the major judgments made since the war and the economic reasoning by which they have been supported. Some years ago a noted authority on wages policy and a prominent British economist, Mr. W. B. Reddaway, criticised the Court's use of statistical information, its disposition to accept data at its face value, and its defects in the field of economic interpretation. It is no criticism of the learned Judges of the Court to say that these weaknesses have been evident in its post-war judgments. In points of its present judgment the Court clearly shows a tendency to over-reliance on evidence furnished by witnesses. Some mechanism should exist to assist the Court to arrive at independent
evaluations of the more technical aspects of evidence placed before it. This was recognised in the Arbitration Act of 1947 where provision was made for the creation of an economic and statistical bureau to be attached to the Court.

For various reasons we believe it would be unwise to proceed with the appointment of this bureau. But whatever the means used, there is clearly need for the economic aspect of the Court's work to be strengthened. Judges are not economists but they are required to make decisions which must of necessity be primarily economic in nature.

There may be some case for reconstituting the Court as a Commission to permit of the appointment of one or two highly skilled and respected economists to the Commonwealth industrial authority. This would not of course preclude the retention of Judges—that would, in fact, be altogether desirable—but it would give the authority a nice blending of judicial experience and economic expertise which it, at present, lacks.

The I.P.A. has consistently maintained that in the modern world there are many matters of economic fact and of theory which can and should be put beyond the bounds of controversy, either political or industrial. Other countries are tending more and more in this direction—the United States through its expert President's Council of Economic Advisers, Britain through its Economic Secretariat to the Cabinet. If Australia were to follow in the footsteps of these countries, the Commonwealth industrial instrumentality, whether Court or Commission, would be able to refer to a body of high economic authority on matters on which it feels the need for greater enlightenment.*—See article "A C.E.A. for Australia" ("Review"—May-June, 1952).

* * *
Recession in the United States

by

J. B. Condliffe
Professor of Economics
University of California

Professor Condliffe is an Australian-born economist. Later he lived in New Zealand where as an officer of the Statistician-General’s office he made the first cost-of-living study in the Dominion.

He has had an outstanding career in economics holding several important professional posts at prominent Universities.

In 1931 he joined the secretariat of the League of Nations and was the author of the famous Annual World Economic Survey published by the League. Professor Condliffe is the author of several books. For his last book, "The Commerce of Nations", he was awarded the Wendell L. Willkie Prize for the most valuable work published on an international subject in 1950.

In this article he deals with a subject of great current importance and incidentally makes some penetrating comments which should contribute to our understanding of the American giant.

ECONOMIC policy all over the world is affected by the view taken of imminent developments in the United States. Whether one likes it or not, the United States is a tremendous force—by the volume of its imports and the demand for its exports, by expectations of financial aid in one form or another and by mingled hopes and fears of private investment by American firms. Its highly developed national economy is something of a colossus. Without its productivity, reconstruction after the second world war must have been a more chequered and painful, as well as a longer, process. There can be few responsible people in the free world who do not feel a sense of gratitude for the writing off of Lend-Lease obligations and for the subsequent succession of aid programmes by which the United States has contributed generously to reconstruction in many countries. There has always
been some apprehension mixed in with this gratitude. One school of economists was apparently convinced that a severe financial crisis was bound to supervene when war orders ceased—something like 1920-21, if not 1929-33. This did not happen. It is in fact a remarkable achievement that has kept the United States economy expanding, with only minor hesitations and adjustments, for eight years following a great war. During these eight years there have been first the conversion from the war to peace, with a considerable, perhaps too great, measure of disarmament, and then a partial reversion to armament production, now beginning to taper off. Mistakes of economic policy have been made, more perhaps in the rearmament than in the disarmament period; but on the whole the American economy has taken these changes in its stride. The most noticeable setback to expansion, in 1949, did not amount to more than a drop of approximately 3% in the national income.

