Editorial — Much Uncertainty

A GREAT deal of uncertainty and confusion continue to exist about the economic outlook and the Government's economic policy. Confusion has been heightened by the changes in the emergency economic measures introduced only 3 months ago. The additional sales tax on cars has been abandoned; the proposals regarding the investment of life assurance and superannuation moneys have been materially altered; and there are strong indications that the November measures relating to deductibility of interest for taxation purposes may have a limited application only.

These rapid changes suggest that the Government is feeling its way in what is, admittedly, an extremely difficult situation. It is fair to say that the Government is by no means sure of the eventual outcome of its policies; but for this it cannot entirely be blamed. Who can be sure what is the correct medicine to deal with the situation in which Australia now finds itself? And, if the medicine now being administered is the correct treatment, how much of it will the Australian people be prepared to take?

In practically every quarter the Government's policy has been criticised, in many instances harshly and destructively. This kind of criticism is all very well, but what would the critics do if they were in the shoes of the Government? So far, apart from the clamour for the re-introduction of import controls, not one alternative suggestion of any potential merit has been forthcoming.

At this point it is well to recall why the Government felt compelled to take emergency action in November.

There were two reasons:—
(1) Internally, inflation was continuing too rapidly for comfort.
(2) Externally, the nation’s overseas financial reserves were being drawn upon at a rate which, if allowed to continue, would have exhausted them within the short space of 2 years.

Both were clear evidence that Australia was living well beyond its resources.

Whatever the Government chose to do to meet this situation would have been hotly attacked. No one likes to be told that the spending spree which he has been enjoying to the full must come to an end. Indeed, the great dilemma which the modern government faces, not alone in Australia — although in Australia the dilemma is pronounced — is that the cure for inflation is, if anything, more unpopular than the disease itself.

Some say that if the Government had not misjudged the future course of events in early 1960, or, if when things were not turning out as expected, it had acted sooner, the November measures would not have been necessary. But how many objected to the “boom” when it was roaring along in full tide and when most of us were finding it so exhilarating? The Government, if it showed some reluctance to “crack” the boom, was merely reflecting an attitude that prevailed through the community. The plain truth is that the boom had to be stopped or, before long, we would have been staring national bankruptcy in the face. Now that it has been stopped — or is in way of being stopped — we would all do well to recognise that it is unlikely to return, for the very good reason that we cannot afford it. Those who are living in hopes of an early restoration of the conditions of mid-1960, seem certain to be disillusioned.

Even its bitterest critics must concede that the measures taken by the Government in the latter half of 1960 have not been entirely ineffective. The more glaring examples of speculative activities — shares and real estate — have virtually disappeared, while the body-blow aimed at the motor vehicle industry in November appears to have been even more effective in reducing the sales of cars than the Government itself had anticipated. There also seems to have been a marked fall in the tempo of housing construction and in the sales of durable goods in the electrical field.

But the real test of the efficacy of the Government’s measures will depend on how far these primary effects of its policies are reflected in a slowing-down of the rising price and cost trend and in a worthwhile reduction in the import flow.

The crucial question now is whether the Government’s measures will prove adequate for the job they are meant to accomplish — and,
in that regard, the all-important need is to reduce the drain on the reserves to a moderate flow and, then, to a dwindling trickle. The answer to this question will be given over the next six to twelve months.

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There are, broadly, two ways of reducing a nation’s spending on imports. One is to cut back the community’s total spending, the reduction in total spending being translated into a lower level of demand for imports. Here the modus operandi are fiscal and monetary restraints. This is the course the Government has chosen with special emphasis on the monetary side and with special attention to the motor car, building and durable consumer goods industries. The other is to control the level of imports directly by import licensing. This was the method used from March, 1952, to February, 1960.

For small or moderate fluctuations in the balance of payments, the former is undoubtedly the right weapon. But some doubts about the efficacy of this weapon must arise when the drain on the reserves is precipitous and when it threatens to be persistent. The doubt exists simply because the compression of spending cannot be taken too far without causing a widespread loss of jobs and a rising percentage of unemployed. But “full employment” is the one major economic objective on which the Australian people seem to be immovable. Moreover, even a small amount of genuine unemployment would deal a shattering blow at the migration programme.

These matters will clarify in the coming months.

Notwithstanding all the critics and the doubters, can the policy succeed? There is one condition — and perhaps only one — under which it could. There will have to be a substantial pick-up in export income (of something of the order of £50 million to £100 million) in the 1961/62 financial year. If this recovery does not occur, then it is very hard to see how the Government could avoid taking direct action against imports by the re-imposition of controls.

With the near-certainty that the drain on the reserves will continue in the remaining months of 1960/1, and perhaps into 1961/2, many will think that the path of prudence would be to restore the controls forthwith. The blood-letting has already been of serious proportions, and a further weakening of the patient would leave him in poor shape to face up to whatever lies ahead.

Nevertheless, it cannot be emphasised too strongly or too often that the re-imposition of import controls is not, as many people seem to imagine, a solution to the basic problems of the economy. It would be attended by a number of serious disadvantages, of which the
Government is no doubt well aware. Indeed, if the restoration of import quotas were to encourage the maintenance of a tempo of economic expansion and development which has become untenable then it would do incalculable harm.

The state of the road ahead is uncertain and nobody knows whether it will get rougher or smoother. At the moment we are in a pretty rough patch the effects of which are, however, being “cushioned” by the efficient “springing” of the modern economic mechanism. In the old days, a recession in export income and a run on the reserves of the present magnitude would have been sufficient to cause a great deal more than the discomforts we are now experiencing. No one in their right mind would want to revert to the old mechanism; nevertheless, the modern devices have the drawback of concealing from the passengers the hazards and dangers of the road over which they are travelling.

In the immediate future — for the next few months — economic and business conditions could get worse rather than better, but there is a widespread hope that in the last half of the year the situation will improve markedly. It should be emphasised that the grounds for this hope are uncertain and tenuous. The right attitude in the present circumstances is, accordingly, to anticipate no miraculous recovery; let us hope by all means (men live on hopes) but let us take nothing for granted.

The drain on the balance of payments may very well slow down. If it fails to do so, then of course, the present policies would have failed utterly. But with the level of the reserves approaching the danger point by June, 1961, a mere slowing down will be hardly sufficient. From then on, opinion may harden (even in Government circles) that the run on the reserves must be arrested entirely and that economic policy will have to be based on the principle of “thus far and no further”.

