Without Inflation

The crucial economic issue in the Western World today is to maintain high or full employment without inflation. Notwithstanding the appearance of unemployment in the U.S. and Canada in recent months, experience over the whole period since the war leaves no doubt that massive strides have been made in correcting the chronic under-employment of the pre-war world. Indeed, the success which has attended economic policy on this front has far surpassed the expectations and fondest hopes of governments, business and trade union leaders, and economic and financial experts. But this success had its price, and the price has been a kind of perpetual, built-in, year-by-year inflation.

For some years the public seemed to be strangely resigned to the prospect of inflation, to accept it as more or less inevitable, and to be grateful for the mercies of continued high employment. This attitude of resignation appeared to be reflected in the thinking of economists and governments, who, while they may have deplored inflation, seemed singularly reluctant to undertake the measures necessary to prevent it.
But the peoples of the world seem suddenly to have grown tired of continuing and apparently never-ending rises in prices and costs. The change in public attitude toward inflation may, in retrospect, stand out as the most remarkable economic and social phenomenon of 1957. It has been paralleled by a resolute determination on the part of governments throughout the Western World to achieve reasonable stability of prices and to use the economic and financial weapons necessary for this purpose. Many Australians are familiar with the efforts being made to curb inflation in the United Kingdom and the United States and have witnessed in their own country, over the last 12 months, a similar disposition on the part of governmental, monetary and wage-fixing authorities.

The precise reasons for this sudden change of front are not easy to determine. But at least partly it would seem to reflect a political hardening among those sections of the community who have carried the major part of the burdens of inflation over the years. These people, comprising mainly the professional and salaried middle-class sections of the community, although a minority, can exert a decisive influence on the outcome of elections, a fact of which most democratic governments seem recently to have become aware. But there is more than politics to it. There has been, among leading economists throughout the world, a growing recognition of the grave social injustices to which chronic inflation gives rise; and also some fear that long-continued inflation contains within itself the seeds of eventual economic recession and that prosperity and development which rely upon continuous inflation are based upon foundations less than secure.

There is—and, of course, can be—no retreat from the goal of full employment. In this respect, opinion has not altered one whit. But there is now a far better appreciation of the injustices and hardships caused by a rising price level, even one increasing at the rate of only 2% or 3% a year. There is also a spreading—although not unanimous—conviction that full employment need not be accompanied by creeping inflation; in other words that full employment and stable prices are objectives that need not conflict.

THIS change in attitude is strikingly revealed in three important economic papers that have appeared in recent months. One is a speech by Mr. Per Jacobsson, the Managing Director of the International Monetary Fund, to a joint
meeting of the American Finance Association, and the Ameri-
can Economic Association in Philadelphia on December 30th
last year. Another is a book of four lectures, "Prosperity
Without Inflation", by Arthur Burns. Burns, as former
Chairman of the President's Council of Economic Advisers
and now President of the famed National Institute of Eco-
nomic Research, commands at least as much respect as any
economist in the United States. The third is the First Report,
published a few weeks ago, by the Council on Prices, Product-
vivity and Incomes appointed last August by the United
Kingdom Government to make independent assessments of
the state of the British economy. A noted member of this
three-man Council is the Cambridge economist, Sir Dennis
Robertson, widely revered as the first figure in British eco-
nomics today.

"People in general," said Mr. Jacobsson, "are getting increasingly
tired of inflation. This does not only mean that they dislike rising prices;
that they have done for quite a time. But it means that now they begin
to recognise the reasons for the price increases, and thus to feel that stable
money is something worthwhile making sacrifices for. It is this feeling
that has made it possible for the authorities to take steps to defend the
currency which only a few years ago would have been politically unthink-
able."

As a notable example of these steps, Mr. Jacobsson men-
tions last year's increase in British Bank Rate to 7%, a move
which has been paralleled in several other European countries.

"Credit expansion," stressed Mr. Jacobsson, "can be no substitute for
saving: a reliable currency is the only true basis for sustained investment.
The experiences of Germany and Italy—two countries which have carried
out cautious monetary policies—prove beyond doubt that in our days,
with so many inventions to be exploited and so many houses and hospitals,
schools and roads needed for a growing population, the difficulty is not
to find outlets for the available savings but rather to increase the flow of
savings in order to sustain a desirable level of investment. The Russians
know this and, indeed, have put into practice a careful non-inflationary
monetary policy. In a speech the other day in Kiev, Mr. Khrushchev even
apologised for the fact that since 1954 there had been no further price
cuts in Russia."

Arthur Burns notes the same tendencies in public think-
ing. He emphasises particularly the social and economic
injustices of continued inflation.

"In recent years, many citizens have come to feel that we have been
preoccupied with the need to prevent the miseries of depression, when in
fact that matter was already being handled fairly well, while we have
slighted the injustice and hardship that flow from inflation, when in fact
these have been multiplying for a generation. Concern over inflation has
been increasing."
"If we continue to tolerate the upward trend of prices", writes Burns, "the lives of millions of our people will surely be blighted and the strength of our entire economy may be damaged."

Burns rejects the view that creeping inflation is inevitable under policies of full employment.

"A persistent, albeit a gradual, inflation need not mark our economic future. I have faith that we will work out an acceptable solution of the problem of creeping inflation, because I see economic literacy spreading among the American people. Nowadays, great numbers of citizens understand that inflation, whether it be gradual or galloping, can wipe out their savings just as effectively as can prolonged unemployment. . . . Most important of all they know that inflation is not an Act of God, and they believe that a mature people should be able to conduct their private and public affairs so as to avoid both depression and inflation."

Burns insists that: 'Reasonably full employment and a reasonably stable price level are not incompatible.'

To marshal opinion against creeping inflation, Burns urges an immediate practical step. He suggests that the epoch-making Employment Act passed by the U.S. Congress in 1946 should be amended by including among its objectives reasonable stability of the consumer price level.

"What we need more than anything else at this juncture of our great experiment in the management of prosperity is a national declaration of purpose with regard to the level of prices that could have a moral force such as the Employment Act already exercises with regard to the levels of production and employment."

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THE First Report of the British Council on Prices, Productivity and Incomes, which has been eagerly awaited, makes no bones about where its authors stand on creeping inflation: "We conclude that alike on internal and external grounds our objective should be to stop the inflation, not merely moderate its course."

The external argument is the familiar one that the viability of the British economy, dependent as it is on huge imports of foodstuffs and raw materials, can only be secured by keeping British exports competitive in world markets. But the Council makes it clear that, in their view, the "internal" arguments against a slowly rising price level would be decisive on their own account. The arguments are based on the fact that creeping inflation effects a redistribution of income within the community which is entirely arbitrary and patently unjust. The Council point out that different
groups of society vary greatly in their ability to protect themselves against damage from slowly rising prices. The sectors most likely to benefit from gradual inflation are industrial wage-earners, businessmen and the holders of ordinary shares.

"On the other hand, there are many useful and meritorious elements in society who are disadvantaged in different degrees by the process. Salaried workers, with their weaker collective organisation and with traditions which rule out most forms of trade union pressure, find it hard or impossible to maintain their real income. Events have been strengthening both their organisation and their determination, and economic forces also operate to prevent an indefinite reduction in their relative advantage. But there is no doubt that rising prices, even if at a slow pace, would mean for them, in the future as in the past, hardship, disappointment and discontent."

Other large groups which suffer from inflation are professional people; pensioners, particularly those relying on private superannuation schemes; the holders of fixed and near-fixed interest debt, principally holders of government bonds, but also investors in debentures and preference shares; and, finally, owners of land and buildings let at legally controlled rents. The Council emphasises the disastrous impact of inflation on government borrowing:

"Once a steady upward trend of prices came to be generally accepted and anticipated, something would have to be done to mitigate the rentier's losses—otherwise the Government would cease to be able to borrow any money on fixed interest terms."