It is true that even such a small sc. pack was exceedingly troublesome to other countries. In part this is a reflection of the weight of the United States in the world economy. In language that Australians can appreciate, an English economist expressed this to me by remarking that "it's bloody uncomfortable to be in bed with a giant." But in larger part, the extraordinary importance attached to an adjustment which was not at all severe in the United States measures the extent to which other countries, willingly or not, had become dependent on the United States maintaining its expansion. In some, reconstruction after the war, coupled with maintenance of expanded social security and generally higher living standards at least for the mass of the people, had entailed a volume of imports which constantly pressed upon their diminished reserves of foreign exchange. In others, ambitious developmental projects produced the same result. In some, there was, for political or social reasons, a long-continued reluctance to face the economic facts of life and set about the painful tasks of reconstruction with diligence and fortitude. As long as inflationary policies, for whatever reasons, continued to be the rule, the margins of foreign exchange available were inadequate to meet even minor strains such as those caused by a small dip in American prosperity and buying power.
It must be said that the national income is not the best measure of what happened in the United States in 1949. The index of industrial activity fell not by 3%, but by 8%. Imports fell by 7%, but imports from the United Kingdom fell by 21%. These are annual figures measured from 1948 to 1949. If the measurements are made from the peak of activity in the last quarter of 1948 to the trough in July, 1949, the figures would be more dramatic.

This could happen again. Indeed it is quite likely to happen before many months pass by. There is widespread expectation, reflected in the stock exchange, though not very perceptibly as yet in any but odd sensitive indices of economic production and trade, that the spring of 1954 may see something of a recession in the United States. The order of magnitude that is envisaged is more like 8-10% than 3%, which would mean a correspondingly greater fall in industrial activity and imports. Up till now (September, 1953), production and trade continue to expand and there are optimists who point to reassuring facts such as the very large volume of personal savings in the hands of consumers and the large volume also of planned industrial investment for expansion. A substantial proportion of the saving, however, such as contributions to pension funds and life insurance, cannot be regarded as liquid, and the expectations of entrepreneurs can change suddenly.

These expectations are the key to the riddle. It is the private, not the public, sector of the national economy which is most liable to expansion and contraction in a cyclical fashion, if indeed much faith can any longer be placed in such an unpredictable concept as the business cycle has proved to be. There is some reason to think that the current talk of imminent recession is widespread enough to have set in motion the changes in expectations that will bring about a recession. It is of course possible that they have also set going preparations to forestall the worst effects of such a recession. But clearly the most important factor is the old and tried, but so recently despised instrument, of monetary policy. Even before the Republican administration came into office, the Federal Reserve Board had successfully freed itself from Treasury
domination to the point where it could set about regaining the control of the money market. As long as it was committed to maintaining gilt-edged securities at par, the commercial banks, which had large holdings of these securities, could always put themselves in funds by selling them to the Federal Reserve Banks. When the Board allowed these securities to fall below par, it put itself in a position where it could exercise pressure on commercial banks by the traditional methods of raising the discount rate, increasing the percentage of reserves the banks were required to keep and, if necessary, selling securities at the market price. The inevitable result of even mild steps in these directions was to cramp the lending policies of the banks and tighten credit. It now costs more to build a house or expand an inventory.

Informed economic opinion applauded these developments which follow the same pattern as the steps by which the Bank of England has secured control again of the London Money Market and proceeded gradually to free it from the maze of regulations under which it had laboured so long. It is surely unreasonable to argue that what is good policy in London is reprehensible in Washington. The real issue is how far and how fast a tightening of credit should go. The monetary network is something like the nervous system. The immediate effect of a stimulant or a depressant must always be considered with one eye on the longer-run effects which are not immediately visible. I am often reminded of these almost-subterranean effects when my neighbour up the hill, who belongs to the soak school of gardeners, leaves his lawn-sprinkler on too long. After a brief interval soggy patches begin to appear in my garden down the hill and these continue to expand for some time after the sprinkler is turned off. In much the same way, when the Federal Reserve Board tightens credit there are some secondary consequences which after an interval create soggy patches in the national economy at points rather remote from those immediately affected by the credit stringency, and these are apt to continue to get soggier for some time after the Board has stopped its disciplinary programme. One such soft spot at the moment is farm prices. Another may turn out to be instalment buying for example of automobiles—the banks are pretty well loaned up now on such paper.
Still others may be the construction industry and inventory accumulations at various stages in merchandising from manufacturer to retailer. It is a tricky calculation to determine just when deflationary pressures have gone far enough but not too far. And the reversal processes do not operate instantaneously. The deflation continues to percolate underground for some time.

It is these monetary decisions, affecting the expectations of the private sector, rather than economies in public spending, either for foreign aid or for domestic armament programmes which now seem likely to bring about some recession in the American economy. The pressure on interest rates and credit availability, however, is not likely to go much further. The Treasury has a rather large part of the short-term debt to renew, and if possible to fund, in the next few months. But the steps already taken have not yet exhausted their deflationary effects throughout the national economy.