In the last decade, industrially, Australia has grown in maturity. We have now to show that we can think and act in a mature fashion when it comes to solving the economic problems which confront the economy from time to time. The trouble is that we have behaved just a bit like the fat boy at the party who wants everything — over-full employment; development faster than any other country in the world; living standards at least as high as any other country; and we have not been prepared to retreat one inch from any of these objectives. If we persisted in regarding all three objectives as inviolate, we would be shutting off all paths that could lead to a way out of our difficulties.
The Affluent Society

IN the last year or two, a new school of economic thought has appeared. “The new idea” seems to have had its genesis in the United States, but it is attracting increasing numbers of supporters in some other countries, including Australia.

The argument, briefly and simply, is that, in the modern industrialised communities, the provision of personal goods and services (motor cars and TV sets, for example) tends to be grossly over-supplied compared with essential community goods and services such as public transport, education, health, city planning, urban re-development and the such-like. The private sector of the economy flourishes and waxes fat while the public sector, by contrast, has a lean and hungry look. Motor cars multiply in their thousands and hundreds of thousands, while the roads to carry them become more and more inadequate and over-burdened. There is thus a glaring lack of balance between those things produced and marketed for the most part by private enterprise, and the services provided by governments and public authorities.

The leading prophet of the new school is a Harvard professor, John Kenneth Galbraith. That he had something significant to say was clear from the fact that his ideas soon passed beyond academic boundaries and became widely discussed among the public, especially in political and business circles. His book, “The Affluent Society”, first published in December 1958, rapidly became a best-seller — a rare distinction for a work of this character. It has been acclaimed by several reviewers as having an importance comparable to the work of Keynes in the nineteen thirties, which culminated in the famous “General Theory of Employment, Interest and Money”. This may be going more than just a little too far. Nevertheless, the ideas of Galbraith are exerting a strong influence, not just in academic circles or among left-wing ideologists (where any ideas which would result in more power to the arm of the public sector could be expected to receive an enthusiastic welcome) but also in current politics.

The coming months and years are certain to see increasing debate over the concepts of Galbraith, both in and out of politics. Indeed, this controversy could, conceivably, boil up into something really big — into the basic political conflict of the next decade. Some preliminary discussion of the main thread of Galbraith’s argument will, therefore, not be out of place.
This is best summarized in his own words:

"The final problem of the productive society is what it produces. This manifests itself in an implacable tendency to provide an opulent supply of some things and a niggardly yield of others. This disparity carries to the point where it is a cause of social discomfort and social unhealth. The line which divides an area of wealth from an area of poverty is roughly that which divides privately-produced and marketed goods and services from publicly-rendered services. Our wealth in the first is not only in startling contrast with the meagreness of the latter, but our wealth in privately-produced goods is, to a marked degree, the cause of crisis in the public services. For we have failed to see the importance, indeed the urgent need of maintaining a balance between the two."

This thesis leads naturally to the conclusion that government expenditures should be increased and should absorb a greater proportion of total national expenditure; even if this means diverting resources from the private to the public sector of the economy by the use of increased taxes and government controls.

To that extent, in its advocacy of the expansion of the government sector, the new doctrine has a close affinity with old-time traditional socialism! But only to that extent! For traditional socialism was concerned, in the main, with inequality in the distribution of goods and services between people. Insofar as it advocated government planning of what was produced, it did so on the grounds that this was necessary to solve the inequalities of capitalist society and to ensure that milk for the poor was produced before champagne for the rich. Traditional socialism also maintained that more would be produced under a system of socialist planning than under free enterprise, which, they claimed, led to restricted production in the interests of private profit and privilege.

Not so long ago, the economic problems of society were a consequence of its comparative poverty, for which, so the socialists said, private enterprise was responsible. Today, the economic problems of society, according to Galbraith, are those not of poverty but of affluence. In each case, the remedies proposed are identical — more government spending and, consequently, more government control.

Those who have clung all along to their faith in the tremendous productive capabilities of private enterprise may derive some comfort from an admission tacitly inherent in Galbraith's doctrine — namely, that the improvement in the lot of the great mass of the people under the modern free enterprise system has been so astonishing that governments can now
turn their attention from the problems presented by private poverty to those presented by private affluence.

But a question that arises is how far is the concept of private or personal affluence valid? Is it true the economy is vastly over-supplied with the consumer goods of everyday commerce, so that people could, without much sacrifice to themselves, do with somewhat less? And even if it is true for America, is it true for a country such as Australia, where standards of personal consumption are, on average, substantially lower than in the United States?

All things are, after all, comparative, and while the mass of people are far better off in personal possessions and everyday standards of consumption than they were 20, or even 10, years ago, have they yet approached that state of personal prosperity which the Galbraith doctrine seems to imply?

The trouble is that the ordinary average person doesn’t feel that he is particularly affluent. On the contrary, he seems to be (or at least he feels himself to be) struggling to make both ends meet. He may live in an attractive modern home, with a reasonably new car in the garage (or street), a T.V. set in the lounge-room, and an automatic washing machine in the kitchen or laundry, but he seems to be labouring under a sizeable load of debt where a good part of his income is committed before he gets it. Moreover, he feels that, in the modern world, he can’t very well get along without these things. They have become, to his way of thinking, necessities, without which his life, and that of the family, would become arduous and difficult.

Moreover, in order to pay for the house, car and T.V. set, he has to work overtime and he himself wouldn’t say “no” to a motor mower to lighten his week-end work in the garden. And, notwithstanding these marks of affluence, he and his wife have to keep a close watch on the weekly budget for food, clothing and all the other odds and ends of everyday living. Then, on top of it all, there is income tax, which already takes an irritatingly large bite out of his weekly pay-cheque. So while, all in all, he may be living pretty well, he is not doing it without quite a lot of head-aches in fitting his commitments and everyday expenses to his income. He may be affluent according to the perspective of the social theorist or historian, but he doesn’t feel that he is. In fact, he is hoping for some rise in his wage or salary fairly shortly, and he would
view with horror any suggestion that he should pay out more
of his present income in higher taxes.

This is not an over-drawn picture; it is a fair description
of the situation of the average person, not just in Australia,
but also, probably, in the United States.