In a significant sentence the Report states:

"These arguments against aiming at a slowly rising price level would, we think, be decisive even for a country like the United States which does not have to bother greatly about its foreign trade position."

It would appear that at the present time the overwhelming weight of official and expert opinion in America concurs in this view.

In an important section of the Report, the Council deals with the main criticism of the policy of damping down demand in order to stabilise the price level. The criticism is that by limiting demand through controlling the volume of money, total production is less than it otherwise would be. The Council's answer is interesting, especially in light of the current position in Australia and the widespread clamour for an easier credit policy.

"Excessive demand cannot be restrained if at the same time it is sought to wring the last ounce of output out of a given constellation of human and material resources. In an over-extended economy it is to be expected that a moderate contraction of demand will tend to eliminate
Without Inflation (Continued)

the most costly units of output, thus diminishing the total flow of money incomes by more than it diminishes the total flow of output, which is, of course, from the “disinflationary” standpoint, the right result. But further there seems every reason to hope that by facilitating a smoother flow of work and a better organisation of labour, and transmitting a pressure towards greater efficiency of management, the less congested condition of demand will also bring it about that the loss of output proves to be no more than temporary. Such conversations as we have had with those experienced in business do not lead us to regard these expectations as unduly optimistic.”

Businessmen in Australia have found that the measures pursued by the Commonwealth Government in recent months (to achieve greater cost and price stability) have resulted in marked gains in general efficiency and a healthier competitive atmosphere in industry.

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THERE has been a disposition in some circles to assail this policy, and to argue that the right course for Australia in present circumstances is one of mild inflation and a slowly rising price level. It is maintained that such a condition is in any case unavoidable in a country in the throes of rapid development; and that if this entails sacrifices, then they should be gladly accepted in the interests of building a greater Australia. We have been told that “you can’t build a nation on a credit squeeze”.

Although it is true that credit policy must be flexible to meet changing conditions, the idea that development can be sound and healthy—or even that it will proceed faster than otherwise—on a foundation of perpetual inflation must be highly suspect. This doctrine seems to come uncomfortably close to the time-worn fallacy that prosperity can be had just by the simple act of creating money. And, if it is admitted that inflation involves sacrifices, then it is incumbent upon the inflationists to show how these sacrifices can be spread fairly through the community, instead of falling on a few sections, as they have in recent years.

The judgment of governments and of expert opinion throughout the world—which has now been delivered—is against the inflationists. The resolve of the Commonwealth Government to persist with its long-term policy of stabilisation (in the face of a mounting agitation to take off the brakes) is thus vindicated. If the Government can follow Kipling’s advice and “keep its head when all about you are losing theirs and blaming it on you”, high statesmanship will have triumphed over politics.
High Taxes

NOT so many years ago it was argued—and generally accepted—that any increase in the burden of taxation would tend to have some adverse effect on the desire to work, on enterprise and ambition. Consequently an increase in taxes would be equivalent to putting a brake on economic progress.

This did not necessarily imply that taxes should never be increased. There were considerations that might sometimes have to take precedence over the strictly economic. Economic progress might have to be sacrificed to the demands of elementary justice, to reducing the gap between the very rich and the very poor. Or serious shortcomings in the community's social services might require and justify an increase in taxes. Or there could be a war when high taxes would be regarded as a negligible price to pay for survival.

But few people, not even some socialists, pretended that higher taxes would not tend to have, what is called in present-day jargon, some "disincentive" effect. Thus, even a renowned socialist such as Sir Hugh Dalton, Chancellor of the Exchequer in the British postwar Labour Government, was able to write in the nineteen thirties: "It is probably impossible to impose heavy taxation in a modern community without thereby causing some check to production."

But we now live in a world which has become accustomed to a scale of taxation that would have seemed prohibitive by prewar standards. Some even argue that high taxes have little or no unhappy effects on production; indeed, that in many cases the effects may be favourable, rather than unfavourable, and that increased taxes can sometimes be the means of securing increased work and effort. These views must be regarded with suspicion.

IN 1938/9 the total of all taxes in Australia amounted to 17% of the national income; direct personal taxes were only 4% of the national income. In 1956/7 total taxes were 27% of the national income; personal taxes just less than 10%. As a rough approximation, it might be said the burden of taxes has about doubled since before the war. Yet this has happened without the economy being brought to a standstill and, on the face of it, without crippling effects on productivity and progress. Indeed, the high taxes have gone along with a period of tremendous development and industrial expansion, although, significantly, not of great gains in all-round living standards. At first sight, then, there may appear to be some substance in the argument that heavy taxes do not impose a drag on efficiency and progress, that is to say do not act as a serious disincentive to work and enterprise.

But, if we go deeper, such an argument, based on the facts of postwar Australia, cannot be substantiated. For who is to say that, had the tax burden been lighter, economic progress might not have been even more rapid than it has been?

Moreover, there is an obvious logical weakness in the view that high taxes have little or no effect on incentives. Otherwise we reach the absurd position that taxes could be increased almost indefinitely without adversely affecting enterprise or the desire to work. Plain commonsense leads us to reject such a conclusion. Clearly, there must come a point
where the tax burden begins to impose a drag on economic progress and to slow down, if it does not put into reverse, the natural trend towards improvements in production and living standards. While it may be possible that a community such as Australia can carry a tax load of around one-quarter of the national income without a serious slackening of the rate of economic progress, it does not follow that the burden could be increased to say 30% or 40% without dire consequences. The problem of economic policy is to discover just when and where the imposition of higher taxes would result in a reduction of effort and a disinclination to take the inescapable risks of enterprise and invention.

For a start, the two extreme schools of thought — those who used to see in every increase in taxation a threat to enterprise and work and those who now argue that increases can have a positively favourable effect on production — are probably both wide of the mark. In the light of postwar experience, the fears of those who, in the pre-war world, believed that any increase in taxation in any circumstances would weaken incentives look unwarranted. In this, as in so many other things, Lord Keynes proved his prescience when he wrote in 1935; "It is not necessary for the stimulation of these activities . . . that the game should be played for such high stakes as at present. Much lower stakes will serve the purpose equally well as soon as the players are accustomed to them." At the same time, Keynes cautioned: "... I believe there is social and psychological justification for significant inequalities of income and wealth."

Whether Keynes would have regarded the inequalities in income which exist in Australia today as sufficient to justify the adjective "significant" is a point for debate. It may be doubted, however, whether he would have gone along with the modern tendency to wave aside the question of incentives when increases in tax are under consideration.

An increase in taxes will affect the incentives of different people differently. It has been suggested that an increase in tax rates on the income of a person with large contractual commitments, say on hire purchase for a motor car and household durable consumer goods such as furniture or a washing machine, will tend to make him work harder so that he can continue to earn sufficient to keep up his payments. The same might apply to a man with a large family with heavy fixed expenses for housing, education and life insurance. Again, a rise in taxes which reduced the family income might lead the wife to seek employment in order to remedy the position.

In these and similar cases, it is argued, an increase in taxes far from acting as a disincentive, could conceivably have an "incentive" effect.

But how far is this reasoning valid?

Confronted with an increase in his taxation it is certainly possible that a person loaded with heavy fixed commitments—and even one who is not—will endeavour to maintain his net income after tax and thus his standard of living. But will his immediate reaction be to achieve this end by working harder? Or will he seek other and less painful means of achieving it? It must be recognised, for a start, that the opportunities of
many wage and salary earners of gaining an immediate, or even early, increase in their income through working harder are somewhat restricted. That being so, it seems more likely that an increase in taxes might persuade the wage or salary earner to press for an increase in his remuneration rather than to work harder. Or it might divert some of his energies into financial speculation. If he is a professional man it might lead him to raise his fees, or, if a self-employed business man, his prices. Or it could result in a cutting down of the quality, rather than increase in the quantity, of the work or the service he provides. For instance, he may decide to endeavour to enlarge his clientele not by working longer hours but by giving less attention to the needs of his individual clients. Or, it may encourage taxpayers, whatever their occupations, to seek ways of avoiding tax which they otherwise would never have bothered to prospect.