Here is a case for arguing that the only country in the world which ought to err on the inflationary rather than the deflationary side is the United States. It is the area where the slogan of full employment ought to be taken most seriously. Only thus can other countries, such as those in the sterling area, contribute to the restoration of international economic equilibrium and at the same time build up their exchange reserves. Larger reserves are needed to tide over precisely such temporary strains on balances of payments as are likely to be caused by a recession in the United States. It is unfortunate that these reserves have not been built up more in these past eight years. But it is asking a great deal of a country organised as is the United States, always to conduct its domestic policies in such a way as to spare other countries the necessity of providing adequate reserves against such emergencies.

It is the path of wisdom to expect and prepare for periodic strains of this character. This is what foreign exchange reserves are designed to do. It may well be that the best way to provide adequate reserves would be to strengthen (and activate) the International Monetary Fund. But the difficulties which the raw-material and food-exporting coun-
tries in particular face in accumulating adequate reserves can hardly serve to justify expectations that the United States will so conduct its economy as never to make use of such reserves necessary. It is true that fluctuations in the terms of trade are the most bothersome of all the factors which affect the sterling area's balance of payments. When raw-material prices are high the manufacturers of Great Britain face high import costs and therefore higher export prices (as do those in other manufacturing-export countries, including the United States). When they are low, the raw-material exporting countries have fewer dollars. But the terms of trade are not determined solely by the great manufacturing countries. The relative movements of import and export prices (which constitute the terms of trade) depend upon developments both of supply and demand. The proximate cause of their fluctuations may be the expansion or contraction of manufacturing activity; but these are not the sole cause.

Of one fact there seems to be reasonable certainty. There is little likelihood that any recession will be allowed to develop into the destructive downward spiral of a major depression. Already the President's Council of Economic Advisers is preparing a shelf of public-works projects. Taxes are bound to come down. There are other compensatory devices available, including a loosening of credit by the Federal Reserve Board. All these take time to bring into operation and more time to become fully effective. The exact moment when they should be launched is not easy to determine. A threatened recession may develop some momentum before the brakes begin to work; but no democratic government can afford to risk delaying their application to the point where bankruptcies and unemployment become self-perpetuating. There is a congressional election every even year in the United States, including 1954: In too many countries economic policy is still directed towards warding off the depression of the nineteen-thirties. Risks are not run and hampering regulations are not removed because of this deep-seated bogey. Eight years after the war, with at least two minor recessions overcome and a third expected recession likely to be limited in time and scope, it is time that this bogey was laid to rest. Apart altogether from action which even a conservative administration must take if it is to retain popular support, the resilience of the Ameri-
can economy should be sufficient guarantee. After twenty years of income redistribution and government experiment, it is not what it was before 1932. There are tremendous forces of expansion at work which will shake off deflationary influences long before they reach depression proportions.

If there were space, one could tell the same sort of story in regard to another bogey. The United States is moving towards freer trade in the long run; but in the short run there are temporary setbacks. This kind of thing must be expected in the attempt to apply direct representative democracy to a community as large as the United States. Its economy is not a monolithic structure directed towards a single defined purpose by a centralized dictatorship. It is the confused result of a diversity of purposes sought by dispersed interest over a wide area. Nothing of this sort has been known before on this scale. Peoples of diverse ancestry, scattered over a continent of equally diversified resources—dry-farmers in desert areas, cattlemen and sheepmen on wide expanses of sparsely-grassed mountain ranges, high farmers in the deep soil of the river valleys, cotton-growers on small share-cropping lots or on great mechanized farms as in Texas and California, speciality croppers and growers of staples, to say nothing of the workers in enormous factory areas in country towns as well as seaboard cities. To mobilize a public opinion that ranges from sophisticated New Yorkers to the back country dirt-farmers of Louisiana, from the open spaces of Texas to the stockyards at Chicago, is not a simple process. Government proceeds by compromise. By and large the United States moves steadily towards taking up the responsibilities commensurate with its economic strength. It does so by the democratic process which is often disappointing but is the ultimate source of its strength. Sometimes its behaviour may seem erratic. There are impatient idealists who would put it in the straight-jacket of some form of leadership. But it does best for the world as it is, an ebullient, vital, sometimes unpredictable, expression of the faith in which it was founded, the equal right of every common man to have his say. This gives scope to all sorts of crankiness, but it also liberates from the masses of the people an enormous and vital energy without which the world would be poorer.