Galbraith gives the impression of having exaggerated the
so-called super-abundance of goods provided by the private
sector. He seems to be over-influenced by the evidences of
extravagance — the tail-fins on the over-long motor cars, the
gleaming appliances in the kitchen, excessive and costly
packaging — and, as a man of education and discrimination,
by the not-infrequent examples of sheer bad taste. But are not
these things just the froth on the vigorous brew? And, in any
case, taken too far, do they not soon produce a reaction in the
mind of the consumer himself? The giant, tail-finned car seems
to have given rise to a widespread demand for a compact, less
opulent vehicle. People are far from naive innocents in the
spending of their own money, and they can quite quickly dis-
tinguish between what is essential and worthwhile and what is
tere frippery.

The sensitive mind often produces a distorted picture
because it sees in too-sharp relief things which would escape
entirely those of blunter perceptions. The exaggeration to
which Galbraith seems subject is well illustrated in the follow-
ing passage:

"The family which takes its mauve and cerise, air-conditioned, power-
steered and power-braked car out for a tour passes through cities that are
badly paved, made hideous by litter, blighted buildings, bill-boards and
posts for wires that should long since have been put underground. They pass
on into a countryside that has been rendered largely invisible by commercial
art. (The goods which the latter advertise have an absolute priority in our
value system. Such aesthetic considerations as a view of the countryside
accordingly come second. On such matters we are consistent). They picnic
on exquisitely packaged food from a portable ice-box by a polluted stream,
and go on to spend the night at a park which is a menace to public health
and morals.

"Just before dozing off on an air mattress beneath a nylon tent, amid
the stench of decaying refuse, they may reflect vaguely on the curious
uneveness of their blessings. Is this, indeed, the American genius?"

If it were (it might be replied) then the hopes for the
free world would be negligible. But are there really many such
cars? Are there no streets but those "made hideous by litter
and blighted buildings"? Is there no countryside left to see but
that completely concealed by bill-board commercial art? Are
most country streams polluted? Is there no decency in the
parks?
Now what of the other side of the economy? Is the government sector as lean and starved as Galbraith would have us believe? Is it really such a "poor relation"? Is it true that in every battle for finance between government-provided facilities and private enterprise, government comes off worse and is sacrificed to the private sector?

Any idea that the public sector — in Australia at any rate — is "starved" of resources, would seem to gain little support from a comparison of government expenditure in the years 1938/39, 1949/50 and 1959/60.

<table>
<thead>
<tr>
<th>GOVERNMENT EXPENDITURE AS % OF G.N.P.</th>
<th>1938/9</th>
<th>1949/50</th>
<th>1959/60</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages and salaries, materials and services purchased*</td>
<td>12.7</td>
<td>15.9</td>
<td>18.5</td>
</tr>
<tr>
<td>Cash social service benefits</td>
<td>3.2</td>
<td>4.4</td>
<td>5.8</td>
</tr>
<tr>
<td>Interest, etc.</td>
<td>5.7</td>
<td>4.1</td>
<td>2.6</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>21.6</strong></td>
<td><strong>24.4</strong></td>
<td><strong>26.6</strong></td>
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</tbody>
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In the last 10 years, government expenditure has maintained and even increased its share of the Gross National Product. If "transfer payments", such as child endowment and pensions and interest on government borrowings (which merely transfer money from one sector of the community to another) are disregarded, then government expenditure today is taking 18.5% of the output of the community, compared with 15.9% in 1949/50 and 12.7% in 1938/39. Spending on public works (excluding dwellings) has risen from 6.5% of G.N.P. in 1949/50 to 8.3% in 1959/60; and of this, expenditure on roads has increased from 1.2% to 2%. Expenditure on education has increased from 1.2% to 1.9% of G.N.P. and on health from 1.0% to 1.3%. Moreover, these have been rising shares in a rising output.

The notion that the public sector is being "starved" and is being sacrificed to the interests of the private sector is certainly not borne out by the experience of the last ten years.

* Spent as follows in 1949/50 and 1959/60.

<table>
<thead>
<tr>
<th>% of G.N.P.</th>
<th>1949/50</th>
<th>1959/60</th>
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</thead>
<tbody>
<tr>
<td>Defence</td>
<td>2.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Roads</td>
<td>1.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Dwellings</td>
<td>0.8</td>
<td>0.3</td>
</tr>
<tr>
<td>Other Public Works</td>
<td>5.3</td>
<td>6.3</td>
</tr>
<tr>
<td>Education</td>
<td>1.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Health</td>
<td>1.0</td>
<td>1.3</td>
</tr>
<tr>
<td>All Other</td>
<td>4.4</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>15.9</strong></td>
<td><strong>18.5</strong></td>
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On the contrary, government expenditure has continued to grow, not only absolutely but also relatively to the remainder of the economy. Public services may still fall far short of perfection, but at least there is statistical evidence of steady improvement.

It is undoubtedly true that many government services are far from adequate. We certainly need more and better roads; we need more schools and better staffed and equipped universities. We need more hospital space. We could do with finer art galleries and buildings devoted to cultural matters for the nourishment of the public mind. We could do with more government expenditure on basic research of all kinds. We urgently need better trains and better public transport. When you come to think of it, there are very few things provided by governments that we couldn't do with more of. There is no limit to the things we would like to have. If we spent twice as much as we are doing on these services, there would still be people who would say that they were inadequate and that more was needed.

But unfortunately — and here is the rub — resources are not unlimited and we are forced to choose between the things we can spend our money on. We can't have everything. If we spend more on roads we may have to spend less on something else — it may be cars, or education, or clothes. The same person who deplores the inadequacy of the roads may quickly change his mind if he is asked to contribute to the additional expenditure. If he has to choose, say, between a new bitumen-paved street (in place of the unmade road outside his home) and the motor car he has set his heart on and has been saving up to purchase, where will his choice lie? Being human, he may very well prefer to put up with the discomforts of the rutted street for the pleasure of having a new, shiny, car in his drive-way. Now the follower of Galbraith may say that this is a foolish choice, that it is not putting first things first and is not in the best interests of the community. But confronted with the same dilemma, how would he himself choose? Would his natural human instinct to possess something for himself assert itself over the communal need, or the communal service which he will use but will never feel that he really owns?

Whether it is right or wrong, the hard truth is that most people like to retain as much control as they can over the spending of their own earnings. They prefer to spend their
own money rather than pass it over to some government department or public authority to spend for them. Reduced taxation is invariably a more popular political battlecry than increased government spending. The weeks and months preceding the introduction of every Commonwealth Budget for the last 10 years have invariably seen a widespread clamour from the press and from organizations of all descriptions for lower taxes. The Budgets in which taxes have been raised, have been greeted with hoots and groans and have had labels such as “horror budget” attached to them. Even when taxes are reduced, the public, instead of showing their gratitude, usually claim that the reductions are not great enough.