It is doubtful whether firm conclusions can be drawn. Arguments might be advanced either way. But, in any case, it is clearly wrong to call an increase in taxes which led to an increase in the amount of work an "incentive." An "incentive" is something which encourages or inspires a person to do more or better. It is "a prize" for improved performance, the carrot which makes the donkey move faster. A tax increase which brings about harder work is not so much a carrot as a stick. Either may make the donkey go a little quicker (although the human animal, one suspects, is much less susceptible to the stick than is the beast of burden). But the two have very different psychological consequences. One leaves a feeling of satisfaction and achievement; the other a residue of dissatisfaction and resentment. If the resentment becomes acute it leads to ultimate rebellion against the tyrant who wields the stick. The donkey, who at first moved faster to escape the penalty of pain, may eventually refuse to move at all.

It is a commonplace of modern industrial psychology, that people give of their best when properly encouraged. They do not give of their best, at any rate for long periods, when under duress. Encouragement has a buoyant, uplifting, optimistic influence on the mental outlook; compulsion has a depressing effect. Heavy taxes give rise to the feeling of 'What's the use; no matter what we do, we can't seem to get anywhere.' If this feeling becomes universal—as it seems to have almost become in postwar Britain—will it not inevitably produce a widespread sense of frustration and hopelessness that can only lead to a slowing down of the vehicle of economic progress?

In certain instances, depending upon the particular financial circumstances and mentality of the person concerned, an increase in taxes may lead to harder work. But it is doubtful, indeed, whether this possibility can be elevated to the status of a general principle. In discussing the effect of heavy taxes on incentives it is easy to fall into error if one argues from the particular to the general. In specific cases it may be true that high taxation has little impact on the will to work, or that an increase in taxes would, for the time being at any rate, result in a greater effort being made. Thus a steeply progressive scale of taxation which may reach punitive levels in the higher income ranges may have little or no effect on the lower income groups who are not much affected by it.
This does not mean, however, that it does not seriously discourage those who take the risks inherent in business investment and enterprise, thus imposing a strong brake on economic progress.

Indeed, it is in its effects on enterprise and risk-taking, even more than in its effects on the volume of work, that heavy taxation exerts a strong "disincentive." The farmer who is considering whether to plant additional acres of wheat, to run more sheep or to milk more cows will have in mind the extra income he might expect to receive by so doing. If he finds that a good part of this income will be taken in taxes, he will naturally be less disposed to take the risks involved and perhaps to choose more leisure instead of more work. A business man who is weighing up the "for and against" of installing an expensive new machine to cut costs and increase his profits, may be disinclined to do so, if the additional profit he would acquire will be largely taken in taxes.

Those who lean in favour of heavy taxes have frequently drawn on the report of the British "Royal Commission on the Taxation of Profits and Income" to support their point of view. The Commission stated: "The evidence which has been presented suggests that marginal rates of tax are not at present a serious disincentive to effort in the lower income groups." But this statement applies only to the lower income groups and even here the Commission was careful to add the qualification: "But it is possible that present rates may not be disincentive, while a rise in taxes would still have a disincentive effect." Thinking more generally of the effects of heavy taxes the Commissioners agreed that they were likely to make a man "disinclined to take on something out of his usual course" and probably tended to "repress effort and to discourage the taking of risks."

In 1954/5 the top tenth of the taxpayers in Australia paid over half of all personal income taxes. This group included in the main, businessmen, farmers and professional men, the group which makes the vital decisions which lead to higher productivity, lower costs and all-round economic progress and development.

TAXATION in Australia has not yet reached the penal levels of the United Kingdom and we should see that it never does. The migration abroad of artists such as Noel Coward and Gracie Fields and writers of the calibre of Nevil Shute; the transfer of shipping to foreign flags and the domicile of large investors in low-taxed Switzerland are all attributed to a desire to escape punitive taxation.

It is sometimes argued that redistributive taxation by leading to a more even spread of wealth brings about a wider spread of opportunity and thus makes for a more dynamic society. This is certainly true where there are great extremes of riches and poverty and where taxes have not reached a point where they have become a serious disincentive to enterprise, work and risk. But does it apply where taxes on the middle and higher incomes have become steeply progressive? Or is it not more likely that in this case the opportunities before the less well-to-do will be limited? Under a steeply progressive tax system it is anything but easy for the majority to become rich, or even moderately prosperous. Income is largely consumed in meeting current expenses, and it is hard to
add to one's capital resources. A leading American economist, David McCord Wright, writing on this problem says: "Any measure which disproportionately hampers the rise on independent terms of the new man and the new enterprise strikes directly at the democracy and the technological creativeness of our society. Yet it can easily be shown that income taxation, even at a uniform proportion, may well favour the man who is already rich at the expense of the man who is trying to better his economic status, the established old firm at the expense of the enterprising new one. The addition of high progressive rates makes things even worse, and the result is frequently a policy for those 'already there'—a policy which helps monopoly and social stratification."

This is probably the most serious of all the aspects of burdensome taxes. It places almost impossible obstacles in the way of the man trying to improve his lot in life by climbing up the economic ladder. In our modern high tax economy, it is an aspect worth a lot more thought by politicians and economists than it is usually given.
Tariff Policy

In recent months, the Tariff Board and tariff policy have been under the fire of criticism. It is hard to assess how much of this criticism is merited. Certainly, on the face of it, the procedural mechanism seems slow and laboured—but this may be inevitable in the process of granting tariff protection. Probably much of the criticism arises from the uncertain state of mind engendered by import restrictions, and the fear that the present scale of duties would prove inadequate if the restrictions were suddenly or substantially removed. Possibly there is a vague feeling that the Board is a little old-fashioned in its approach and that it has not yet adjusted its thinking to the greatly increased importance of secondary industry in the rapidly developing Australian economy of the nineteen fifties.

There have been signs that Canberra itself has not been entirely satisfied with the approach and operation of the Tariff Board in recent years. The retiring Chairman, the highly regarded Mr. M. E. McCarthy, has been succeeded by Dr. W. A. Westerman, who has achieved prominence for his work in the administration of import restrictions in the Department of Trade. It may be significant that Dr. Westerman is well known for his faith in Australian manufacturing and its competitive capabilities. The Commonwealth Government has also taken steps to enlarge, and presumably strengthen, the staff at the disposal of the Board.

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As an institution in the economic life of Australia, the Tariff Board has enjoyed a position of high respect and, for a body engaged in such a contentious field, it has been, until recently, singularly free from criticism. It has taken a broad and wise view of its functions. It is something more than a mere instrument for advising the government of the day on the scale of protective duties. It has developed into the nearest approach we have to an economic general staff independent of government direction. The Board's careful and measured Annual Reports have come to take almost the nature of an economic review of the economy and its problems. It has not hesitated to comment upon controversial matters and, at times, to criticise government policies. For example, a recent Report drew attention to the large cumu-
lative cost burden imposed on industry by the payroll tax and also pressed the case for a more liberal scale of depreciation allowances.

The Board has established its own standards or criteria by which to assess claims for tariff protection and these standards have, on the whole, undoubtedly been reasonable and just. Over its history, the Board has shown a keen understanding of its vital responsibilities for the health and stability of the Australian economy. It may have made mistakes; but then what institution, concerned with the complex tasks of economic advice and administration, hasn’t?

Why, then, the recent fall from grace, if such it can be called?