It may be argued that, in acting in this manner, the people are being ignorant and foolish, that they would be far better off if they were prepared to pay the price of better community facilities of all kinds — to go without the motor car in order to have the roads. But perhaps the public instinct in these matters is not so short-sighted as may appear. The collective democratic choice is, admittedly, by no means always right. But, in great matters, it is usually more right than wrong. If it were not, democracy would be a disastrous flop.

Democracy has a kind of instinctive distrust of heavy government expenditure. It seems to be prepared to go so far, but little or no further. It knows from experience that government spending often tends to be wasteful and extravagant, not because public officials are by nature more wasteful and extravagant than other people, but simply because they are not subject to the disciplines and checks, the crucial test of profit and loss, the close equation between costs and benefits, which apply in other fields of activity. The people know that more money for government purposes necessarily means more power for public officials. They fear the growth of big government and the spread of bureaucracy. And while they know, and are prepared to concede, that modern society cannot be conducted effectively without big government, they don’t want it to become too big. The arguments of the supporters of more government spending may, at first blush, appeal powerfully to the logical faculty and even to the sense of what seems morally right, but, in the ultimate analysis, the brightest and the most attractive star in the heavens, is the star of personal freedom. And personal freedom for most people consists, in no small part,
of retaining the right to spend a goodly proportion of what they earn in the way that they themselves choose.

As a great British philosopher pointed out, people do not want a "dictated felicity". They want to be the architects of their own lives. This craving for personal freedom may lead to a world which is far from perfectly ordered; which is in many respects untidy; which is in some senses lacking in proper perspective; which is full of apparent inconsistencies and illogical extravagances; but it is the kind of world which, though abhorrent to the tidy mind of the social planner and reformer, is the one in which most of us prefer to live. And with all its weaknesses and drawbacks, it may well be the best, for it releases something in the individual, some dynamic force, which, in the end, serves the ends of society.

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As a political programme for Australia, the idea of greatly expanded public spending, along with more taxes and controls, would be certain to be vigorously opposed. Nor would it, in all probability, be economically sound. For those things that the people cannot politically prevent (in the short run at any rate) they can find ways of economically resisting. And their resistance would set up pressures in the economy which would aggravate the already strong inflationary tendencies inherent in rapid economic expansion. Moreover, the effect of higher taxes and controls on enterprise and productivity within the private sector could be serious. The level of productivity sets up an impassable barrier to our economic ambitions and to all the things we would like to do. If it should fall, then standards throughout the whole economy would be dragged down, those in the public sector along with those in the private.

Community needs, as well as individual, will best be met by economic policies designed to make our society more productive. It will always be important to encourage sound growth in the private sector and to increase the size of the national cake by means of higher productivity. This is the only real way of getting bigger slices to meet the needs of the individual and also the community requirements of government-provided facilities. At the same time it offers the exciting prospect of reducing the real burden of taxes. This should be the answer of democracy and free enterprise to the Galbraith doctrine.
THOSE who knew Mr. Grimwade well would find it difficult to believe that he has gone from us. He was that kind of man. His own strong appetite for living was shown by his widespread interests all of which he pursued strenuously — business, finance, farming, national affairs, scientific research, sport, and even club life and social activities.

Mr. Grimwade was an outstanding figure in the business life of Australia. He was a leader in every sense in the affairs of the I.P.A. from 1943 to 1951.

The Institute had not been long established before Mr. Grimwade was invited to become the Chairman of its Executive and Editorial Committee. He brought to this task vision, determination, unwavering persistence, and what success the Institute might ultimately claim to have achieved was in no small measure due to him. His work as Chairman of this Committee could not have been bettered. Both in the development of the thought of the I.P.A. on great national issues and in its establishment on a sound financial footing, he made a notable and lasting contribution.

Mr. Grimwade was a man of firm, undeviating purpose and complete integrity. Everyone associated with him had a great respect for his high intelligence and character, but more important, they knew he would never let them down. He was a man to be trusted. Nothing better can be said about anyone. Those who worked with him or under him came to appreciate his direct, and sometimes blunt, personality. He said exactly what he thought — no more and no less. As a consequence one always knew what he stood for and where he stood. He was a straight-forward man, in the true meaning of the word. There was no deviousness in his make-up. He drove straight for his goal, often through the toughest obstacles, and he seldom failed to get there.

His name will always be an honoured one at the Institute, not only for the work he did, but also because of the man himself. There was nobody quite like him. He was an uncommon man, an individual. It is the uncommon people of the world who do the things that one remembers.
Wool Faces Difficulties

In recent months Australia’s great national industry and key export earner, wool, has become the focus of attention. The industry is confronting a two-pronged threat — increased competition at the marketing end and rising costs at the producing end. This is endangering not only the financial stability of the industry itself, but also the prosperity and prospective rate of development of the Australian economy. In this situation the Commonwealth Government has been led to appoint a three-man Committee of Enquiry into one, but only one, important facet of the industry — that is marketing.

For practically the whole of the 1950's wool kept within the 60 to 90 pence a pound price range and in the freak year of 1950/1 reached the extraordinary price of 144 pence. By contrast, the 1960's are opening with wool prices around 50 pence a pound. Few are prepared to predict any substantial improvement on this figure and some even see a declining price trend ahead for the rest of the decade. Nor is the price received the end of the matter. Over the last ten years or so, wool-growing costs have about doubled. In “real” purchasing power wool now returns the grower only 25 pence a pound compared with the 60 or 80 pence of the early 1950’s. Estimated wool income for 1960/1 (after deducting cash outgoings and depreciation) will barely exceed £100 million. Over the 1950’s wool income averaged over £300 million a year in terms of 1960/1 prices). Thus, compared with today, wool-growers throughout the 1950’s had an additional £200 million a year, much of which could have been re-invested in property improvements and in expanding production, or otherwise used for assisting national development (through taxes and investments in industry and public works).

More serious is the loss of overseas earnings. Over the 1950’s wool financed imports at an average level of £440 million a year (in 1960/1 import price levels); this financial year it will probably only pay for about £340 million worth of imports.

It is not easy to generalise about the wool industry. “Sheep only” properties now account for less than half of all sheep. Of some 90,000 holdings running 200 sheep or more, 35,000 are also wheat farms and 26,000 also run beef cattle. About one-quarter of all sheep are suitable for fat lamb production.