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To some extent the Board seems to be the victim of circumstances.

Perhaps we have all been slow to realise the tremendous changes which have occurred since pre-war days in the environment in which the Board must carry out its work. There appear to have been five major changes.

1. Rapid Growth:

First, before the war Australia was a relatively stagnant economy. Overall growth was slow and the contribution of secondary industry to the economy was fairly stable. In the post-war years the manufacturing sector has expanded with unprecedented speed. This expansion is intimately tied up with the massive programme of development and population increase, since, directly or indirectly, manufacturing must shoulder the task of providing employment for a large proportion of the annual additions to the working population. It has become a major factor in the new, industrialised Australia. Today manufacturing employs nearly 30% of all workers (pre-war 20%) and contributes £1,500 million or 60% of net annual production. This vast change in the significance of secondary industry in the economy must clearly serve both to enlarge and complicate the tasks of the Board.
2. *Import Controls:*

Tariff policy in Australia has been complicated by two other important changes in the economy. The first is the emergence of an acute and continuing balance-of-payments' problem and the necessity for far-reaching controls over imports. Dollar goods have been subject to exchange controls since 1936—although to a much greater degree since 1949. Since 1952 all imports have been subject to licensing provisions. Imposed in the first place as a strictly temporary measure, import control seems to have become almost a permanent feature of the Australian economy. Although exposed to obvious abuses, a better alternative has not yet been found. (Perhaps Dr. Westerman's appointment has been made partly in the hope the Board may evolve some system, presumably based on selective tariffs, to reduce the ambit of controls.)

The Tariff Board, hoping that equilibrium in the balance of payments will be reached mainly by increasing export earnings, has consistently discouraged manufacturing activities which rely on import restrictions rather than the tariff for protection. But the implications of the protective incidence of import restrictions cannot be escaped indefinitely, if these hopes of additional export income do not materialise.

3. *Great Rise in Costs:*

The third change affecting Australian trade policy is the unprecedented rise in the domestic cost structure since the war. This increase has substantially exceeded that of most of the other Western trading nations and it seems only fair to infer that it has substantially weakened the competitive status of many local manufacturers. Minimum hourly wage rates in Australia appear to be at least 60%—in some instances around 100%—higher than in United Kingdom, to which must be added greater “fringe” costs such as longer holidays, long service and sick leave pay. The actual rate of protection against dutiable British goods appears to average around 60%—25% on account of the exchange rate, 15% for freight and insurance charges and 20% for duties. While the Tariff Board in its various Annual Reports has exhibited concern at the high level of Australian costs, it has not shown that it considers large upward adjustments in the tariff to be necessary to compensate for cost disparities. This has given
rise to doubts in some quarters whether the old conceptions of what constitutes adequate protection are any longer valid.

4. An International System:

The fourth important change arises from the fact that tariff policy has now to be assessed and administered in a world striving toward greater freedom of international trade. This is in marked contrast to the situation in the highly protectionist pre-war decade when doctrines of economic nationalism held sway and many nations were seeking to achieve the maximum possible measure of self-sufficiency. Since the war the goal of liberalising and expanding world trade has led to the establishment of a number of important international bodies of which the Board’s deliberations must take cognisance. Australia has become part of a wider international economic system which has compelled some sacrifice of national sovereignty in economic matters. All this has meant that the problems with which the Tariff Board deals must be broached from a broader and more complicated viewpoint than the simpler, direct, “nationalist” approach possible before the war.

Let us look at this “new order” in more detail. Australia participated in the efforts in 1947 to set up the International Trade Organization (ITO) which was to make a start on the job of dismantling the maze of barriers to international trade which grew out of the depression, the militant economic nationalism of the “thirties” and World War II. ITO was succeeded by GATT (The General Agreement on Tariffs and Trade) to which Australia is a party. Under GATT Australia is obliged to extend “most favoured nation” treatment to the 34 other member countries. This means that tariff concessions granted to any particular country must be granted also to all the signatories to GATT. Although existing preferences can be retained, preferences cannot be increased. Australia has, however, been able to take advantage of “escape” clauses applying to balance-of-payments’ difficulties and protection of domestic producers.

The Ottawa Agreement—a key element in the pre-war tariff—has now been discarded under the pressure of developments in post-war trade. Australia felt she was losing valuable export trade to countries unable to compete on the Australian market because of preferences granted to British manufac-
urers. She was also denied the full advantage of price competition on many import items. After extensive negotiation the Ottawa Agreement was superseded by the U.K.-Australia Trade Agreement in November, 1956. The new arrangement overcomes many of the objections to Ottawa and, in particular, recognises the needs of Australia's own industrial development and her responsibilities under GATT.

The main provision of the new Agreement is the concession that Australia may reduce tariff preferences to $7\%\%$ on a wide range of goods basic to Australian industry, irrespective of present margins. The minimum level of preference on other goods is to be $7\%$ or $10\%$, depending on the previously existing preferences. Under the Ottawa Agreement goods from foreign countries had to pay an additional $12\%$ when the duty on similar British goods was $15\%$ and as much as $17\%$ when the duty on British goods exceeded $25\%$. The new Agreement should have the effect of increasing Australian trade with non-British countries and also reduce the cost of imports.

As part of its policy of improving trade relations with good customer countries, the Australian Government signed a new Trade Agreement with Japan in July, 1957. In return for assurances that Japan will maintain and expand her imports of wool, wheat, sugar, barley and certain other primary products, Australia has agreed to grant "most favoured nation" treatment to Japan and to consider the possibility of Japanese membership of GATT within the next three years.

Australia is also vitally concerned with proposals to establish a European Common Market and Free Trade Area. In March, 1957, a six-nation community (France, West Germany, Italy, Belgium, Holland and Luxembourg)—already operating a common market in coal and steel—agreed to establish among themselves a universal common market with a uniform external tariff within the next 12 to 15 years. The Free Trade proposal involves abolition of duties on manufactures between 17 West European countries (including the Iron and Steel Community) but, unlike the Common Market, still leaves each member free to determine tariffs against non-members. This would mean that the United Kingdom will be able to retain existing Commonwealth preferences against non-members. The United Kingdom also wishes to exclude
agricultural products, so that any Commonwealth preferences on these items would remain, even against members of the Common Market and Free Trade Area. Strong attempts are also being made to prevent the inclusion of overseas dependencies in the Free Trade Area. The British Prime Minister, Mr. Macmillan, has stated: "The United Kingdom is not prepared to enter the Free Trade Area at any price. Equally the price of failure (to agree) may be very heavy indeed."

5. Exchange Rates:

The fifth and final change affecting trade policy in the post-war world is the attempt to achieve international control over exchange rates through the International Monetary Fund. National sovereignty in fixing exchange rates has been considerably weakened. The Fund which controls a good part of exchange rates is resolutely opposed to currency depreciation as a means of gaining trading advantages. It also outlaws currency restrictions unless justified by "temporary" balance-of-payments' difficulties.

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The economic environment, both domestic and international, in which the Tariff Board must do its work has thus changed drastically. It is not surprising that there have been demands for a "new look" at tariff policy and at the functions and "modus operandi" of the Board. Indeed an official review of the purposes of the tariff in the expanding Australian economy, which led to a clarification of its position, might be welcomed by the Board itself. Even if such a review indicated that no basic reforms in tariff-making were necessary, it would at least help to dispel the aura of disquiet at present surrounding the Board and to re-establish its old-time prestige. There has been no survey of the place of the tariff in the Australian economy since the classic report of 1929—nearly thirty years ago—by a committee of distinguished economists. It may now be time for another.