The industry is perhaps best understood if sheep raising is separated into three broad zones — pastoral, wheat-sheep and high-rainfall mixed-farming zone. The pastoral zone comprises the dry interior — the 10"-15" rainfall belt —where sheep are run on natural pastures. The typical pastoral property is about 60,000 acres in area and carries about 5,000 sheep. Cheap land and healthy conditions have combined in the past to keep costs relatively low, but long-term profits can be reduced by drought losses.

Traditionally associated in the popular mind with wool-growing, the larger outback sheep station has declined in importance. Sheep numbers in Western New South Wales are now less than half what they were in the 1890’s, and in the better rainfall areas the larger wool-growing properties have been broken up by subdivision. Forty years ago, 36% of all sheep were in large flocks of 10,000 or over; today this group accounts for less than 13% of all sheep. Already at or near peak carrying capacity, the pastoral zone would appear to offer a limited scope for long-term expansion — indeed sheep numbers in this zone are little more than they were before the disastrous 1944-46 drought.

On the other hand, sheep numbers in the wheat-sheep and high rainfall zones
have increased by over a third since 1943. The wheat-sheep zone in the 15"-20" rainfall belt is now the most important—accounting for 40% of all sheep. However, the fall in wool prices and the guaranteed home consumption price for wheat could result in a swing to wheat production at the expense of sheep. If such a swing became widespread wheat yields could decline because of the depleted fertility of the soil.

Possibilities that exist for the expansion of wool production would seem to be mainly confined to the high-rainfall zone where intensive grazing is carried out on sown and improved natural pastures. Apart from the elimination of the rabbit pest through myxomatosis and 1080, pasture improvement has been the factor most responsible for the two-thirds increase in wool production since 1947/8. Although assisted by the latest clearing methods and by scientific farming practices, the high rainfall area is the most vulnerable to rising costs—less healthy conditions and pasture improvement entail higher expenditures on labour and materials. Carrying capacity in this zone has improved because of heavy capital improvement expenditures over the last 10 years, but, unless prices recover, production must eventually decline.

The table below, compiled by the Bureau of Agricultural Economics from a representative sample of properties, shows a disturbing decline in the fortunes of the wool industry between 1952/3 and 1958/9.

It must be emphasised that these are average figures. Even with wool at present low prices well-run properties which are relatively free of debt can be made to pay satisfactorily.

It seems certain that results for 1960/1 will be as bad as, if not worse than, those shown for 1958/9; prices are only slightly better than in 1958/9, although not as high as 1959/60, but in the meantime, costs have been rising. Unlike wheat-sheep farmers whose income has been buttressed by a guaranteed home consumption price scheme, graziers in the low and high rainfall areas were most adversely affected by the fall in wool prices from 82 pence a pound in 1952/3 to 49 pence in 1958/9. Present wool prices barely return the average grower a "living wage", leaving little or no surplus for re-investment to expand future production. This is the basis of the disquiet now surrounding the industry. Unless there is an improvement in prices, eventually there seems no escape from some form of financial assistance to wool-growers.

If the wool-grower had to be assisted by a subsidy, the annual burden on the rest of the community, in view of the great size of the industry, could be of frightening proportions. For instance a

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<th>COSTS OF PRODUCTION, GROSS RETURNS AND NET INCOME PER PROPERTY</th>
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<tr>
<td>Zone</td>
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<tr>
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<tr>
<td>High Rainfall</td>
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<td>1952/3</td>
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*Excluding interest and any return to the proprietor for the labour and management and capital invested.
subsidy of 1/- a pound would cost about £80 million. It is one thing to subsidise peanuts; it is quite another to subsidise wool.

Prospects of improved wool prices rest on the future of world demand for the product. In this connection two questions are paramount. How will wool make out in competition with synthetics in the Western countries? Will living standards in the under-developed Asian countries, particularly China, rise fast enough to make possible a substantial increase in demand from this area of massive populations?

Over 60% of wool's existing market is in Western Europe and North America, but due to competition from man-made fibres and to other factors, this share may progressively decline unless the cost of wool is low. The level of demand in China and Japan will become critically important to the industry's future. If per capita consumption in China were to rise to a level only half that of Japan, this would absorb two-thirds of Australia's present clip. But until living standards in Asia rise sufficiently to enlarge the market, wool promotion will have to be largely aimed at the Western countries. Here the utmost effort may have to be concentrated to maintain, let alone improve the present share of the market against the onslaught of synthetics*. In 1948 synthetics had barely been developed and consumption of these fibres in the United States was negligible; today United States consumes 3 pounds a head; over the same period per capita wool consumption has declined from 5 pounds to 2½ pounds. The share of synthetics in the world's textile markets has grown from 1% in 1949 to 4% today and the share of rayon from 14% to 17%. Cotton's share has declined from 72% to 69% and wool's from 13% to 10%. However, the total textile market has expanded about 70% over this period.

No man-made fibre has yet achieved the all-round versatility of wool but a number of individual fibres have been developed with special qualities each competing with wool. For example, nylon, which accounts for more than half of all the production of synthetics, has won a large slice of the market for men's socks, mainly because it wears better than wool. Nylon's gloss finish adds appeal to part-wool fabrics and knitwear. Terylene, which washes better and creases less, is replacing wool in light-weight suits. Orlon is as warm as wool, but washes better and is lighter and is therefore in demand for blankets; only one blanket in every 20 sold in the U.S.A. is made of pure wool.

Throughout a very wide range of textiles, manufacturers are finding that the addition of even a small percentage of man-made fibres can enhance the durability and sales appeal of their product. 40% of all synthetic fibre production in U.S.A. is now replacing, marrying or competing with wool. It is asserted in some quarters that the giant chemical companies, through the sheer weight and appeal of their advertising, have forced their product on consumers and hence on manufacturers even though wool would be a better buy. This is perhaps the under-lying reason which has led the Australian Wool Bureau to advocate a doubling of the present 5/-a-bale contribution to wool promotion.

But synthetics have not been the only cause of the declining market for wool, particularly in the United States. Social and technological changes have played some part. With heated homes and cars, people no longer feel the same need for heavy woollen clothing, and in these days there is more emphasis on casual wear

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* Synthetic fibres are made from raw materials such as petroleum or coal whose molecular structure is re-arranged to form a substance suitable for making into a fibre. They are distinct from rayon which is made from a base material already suitable for processing into a fibre.
and less on more formal modes of dress. Washing machines take blended garments better than pure wool.