One point of criticism is the apparently extreme slowness of the tariff-making process. This is by no means wholly the fault of the Board itself. A scrutiny of cases over recent years suggests that although some tariff applications take three years—from the date when a request is first made to
the Minister for Trade to the tabling of the amending schedule in Parliament—the average time has been around 18 months. It seems to be on average about five months before an appeal is heard. The Minister has to refer the matter to the Board, and witnesses, including overseas representatives, have then to be notified. The Board may then take, say, eight months before presenting its report to the Minister. Whether or not this time is unnecessarily long, there is undoubtedly much for the Board to do. Witnesses have to be heard; reams of documentary evidence on labour and other costs, profit histories, present and prospective demands, the numbers employed in the industry and so on, have to be examined and weighed. Before making its recommendations the Tariff Board has to satisfy itself that protection is granted only to economic and efficient industries, and then, only to the degree that will enable overseas industries to continue in reasonable competition on the local market. Special consideration is, of course, given to “infant” industries with promising prospects and due regard is also paid to the needs of national defence. Finally the Board must prepare its written report and recommendation for the Minister. It may well be feasible to shorten this procedure without seriously affecting the quality of the Board’s final decisions. At the same time it is obviously better that all matters should be thoroughly weighed, even at the cost of some delay, than that the Board should rush through a hasty, ill-considered judgment merely to save time. The matters at issue are too important for that.

After the Board has sent its recommendation to the Minister, another four months may elapse before the Minister accepts or rejects the Board’s decision and introduces any change in rates of duty to Parliament. A large part of the time lag in reaching a decision sometimes arises from Australia’s obligations under GATT. A number of items are “bound” against tariff increases, and, when this occurs, any proposed upward revision is subject to the consent of all member countries.

Other criticisms of the Board arise from the concern in some quarters that it is not fully alive to the key role of secondary industry in the development and migration programme, and that it is not paying sufficient heed to disparities between Australian and overseas costs in fixing tariff levels.
In some cases, it is said, industries are encouraged to invest large sums of money in plant and equipment, but adequate assurances that the new industry will be protected are not provided. Under these circumstances many manufacturers naturally display a reluctance to undertake new avenues of investment. The whole situation is, of course, obscured by import restrictions. Many manufacturers fear that if overseas trade improved sufficiently to enable the restrictions to be removed, they might find themselves in serious straits. These fears are understandable.

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HISTORICALLY, Australia is wedded to the tariff as an instrument to foster the development of its manufacturing industries. Industrialisation in a young and small country cannot be achieved without ample protection. Australia is now becoming a highly industrialised nation and most Australians want it that way. They would certainly look with horror at any failure to provide adequate protection for secondary industries.

At the same time a reasonable balance has to be struck. This would be conceded by most manufacturers themselves. Some overseas competition is certainly desirable. Consumers are presented with a wider choice and local industry is kept on its toes in regard to technical and other developments abroad.

It should also never be forgotten, too, that the long-term interests of Australian manufacturing itself lies in the healthy expansion of exports based on a competitive cost structure. The 1929 Committee on the Australian Tariff concluded that the tariff had enabled the country to support a larger population at a higher standard of living than would otherwise have been possible. But it was at pains to warn that no further increases be made without rigorous scrutiny of the costs involved. Through a process of passing on, the extra costs entailed by protection eventually fell upon the export industries. The Committee estimated that the tariff was adding around 10% to the costs of export industry as a whole and if extended might result in loss of export markets.
The faster export income rises the faster will be the growth in living standards and of a wider home market for the products of Australian factories. Conversely any permanent reduction of export income must adversely affect secondary industry. Local demand would fall off, and restrictions might have to be placed on imports of materials and equipment essential to the efficient conduct and continued growth of industry.

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We cannot live in a world of our own. We are part of an international system increasingly linked by economic and strategic considerations. If we want other countries to show respect for our particular way of life we have got to be prepared to demonstrate a reasonable understanding of their problems. To sell we must also buy. Economic autarchy is an outmoded and destructive doctrine which the world has been striving to discard since World War II.

As with most things in life, moderation is the path of wisdom. Australia's future tariff policy must attempt to tread a middle course. Prohibitive protection cannot be entertained. At the same time we must be careful to ensure that the nation's legitimate aspirations for industrial progress are being met.
What Business Thinks of the Public Service

Extracts from a Paper given to the Institute of Public Administration by the Director of the Institute of Public Affairs, Canberra, March 27, 1958.

There are very different values and standards in the public service and business and this is necessarily so. While I believe it to be true that modern business procedures can be increasingly applied to the routine administrative activities of government departments, quite a large part of the work of the public service does not lend itself to strict business methods or to business conceptions of right and wrong. The critics of the public service sometimes forget this altogether, or at least fail to make sufficient allowance for it.

Equally it is true to say that the public servant sometimes fails to be sufficiently tolerant of the standards which obtain and must obtain in business. He does not always fully comprehend the businessman's attitude and the motives by which he is actuated.

All this gives rise to a tendency for the businessman to be over-critical of the public servant, and conversely for the public servant to be over-critical of the businessman.

In these matters we should seek to be tolerant. We should try to put ourselves in the other person's shoes; to see the problem through his eyes. There is undoubtedly scope for more tolerance in the relationships of business and the public service, and I think possibly there is more tolerance and a better understanding today than there was in the years after the war. But there is still room for improvement.

We are all to some extent the creatures of our environment. It is surely wrong to expect the man moulded in the traditions and methods of the public service to look at life the same way as the man whose life has been spent in business and more particularly as the man who is in highly competitive business. Two environments which differ so vastly will produce quite a different species of animal. But the important thing, I believe, is this—they are different in kind, not in quality. One is no better than the other—morally no better, intellectually no better, in ability and energy no better. They are merely different.

If there is one thing I think both businessmen and public servants could do with great advantage, it is to rid themselves of any notion that, in some mysterious way, one is superior to the other. Nothing could be more false. At the risk of treading dangerous ground, I would say that what the public servant should be particularly careful of is the idea that he possesses a kind of moral ascendancy over the businessman. Such an idea, if you stop to think about it, is, of course, complete nonsense. I am speaking now in general terms. There are, of course, some public servants who have a nobler conception of life than some businessmen. The converse is equally true. But I am not concerned with individual cases. What I am concerned with is the idea that the public servant as such is a better man, in general moral standards and outlook, than the businessman as such.

This idea where it exists—and it is by no means universal—probably has its roots in the fact that the public servant must have regard always to the interests of the nation, of the whole community, whereas
the businessman is concerned, partly at least, with his own narrower, personal interests, and the welfare of his particular business. But this is, surely, purely an accident of position. The public servant, who takes as the acid test of right and wrong, the elusive concept of the public interest, is merely carrying out his job. That is what he is paid for. The businessman is operating in a tougher environment. He must show a profit, or he will soon have no business at all.

This does not mean that the businessman in his pursuit of profit is necessarily running counter to the public interest. On the contrary, in most cases the business that achieves success and shows a healthy profit and loss account and balance sheet is serving the public interest by that very fact. It has served the public through its anticipation of the public's needs; by providing products and services which it wants and for which it is prepared to pay; by pioneering new fields of production; by its attention to efficiency and cost reduction.

There is a disposition to envy, success, to assail good profits; but before we do so it is only fair to ascertain how these profits have been made and to what extent they represent a reward for efficiency and for enterprise above the average.

On the whole I believe it to be true that the best type of businessman consciously applies the test of the public interest to his own activities and makes a significant, and sometimes unrecognised, contribution to the general national welfare. Nevertheless, it is only fair to recognise that the businessman is exposed to much greater temptations than the public servant. What, for instance is the businessman to do who knows that unless he can secure a higher protective tariff on his goods, he will go out of business? Yet it may be clearly against the public interest that the tariff should be granted. Should the businessman refrain from any efforts to obtain the tariff? Should he gladly commit suicide? That, I suggest, is expecting altogether too much of human nature.