Some experts doubt whether wool promotion can be as effective as advertising campaigns sponsored by the manufacturers of synthetics. Wool passes through so many processes and has so many end uses, that it is difficult to know who to aim at. Synthetics' manufacturers on the other hand, know where their product goes and are constantly on the alert to make improvements. Synthetics have novelty, and therefore news value; this puts a traditional product like wool at a disadvantage. A tricky problem confronting the wool promoter is the fact that the product is now used extensively in blended fibres. For instance, in the United States all the main wool manufacturers are heavily committed to the use of man-made fibres.

The present policy of the Wool Bureau is to promote only 100% wool, which is not necessarily promoting wool 100%. The Bureau should endeavour to have in all blends a greater proportion of wool fibre than synthetics. In view of the importance of this matter of promotion to the whole Australian economy it may be that the Wool Bureau should be reconstituted to include also business talent and experience from outside the ranks of the growers. The Wool Bureau is undoubtedly justified in pressing for greater expenditure on wool promotion (present promotion costs are only ½% of gross sales compared with 5% for synthetics). But in the long run wool must stand or fall by giving consumers what they want at the right prices. More research must be devoted to improving the attributes of wool to keep abreast of its rivals, but above all, costs must be kept competitive. In this connection there is the disturbing report that a revolutionary new Italian fibre "Meraklon" will probably market at a price substantially below the present price of clean wool.

However, there is a brighter side to the picture, particularly outside the U.S.A. In the Bradford worsted trade the proportion of synthetics used appears steady at about 15%. In the tropical parts of South and Central America there is a growing demand for lightweight all-wool suiting and there is probably a large potential market elsewhere in tropical regions where it is hot during the day and cool at night. There is some reassurance in the fact that, in Japan, our number one wool buyer, the quantity of viscose rayon used for mixing with wool has fallen from 44 million pounds in 1955 to 20 million pounds in 1960. With lower wool prices it is no longer necessary to cut costs by adding cheaper substitute fibres. The Australian Trade Commissioner in Japan recently reported that "with wool prices at their present level synthetics are not making any significant headway in displacing wool. As a result, the demand for synthetics has not, as yet, achieved sufficient popularity to permit production on a basis which would enable costs to be lowered substantially."

Vigorous promotion is most necessary to the wool industry, but if we rest our hopes of a spectacular lift in demand upon it, we are likely to be disappointed. Equally we should not expect that we can make any appreciable difference to selling prices by controlling supply. It seems clear that unlike 1951 when a reserve price plan was rejected, a substantial body of wool-growers now favour it. The schemes then put forward aimed at building up a stabilisation fund in time of good prices and supporting the market by purchases of wool when prices fell away. The Australian Wool Growers' Council, representing mainly the larger growers, has resolutely opposed a reserve price scheme on the grounds that the
added costs would outweigh the assumed benefits. In the Council's view any attempt to relate the reserve price to costs of production would be "the first step on the road to an artificially-protected industry, completely out of touch with economic realities and dominated by political considerations".

Many growers obviously have in mind a reserve price which will return them a reasonable margin of profit, but if the reserve price is fixed too high then it can only encourage the use of lower-cost substitutes and still worsen the position of the industry.

Furthermore, a reserve price scheme would cost a great deal of money — in some years possibly running into tens of millions of pounds. Who is to find it? In the case of the wheat industry the home consumption price has been met, until recently from money accumulated in a stabilisation fund in years of good export prices. But on the present narrow margins between selling prices and costs and with the increased burdens of market promotion, it is difficult to see how the wool industry can be expected to finance its own stabilisation scheme. Realistically, it would seem that a support price scheme would have to be financed by the taxpayer. In view of the size of the industry, this burden could reach staggering proportions if the reserve price were much out of line with what the world was prepared to pay.

It will no doubt be the task of the Committee of Enquiry into Wool Marketing to report upon these difficult issues. But it is clear that a reserve price scheme is no panacea for the problems of the wool industry and that a solution must eventually depend on a better relationship between costs and prices.

One thing stands out — the continuance of inflation, even at a moderate pace, would further endanger the financial foundations of Australia's major industry.
How Effective Can The Budget Be?

In the December, 1960, number of "The Economic Record" there is an article by Professor H. W. Arndt of the Australian National University on fiscal policy as a means of curbing inflation. The conclusion of the author is "that fiscal policy represents an effective and indeed indispensable instrument for the control of inflation".

In a footnote to his article, Professor Arndt states that he is indebted to the Institute of Public Affairs, Victoria, for provoking him into writing it. Indeed, the article is a criticism of views which the I.P.A. has advanced from time to time on this matter.*

Professor Arndt is one of the ablest economists in Australia, a distinguished representative of the academic branch of the profession and one for whom the I.P.A. has considerable respect. In this article he does not, in our opinion, maintain the high standard of thought customary in his writings.

In the first place, his attack on the viewpoint of the I.P.A. is ill-directed. The I.P.A. is not, as his article implies, an opponent of fiscal measures. It does not contend (nor has it ever) that the instrument of the budget is entirely barren of virtue as a means of curbing inflation or of overcoming deflation. What we have done is to question how far budget policy in general and increases in taxation in particular, in a climate of exceptionally rapid economic expansion and population increase, can be effective in ridding the economy of inflation and, more important, in correcting a serious and chronic deficiency in the balance of payments. Our belief is that they cannot be very effective and, further, that the facts of the last 10 years bear this out.

In a less tempestuous environment of slower growth, placing less strain on the resources of the community, the budget may well come into its own as an effective instrument of economic control. But when a storm is raging, it is anything but easy to erect barriers (of any kind) sufficiently strong to protect the homestead against its consequences. In these circumstances one must depend upon an abatement of the storm. Fortunately, in economic matters, this is not something we are

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*Articles relative to this matter have appeared in the following I.P.A. "Reviews":
October/December, 1955: "Proposals to Increase Taxes."
April/June, 1960: "No Time to Increase Taxes."
entirely helpless to influence. Insofar as the storm is the consequence of the basic policies we are pursuing, we have it in our power to alter those policies. If we refuse to do so, we must live with the consequences.

We have questioned the effectiveness of the budget for both political and economic reasons. Professor Arndt deals at some length with these reasons and endeavours to refute them. But, for the most part, his arguments seem to fortify rather than overthrow our own conclusions.

Let us look, first, at the political reasons for the stand taken by the I.P.A., for these, after all, are the most important. If the political obstacles to the effective use of fiscal policy to control inflation are virtually insurmountable, then no amount of economic argument will establish its effectiveness. Economics proposes, but politics disposes.

What are these political obstacles? Professor Arndt lists two:

1. The powerful resistance which democratic governments face in imposing higher taxes or in reducing expenditure.
2. If taxes are increased with the intention of providing a “surplus” and of drawing off purchasing power from the community, there is a strong temptation for governments to spend this “surplus”, thus undermining their own good intentions. Professor Arndt calls this Parkinson’s Second Law — that is “the tendency for expenditure to rise to meet income”.

Both these obstacles to the effective use of the budget for curbing inflation have been mentioned by the I.P.A. in articles that have appeared in “Review”.

Professor Arndt states: “By far the most serious ground for pessimism about fiscal policy for the control of inflation is the extreme reluctance of democratic governments to use it forthrightly and drastically.” We agree entirely! How, then, can this pessimism be dispelled? How can governments be encouraged to use the budget instrument “forthrightly and drastically”? How can the great political obstacles to the effective use of the budget for controlling inflation be overcome?

On these matters Professor Arndt offers nothing convincing. In fact what he says only serves to deepen the pessimism one is compelled to feel regarding the efficacy of the budget as a means of exercising control over inflation.
In a situation where taxes are already high, it is very difficult for the government to raise taxes further because of the tremendous public opposition it is certain to encounter. Small increases, admittedly, can be made. This was done in the Commonwealth Budget last August. But who could seriously feel any confidence that tax increases which were estimated to realise no more than an additional £37 million in the current financial year, and to produce a budget surplus of a mere £15 million, could make a strong contribution to disinflation when total spending will amount to some £8,000 million. To be noticeably effective, a very much larger increase in taxes (and a very much larger budget surplus) would be required. But if the Government got savage with taxes, the public would get savage with the Government.

Again, in a situation of rapid population increase, where there is a tremendous need for additional community services of all kinds, it is anything but easy for the government to curb, let alone reduce, its spending. When there are glaring inadequacies in education and hospital services, roads, sewerage, public transport and a hundred and one other things, governments are under constant pressure to rectify them.

How does Professor Arndt propose to remove these obstacles to effective budgeting? He offers no practical proposals. Having described the obstacles all he says is: “There is really little more that needs saying on this point. What is wanted is education of the public and political courage among politicians.” In other words, if we had a different public and a different brand of politician, the budget could become a powerful instrument for the control of inflation.

This, surely, is the height of unrealism. In its discussion of this subject, the I.P.A. was not dealing with some hypothetical world of the future, but with the world as it is today. Perhaps when we have a better-educated public and more courageous politicians, fiscal policy (supported by other measures) might be a more effective weapon for curbing inflation. But, for the present, we have to take the public at its existing standard of education and politicians for what they are and not for what they should be.

Governments are not in the habit of committing political suicide. Nor should anyone expect them to. Yet, if they fly in the face of a strongly-held public viewpoint, this is what they
would be doing. Professor Arndt himself concedes this in one sentence of his article. He says: “Even if governments could ignore the clamour of interest groups — and as politicians they clearly cannot — . . . ”

We are, it is true, entitled to expect courage from our governments, but hardly the kind of courage which would bring about their own destruction. Yet what government, except in conditions of grave emergency, could add substantially to the present heavy burden of taxes, without the near certainty that it would be cast out of office?

Professor Arndt wrings his hands about “the deplorable state of public ignorance” and “the outpourings of special pleading by sectional pressure groups”. He says that in light of these obstacles, “the difficulties of governments in justifying a policy of surplus budgeting are real enough”. Nevertheless, he claims that we need not altogether despair. Surpluses can, on occasions, be achieved and he points to the “Horror Budget” of 1951 and the “Little Budget” of March, 1956, as instances of what can be done. He could hardly have chosen worse examples and, in fact, he proceeds immediately to refute himself. He writes: “The fact that, on these occasions, the substantial Commonwealth surplus was used to support State public works programmes did not make it useless for disinflation, since there is every reason to believe that in its absence, the same public works expenditure would have been financed by central bank credit.” In other words there was no true budget surplus and therefore no effective contribution by these budgets to disinflation. All that could be conceded is that the budgets were less inflationary than they would have been, had taxes not been increased and assuming the same level of public expenditure. In both 1951/52 and 1955/56, in spite of tax increases, government spending had to be supported by central bank credit. In 1951/2, when inflation was rampant, expenditure of State and local governments on public works increased by £87 million over 1950/51. No wonder resort had to be made to Treasury Bills.

In fact, both these instances provide a classic example of good intentions going by the board. The objective of the Commonwealth Government to achieve substantial surpluses in these years was undermined by the tremendous pressure brought to bear on it from the States for increased financial assistance for their public works programmes. Nothing could better confirm
what the I.P.A. has argued — namely, that in the present environment of rapid development, with the States constantly on the doorstep of the Commonwealth clamouring for money to spend on the lagging services for which they are responsible, a budget surplus becomes little more than a pious aspiration.

* * *

What of the economic — as distinct from the political — obstacles to the effectiveness of fiscal policy?

The I.P.A. has emphasised three:

1. An increase in taxes tends to fall on savings rather than on spending. In other words, rather than forego a reduction in their habitual living standards, people will tend to pay an increase in taxes by cutting down their savings.

2. Increased tax, whether direct or indirect, lead to compensatory action by income-earners, to increase their money incomes.

3. Increased taxes adversely affect incentives and thus productivity.

Professor Arndt’s reply to these arguments is far from convincing. “It is certain,” he says, “that part, perhaps the major part, of an increase in personal income tax will fall on saving”; but he suggests that at least 25% of the additional revenue raised will be paid out of a reduction in consumer spending. This is a significant concession to the I.P.A.’s point of view. It would mean that in order to cut back total consumer spending (which is running at around £4,000 million a year) by say £100 million, income taxes and indirect taxes on consumer goods would have to be increased by £400 million — an increase of a 33 1/3 per cent. In any case it is clear that if the object of the increase in taxes is to materially reduce expenditure on consumption, and to avoid any large cut in investment (that is development) then the increase would have to be very large indeed. The fact that people are so ready to draw on savings to maintain their current living standards (and this much is conceded by Professor Arndt) illustrates the extreme difficulty of reducing consumer spending. This has led the I.P.A. to argue that, in conditions of rapid inflation, the attack must be aimed at the only point where it can hope to be really effective — that is, at the reduction of investment.