What I am getting at is that it is easy to be good if you are never exposed to temptation. There are after all more ways than one of committing sin, and the sin of self-righteousness must stand high on the list of the most reprehensible. I am not for a moment suggesting that many public servants are self-righteous. I am sure that most are not. But the danger of assuming a "holier than thou" attitude is one to which the public service is peculiarly exposed, and of which it needs to be constantly beware.

I WOULD say that, so far as my own experience goes, there are three main general criticisms of Canberra frequently heard in business circles;

First, that it is too big.
Second, that it is too remote.
Third, that it tends to be "anti-business."

Now as for the first criticism, I do not think there can be much doubt that it is valid. My own belief is that the work of the Commonwealth Public Service could be carried on just as efficiently, just as effectively, with quite substantially fewer numbers. There is a natural, almost irresistible tendency for administrative staffs in large and complicated organisations to grow beyond, and occasionally far beyond,
the necessities of the job they are called upon to do.

There is no doubt that "empire building" can go on in the administration of large private businesses just as it does in government departments. And, quite apart from "empire building," staffs both in government and in private enterprise are sometimes built up not necessarily to add to the prestige of the departmental or sectional head concerned, but in the sincere belief that the extra numbers are really necessary to do the job.

The departmental head in a business however has a harder task to justify increases in his staff than his opposite number in government. In business the factor of cost is of much greater importance than in government, because business is under compelling need to show a profit. Costs are likely to be much more rigorously scrutinised. When governments spend more (and they are the ultimate arbiter of the size of government spending) they only have to justify their spending to the tax-payer, who is rather a remote individual. He can kick up a fuss—as he usually does—but he cannot do much more. But if a business consistently fails to show a profit, the top executives are likely to find themselves out of a job, or at least in line for demotion. This does not imply any superiority of business over government administration. It is simply a frank recognition of the different circumstances which apply to each. If you transfer the business executive from business to public service, then it won't be so long before he acts like a public servant. Conversely, if you transfer the public servant to business, he would, I predict, become much more cost conscious, and eventually he will act like a businessman.

In these days when government administration has become a huge and significant factor in the life of the community, it is a good thing that it should be constantly exposed to the searchlight of criticism and review. When the criticism is fair and objective and firmly bedded in the concrete of fact, then the public servant should not be over-sensitive about it. If, however, as sometimes happens, the critic fails to get his facts straight first, or indulges in wild exaggeration, then the public service has every right to feel aggrieved.

Now what of the second complaint—that is, that Canberra is too remote.

Remoteness from the everyday life of the people may induce a kind of remoteness of the mind, a mental unreality, a theoretical rather than a practical approach to national problems. One tends to look at life from afar. I often think it is a thousand pities that business people and public servants are, in the Australian setting, unable to mix freely in business affairs and social intercourse from day to day. I am sure that that would lead to a much better understanding, of one another and, in the process, a much better understanding of national problems. The approach of the public servant would gain in realism; that of the businessman would gain in appreciation of wider national considerations. Both could not fail to benefit vastly. But, as things are, that is not altogether possible.

I know that most Canberra people are by no means unaware of the dangers of their enforced isolation and do at least something to over-
come them. But any situation in which the processes of government take place in an environment entirely different from, and far removed from, the everyday life of the governed is one fraught with hidden menace. I think you will agree that the menace can be averted—and indeed will be averted—only if we are constantly alive to it. That is my sole justification for mentioning this matter here. But having said all that, it is only fair to add that Canberra is not something for which the public servant can be blamed. If any blame is necessary, then it must be directed at the Australian people altogether.

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The third criticism is the complaint that Canberra tends to be "anti-business." It is difficult to determine whether, or to what extent, this complaint is justified. It is certainly one that is not unique to Australia. One finds more or less the same kind of thing in most of the other democratic countries, in the business attitude to, say, Washington or Whitehall or Ottawa.

To some extent such a feeling may be inevitable. The public service is compelled to take decisions almost everyday which cannot fail to be unpopular in certain business quarters. Often these decisions may be right; sometimes they may be wrong. But whether right or wrong they can hardly avoid giving rise to irritation and resentment among the people directly affected by them.

Take the man who applies for a licence to import certain goods. His application comes up for consideration and is rejected. From the national standpoint, the decision may be perfectly right. But what is its effect on the person who wants the licence? He would surely be more than human if he did not feel some measure of irritation, and even annoyance.

But apart from decisions which affect particular business interests, I think I am right in saying that there is a general feeling among business people that where there is a doubt about whether this course or that should be pursued, Canberra too often comes down on the side least favourable to business. Should a certain control be removed? Should company tax be reduced? Should payroll tax be abolished? Should extra depreciation allowances be granted? These are the kind of marginal questions on which business feels that Canberra, more often than not, takes a stand adverse to the interests of business.

There is another example of this feeling. When weaknesses appear in the economy, and restrictions have to be applied, it is felt that these restrictions usually fall on the private sector of the economy rather than the government sector.

A major part of the burden for securing the great objectives of national policy, for example, full employment, national growth and progress, falls upon business, and the community cannot fail to be adversely affected by unnecessary conflict between business and government. The aim should always be to reduce the differences and expand the areas of agreement and thus strengthen the co-operation between the two.

There has, for instance, been a great deal of criticism in business circles in recent months of the "credit squeeze." What are we trying to do in Australia at the moment? After years of inflation,
are we, at long last, trying to preserve a reasonably stable internal purchasing power for the £? If so, why are we trying to do this? Why the apparently sudden change of front on this issue? Why has it suddenly become all-important to stop price rises, and, if really all-important, is the present tight rein on credit inescapable? Here is a matter on which clear, unequivocal, explanation could greatly help to clear up misunderstandings, to overcome antagonism in business quarters and enlist their co-operation in the achievement of national objectives considered to be of over-riding importance.

IN the highest ranks of business there is a proper appreciation of the tremendously complex character of the decisions which Canberra is called upon to make and of the great burden of responsibility which falls upon those people who have to make them. There is also not a little admiration for the capacity, energy, and fair-mindedness which many leading public servants bring to this task. Few people envy them their job. In the field of economic policy-making, the work is of the highest class. It is sober, responsible, disinterested, and animated by a sincere desire to do what is best. I have not always agreed with what has been done or said, but that has not lessened my admiration for its quality.

We sometimes forget that the Australian economy is a highly volatile economy. We can be in a state of unprecedented boom one year with almost a surfeit of riches. Next year we can be nearly on the rocks and facing shipwreck.

The task of government and government administration in these conditions is peculiarly difficult and the responsibilities correspondingly great. Serious errors of policy can have disastrous consequences. A heavy burden falls upon the higher public service and it is, above all, necessary, that it should unceasingly strive to maintain the highest standards of economic and social analysis, and of dispassionate, unbiased enquiry and advice. Where any section of the public service fails to do so, where it falls below these standards, it reflects on the prestige and standing of the whole of the service.

There have been occasions, I believe—fortunately they are few—when the best standards have not been achieved. There has been a disposition to support or justify policies not by unbiased scientific analysis and investigation but by assertion, by dogma, and by the half truth. These are, admittedly, exceptions to the general rule, but the public service cannot afford exceptions. The public service should not—indeed it cannot afford to—have any truck with propaganda or anything that savours of the methods of propaganda. That should be left to the politician. Propagandist methods do not belong in the permanent service and I hope that those who are tempted to indulge in such methods incur the strong displeasure of their colleagues, as no doubt they do.

Australia, and the business community in particular, expect a lot of the public service and are entitled to do so. Its intellectual integrity must be beyond all doubt. It is, admittedly, expecting too much of fallible human beings to expect that they will never make mistakes. The public service can afford to be in honest error; what it cannot afford is to be false to the ideal of honest service.
The External Picture

By


Minister for External Affairs

The I.P.A. is privileged to have this survey of the international situation from Mr. Casey who stands high in the Councils of the world. Mr. Casey has spent almost his entire working life as diplomat and administrator in Britain, United States, India and the Middle East, or as a Cabinet Minister in his own country. Few men in world affairs today have had Mr. Casey's breadth of experience of the international political scene.

Any review of the world situation must be mainly concerned with relations between the Democracies and international Communism, whatever the geographical area under discussion.

Disarmament

The most important single aspect of the relationship between the democracies and Communism concerns the efforts that have gone on for many years to achieve some reasonable limitation and reduction of armaments. Disarmament discussions have been proceeding in the United Nations since 1946. The stated aim of these talks is the conclusion of an agreement providing for large-scale reductions in the levels of armed forces and armaments, and the eventual abolition of all nuclear weapons and weapons of mass destruction. Little has been achieved, but in the last couple of years there has been an encouraging trend to concentrate on what are called measures of partial disarmament. Obviously it is unrealistic at the present time to talk in terms of the complete abolition of nuclear weapons. What is needed is a limited agreement which will lessen the threat of war by providing for a system of international inspection to guard against the danger of surprise attack, halt the present build-up in conventional and nuclear armaments, and so enable a begin-
ning to be made in reductions in existing levels of armaments of all sorts.

Discussions in the Sub-Committee of the Disarmament Commission have been useful in defining areas of agreement and of disagreement between the Western and the Soviet positions. Unfortunately, the areas of disagreement far outweigh the areas of agreement. On most major points the two sides are still a long way apart. This was demonstrated by the brusque Soviet rejection of the proposals for partial disarmament put forward by the Western powers in August 1957. These proposals provided for reductions in conventional armaments and levels of armed forces, a two-year cessation of nuclear test explosions, the cessation of the production of fissionable materials for weapons purposes and a system of mutual aerial and ground inspection to guard against the danger of surprise attack.

These proposals and the latest Soviet proposals were discussed at the Session of the United Nations General Assembly in late 1957. A resolution based on the Western proposals was adopted by a vote of 56 in favour, 9 against, with 15 abstentions. This vote was an encouraging endorsement of the years of patient work which the Western powers have put into the disarmament talks, and an exhortation to the Soviet Union to settle down to the serious technical discussions which must precede the conclusion of a disarmament agreement.

Unfortunately, the present prospects are not bright. Late in 1957 the Russians announced their refusal to participate further in the work of the Disarmament Commission as then constituted. In an effort to meet the Russian attitude, the size of the Disarmament Commission was increased by the United Nations General Assembly from 11 to 25, but Russia still refused to participate.

It is to be hoped that Russia will reconsider its position and resume the discussions. The key to the whole problem of disarmament is the question of mutual international inspection of the operation of any agreement that may be reached. To date, the Russians have shown the greatest reluctance to agree to even a reasonable degree of international inspection within its borders. Until it does so, there seems to be no hope of the talks coming to a successful conclusion.

East-West Relations

It seems that the Communist objective is, by constant and repeated professions of the desire for co-existence, to win over the non-Communist and un-committed countries and to prompt the Western democracies to drop their guard. Further, past evidence suggests that while continually talking about peaceful co-existence, the Communist aim is to extend Communist influence and foment grievances against the West.

The Russian leaders have lately addressed a series of letters to the major Western powers. The apparent aim of this correspondence is to arrange "summit" talks. The sincerity of the West's desire for peace is beyond doubt. They would join "summit" talks if there was any reasonable chance of success. However, such talks, to have any prospect of success, must be preceded by thorough preparations and there must be broad agreement on the subject matter of the agenda. These preparations could take place
through the Foreign Ministers of the countries concerned or through diplomatic channels. It would be disastrous if each side brought up for discussion proposals to which the other side could not possibly agree. This would only result in highlighting the points of disagreement and hardening their respective attitudes. A well-chosen and mutually agreed upon agenda might provide an opportunity for some advances to be made by each side on matters on which agreement was possible and on which subsequent discussion might develop into a wider area of agreement.

Apart from proposals relating to disarmament, the main subjects that have been variously suggested from either side for summit discussion are—reunification of Germany; freedom for Eastern Europe; establishment of a nuclear free zone in Central Europe; a non-aggression pact between N.A.T.O. and the Warsaw Treaty powers; use of the veto in the United Nations; the Middle East; and the peaceful use of outer space.

British-American Relations

A MATTER of the very highest importance in the world is the relationship between the United Kingdom and the United States. Interdependence and close cooperation are the key notes of the relationship. The partnership is based on confidence and trust between the partners in all aspects of international affairs.

The partnership was gravely shaken in late 1956 over the Middle East situation, but has achieved a remarkable come-back since Mr. Harold Macmillan became Prime Minister.

It is useful to look at the remarkable record of achievement in the rebuilding of British-American relations, during the past year.

The year 1957 opened by the visit of Mr. Duncan Sandys (United Kingdom Minister for Defence) to Washington for official talks. This was followed in March, 1957, by the meeting between Mr. Macmillan and President Eisenhower at Bermuda, a conference which did much to pave the way for the work of the following months. In October, 1957, came the most successful visit by the Queen to the United States, which was followed shortly afterwards by a further conference between Mr. Macmillan and President Eisenhower in Washington.

In the very difficult field of disarmament the United Kingdom and the United States took an almost identical line which contributed in a major way to the agreed proposals finally drafted by the United Kingdom, the United States, France and Canada.

Similarly, in the United Nations General Assembly at the end of 1957 there was a remarkable similarity of view between Britain and America on all important issues, and there was the fullest consultation and liaison between members of the two delegations. At the N.A.T.O. Summit meeting in Paris in December, 1957, both Mr. Macmillan and President Eisenhower showed a heartening identity of view and purpose.

In fact, I believe that it can be said that the state of the world has created a common realisation in both the United Kingdom and United States that each is indispensable to the other. This has been reflected in 1957 by numerous examples to co-operation and of evidence of a fundamental ability to work together.
Each of these two great democratic partners has a great deal to contribute to the survival of the democratic world. The interests of the British Commonwealth are world-wide, although the material strength of Great Britain has been sapped by their efforts in two world wars. The emergence of the United States as the greatest single democratic world power has been rapid and dramatic. Their vast and continuous contributions towards the revival and support of all threatened democratic countries have saved a dozen countries from being absorbed in the Communist fold. The scale and scope of American aid to the democratic world is without precedent in the world's history.

European Economic Community

On 1st January, 1958, the inauguration of the European Economic Community marked the latest stage in the development of a more closely integrated Europe. The six countries which constitute the Community are—France, Italy, Western Germany, Holland, Belgium and Luxembourg. In recent years these six countries have represented the most rapidly expanding major market in the world. When the European Economic Community is fully implemented, these six countries will form a large economic unit, working to a common policy which promises to lead to an expansion of production, a growth of trade between the member countries, and increased living standards for the 225 million people of the area.

With this greater economic integration it is hoped there will also come greater political stability and greater resistance to Communist infiltration.

Discussions have also been going on for some time for the establishment in Europe of a free trade area to include all the Common Market countries and the other countries belonging to the O.E.E.C. (Organisation for European Economic Co-operation).

Australia's interest in this proposed free trade area lies primarily in the problem of finding some means by which the United Kingdom may associate itself with the current developments in Europe and at the same time maintain her close economic ties with her Commonwealth partners.

The Australian Government will follow closely these new developments in Europe to ensure that Australia's interests are protected.

Middle East

The announcement on 1st February, 1958, by President Nasser of Egypt and President Kuwatly of Syria, proclaiming the union of their two countries is the most recent event of great interest in the Middle East.

Just prior to the proclamation of the Egyptian-Syrian union there was a meeting of the Ministerial Council of the Baghdad Pact in Ankara. The Pact countries—Iraq, Turkey, Iran, Pakistan and the United Kingdom, supported by the United States, are united in their determination to resist the various pressures, which international Communism is at present exerting in the Middle East.

Examples of this Communist drive are numerous. The Soviet loans, the supply of Communist arms to Egypt and to Syria, the attempts by the Soviet Union to create at the United Nations a crisis in Turco-Syrian relations, and the constant bombardment of Russian radio propaganda...
directed at the Middle East. Communist China has also entered the field with a loan of 75 million Swiss francs to Yemen. This small country which has a border dispute with the Aden Protectorates, is reported to be thinking of joining the Egypt-Syria union.

Relations between Israel and her Arab neighbours remain strained. As long as the Arab-Israel hostility is unresolved, it represents a source of danger to the area, by providing Russia with the facile cry that Israel is the tool of Western Imperialism, which tends to be music in many Arab ears.

In short, the Middle East remains a scene of some confusion, to which at present there is no sign of an overall solution.

South-East Asia

In South-East Asia the situation has both encouraging and disturbing aspects. During the past twelve months most, but not all, of the countries of the area have continued their progress towards political and economic stability.

1957 has seen the emergence of the independent Federation of Malaya and the conclusion of a constitutional agreement between Singapore and the United Kingdom. On the other hand, 1957 has seen the admission of Communists into the Government of Laos, the current political and economic crisis in Indonesia and by the continued efforts of international Communism to increase its influence over the countries of South-East Asia.

In Burma and in Malaya, the Communist parties are striving to secure recognition as legal political parties. In Indonesia the Communists have had considerable success in increasing their political influence through parliamentary means (notably in the Java municipal elections) and have exploited the current Indonesian crisis by professing to be the champions of extreme nationalist aspirations.

Selective economic aid by the Communist countries to the countries of South-East Asia has been based on their efforts to establish the proposition that “neutralism” pays.

One of the most significant recent developments in South-East Asia was the agreement reached in November, 1957, between the Royal Laotian Government and the Communist dominated Pathet Lao for the reunification of the country. The two northern provinces of Laos, which had been largely under the control of the Communist dominated Pathet Lao since the Geneva Agreement of 1954, were to be returned to the jurisdiction of the Government of Laos and the Pathet Lao fighting units were to be integrated in the National Army of Laos. In return the Pathet Lao were given two portfolios in the new Government of National Union. Laos thus becomes the first country in South-East Asia to accept Communists in its Government. While we can sympathise with the desire of the people of Laos to re-unite their country, it will be a tragedy for them and the rest of the area if, in their eagerness to achieve reunification, they have accepted a settlement which affords the Communists the opportunity to bring the country into the orbit of Communist domination.

While the Malayan Government has embarked on a constructive programme to consolidate the Federation's still young independence, it has still the major problem of meeting its promise to the people to end the Communist terrorist menace within the 12 months following in-
dependence. Its policy of extending amnesty terms to the Communist terrorists until the end of April, 1958, has been followed by a heartening number of surrenders in the country regions. In the face of overtures by the Communists for a compromise settlement and for recognition as a legal political party, the Prime Minister (Tungku Abdul Rahman) has declared his firm intention of refusing anything less than unconditional surrender.

By agreement, initialled between Singapore and the United Kingdom in April, 1957, Singapore will obtain internal self-government with the introduction of a new Constitution late in 1958 or early 1959. Interest will be focused on Singapore during 1958 when the stability of the present Government (a coalition of the Labour Front, the Alliance and the Malayan Union) may be challenged by the opposition group, the People's Action Party, which recently secured a majority in the Singapore City Council elections.

The bloodless Army coup in Thailand in September did not change the basic nature of Thai politics. The general elections held in December, 1957, returned an Assembly similar in composition to its predecessor, and a new Government has recently been instituted under General Thanom, whose policy is to continue Thailand's alignment with the West and membership of S.E.A.T.O.

This has contributed to a breakdown of inter-island communications, a curtailment of exports, production and of foreign exchange earnings; some pressure on essential food supplies and, in fact, a further aggravation of Indonesia's already substantial economic difficulties. This new deterioration in political and economic conditions provided fresh impetus to dissident leaders in Sumatra and the Celebes to put heavy pressure upon the central government for political and economic reforms. They demanded in effect the limitation of Communist influence and some decentralisation for the outer islands, in administration of economic affairs. When they did not secure satisfaction, the dissidents proclaimed in February, on Central Sumatra, a rival "Government of Indonesia." Since then, there has been some fighting between adherents of the two regimes.

This disorder and actual hostilities are an obvious cause of concern to Australia. It is our desire to see a suitable and democratic government in this country which is nearest to us, and we could be adversely affected by the emergence of stronger Communist influence or by continued disorder there.

East Asia

Two of the most important countries in the Pacific region of which Australia must take due account are Japan and China.

With its admission to the United Nations in 1956 and election to a non-permanent seat on the Security Council from 1st January, 1957, Japan has become again a full member of the international community. Moreover, as a democratic constitutional monarchy it is committed to the free world position. Australia has tried to follow a sym-
The External Picture (Continued)

pathetic and co-operative policy towards Japan in the interests of helping it both as a free world partner and as a Pacific neighbour. There have been increased comings and goings between Australia and Japan on government and other levels, the conclusion of the Australia-Japan Trade Treaty, and the settlement of most outstanding issues between us. There is much mutual advantage in this improved association.

Unfortunately, China is another matter. Under its Communist masters, mainland China is committed to the cause of international Communism, the antithesis of what Australia and the free world stand for. We have watched for a more liberal approach, internally and externally by China, but have seen nothing encouraging.

We see the position of Formosa and the Nationalist Government as a reflection of the state of affairs in China. There is no moral or practical argument for abandoning Chiang Kai-Shek's government and the ten million inhabitants of Formosa to the Communists. Although there has been a lack of serious hostilities in the Formosan area for some time, it is well to remember that the problems there are unsolved, the tensions still acute, and the Chinese Communists still committed to their aggressive designs.

Conclusion

We are at a stage of world history where the Communist bloc appears to have a number of advantages over the Free World. Although we know what tensions are built up in the satellite countries by this tight control from Moscow, and we have an example in Hungary of how an oppressed people can risk all in an attempt to shake off this foreign control, we cannot ignore the general effectiveness of this tight central control of the Communist world and the implications it has for the democratic world which is threatened by it. Communist policy is set by a relatively small group of men whose decisions govern a completely conformist world-wide apparatus equipped to explain and justify the "line" adopted by Moscow and Peking. In the democracies, decisions are arrived at by a process of consultation, with Governments responsible to legislatures and public opinion.

It is clearly necessary for us all at this time to examine where we stand. It is not enough for the countries in N.A.T.O. to confine their thinking to the frontiers of free Europe, nor is it enough for the members of S.E.A.T.O. to look only at the southern border of China or for the members of the Baghdad Pact to show anxiety only about what the Communists do or threaten to do in the Middle East. There is a common identity of interest by the members of N.A.T.O., S.E.A.T.O. and the Baghdad Pact, and there must be a global sense of responsibility. As we achieve that, confidence will increase among the nations outside the Communists' orbit.

Tyranny maintains an apparently monolithic front until it suddenly crumbles. The world has had many examples of this. A living organism cannot remain static for long and we believe that history has proved democracy to be more adaptable to changing conditions than any other political system. It is Communist tyranny more than democracy, which contains within itself the seeds of its own undoing. We must maintain our courage and our unity and a common resistance to the Communist menace in its many forms. If we do this, I believe that a vastly more hopeful and constructive future awaits mankind than now appears in sight.