Professor Arndt agrees that higher company taxes will, in part, be passed on in higher prices. But, he says, that the higher
prices which result from these taxes, or from indirect taxes, reduce the real incomes of consumers and thus squeeze out excess demand. This is tantamount to saying that in order to cure rising prices we need a further rise in prices. He makes the surprising assertion that the rise in prices is “once-for-all,” and provided the extra tax revenue is not spent, “the inflationary gap is closed,” and, presumably, everybody is happy ever after. But are they happy? Since when, under conditions of full employment, was a rise in prices “once-for-all”? The incomes of a large proportion, about one-third, of Australian wage-earners, are still directly linked to the price level. With the rise in prices caused by the increase in taxes, wage costs rise and prices rise further. The industries not directly affected — say those in Victoria — by the increased wage costs, feel some impact in higher material and equipment costs. These will be passed on in higher prices. The eventual rise in prices is bigger than the rise directly attributable to the increase in taxes. The rise may be sufficient to cause people, other than those whose incomes are linked with prices, to look for a rise in their money incomes. In any case, they will be certain to press for an increase simply so that they will not fall behind, or not too far behind, the most favoured groups. Does anyone imagine that increased wages for those under State awards do not lead to pressure for higher wages for those under Commonwealth Awards?

Professor Arndt moves uneasily through this maze and eventually concludes that “… to the extent that a wage-price link operates, indirect taxes (and to a less extent taxes on business profits) are inferior to personal income tax … as instruments of disinflation”. His rejection of the view expressed by the I.P.A. is based on the curious argument that income tax increases have never played any part in wage bargaining “which, rightly or wrongly, is conducted in terms of pre-tax rates”.

This may be true, but it does not mean that increased income taxes play no part in the general pressure for higher wages. Under the pay-as-you-earn system of tax collection, wages to most people are what they get in the weekly envelope (i.e. what is left after tax has been deducted). If the mass of the community find they are getting less in “take-home pay”, it would be wholly remarkable if they accepted it altogether passively, and without any “build-up of pressure” for a compensatory increase in their pre-tax incomes.
One vital economic reason for keeping taxes down is to retain the maximum incentives to increased productivity and to risk-taking enterprise. Professor Arndt dismisses this as "negligible". Others would not agree.

A re-statement of the I.P.A.'s position on fiscal policy is at this stage called for. We do not oppose its use as an instrument of economic control. That would be entirely absurd. But we question its effectiveness in reducing expenditure and thus for controlling inflation and correcting a balance-of-payments deficiency, in conditions where taxes are already high (or felt by the community to be high) or in conditions of exceptionally rapid economic expansion where the need and demands for capital expenditure by governments are necessarily very heavy.

This does not mean that the budget could not be effective under other conditions. Nor does it mean that, even under present conditions, it is devoid of all significance. If it cannot be a decisive weapon of disinflation, at least it can avoid giving further encouragement to inflation. Because, in a climate of high taxes and rapid economic expansion, budget surpluses may be difficult, if not impossible, to achieve, this does not mean that budget deficits cannot be avoided. In fact, it is vitally important that they should be and the Commonwealth Budget of August, 1960, was in this respect, though not perhaps in others, undoubtedly a step in the right direction.

Professor Arndt says that those who reject fiscal policy for the control of inflation cannot escape the responsibility for suggesting alternative policies. In a footnote he quotes the I.P.A. as suggesting, as an alternative, a reduction in the pace of economic expansion and population increase. He rejects this on the grounds that other countries, where population is relatively stable, are experiencing the same problems as Australia and because such a course would be tantamount to an admission of defeat.

On this, we desire to say several things. In the first place a reduction in the rate of economic expansion has not been proposed by the I.P.A. as an alternative to fiscal policy — but as a condition under which fiscal policy would have some chance of becoming effective. At present it has little or none. With a slowing down in the pace of development, the pressure
on public capital expenditure would be reduced, a lower level of government spending would be possible, and a substantial budget surplus would come within the orbit of practicability.

The fact that other countries, where population is relatively stable, are suffering from some of the same problems as Australia, provides no grounds for the rejection of the I.P.A. argument. Inflation, admittedly, is not a condition peculiar to rapidly expanding economies. Nevertheless, inflation and balance-of-payments difficulties are much more likely to occur in countries undergoing rapid development, since large-scale development gives rise to abnormal demands for capital expenditure and places a greatly additional strain on the resources available.

Professor Arndt is horrified by any suggestion of a reduction in the rate of expansion, but here he is inconsistent. For the logic of his own policy for the control of inflation through the budget, if it were to be effective, would lead to just that. In one part of his article, he says that even that part of increased taxes which is paid out of saving "does some good by curtailing funds available for investment"; and in another he argues that increased taxes will reduce the supply of loanable funds for private and public investment and will therefore have some disinflationary monetary effects. In other words, he welcomes a cut in investment as a necessary contribution to disinflation. But what is "investment" but another word for "development"?

Professor Arndt subscribes to the school of thought which believes in high taxes allied to heavy government spending. Although, at one place in his article, he says it does not matter, in principle, whether a budget surplus is achieved through cuts in government expenditure or by increases in taxation, there is no record of this school ever supporting the former course. On the contrary, it has consistently advocated increases in government spending. These views, no doubt, are honestly held; but so, too, are the views of some others who oppose the ideas of this school with reasoned argument. It is unfair to bracket them, as Professor Arndt does, with "the special pleadings of sectional pressure groups".
Since I have been an adviser on economic matters to Senator Kennedy and a member of his Task Force on the economy after his election, I should make it clear at the outset that this article is not based on inside information. What I have to say is based on published materials and particularly on the record of Senator Kennedy before he became President, on statements he has made since, and also on the Democratic platform.

One of the fundamental issues of the campaign was growth, with the Democrats emphasizing the need of greater growth and the Republicans on the whole stressing the point that above all what was necessary was to stop any possible inflation even if the result might be some discouragement of growth. In general the Democrats have held, and I think quite rightly, that their growth was greater from 1947 to 1952 than Republican since 1952. We need not go into the details because there are all kinds of differences concerning the appropriate period for comparison. What is of great significance is that on the whole, Democrats have stressed the point that growth must be achieved in large part through governmental measures such as increased expenditures on education, on housing, on health, lower rates of interest and the like. The Republicans, on the other hand, have tended to take the position that what will give maximum growth is a limited governmental interference and much greater dependence upon private incentives. The Republicans would change our tax structure in such a way as to encourage total amount of investment inclusive of increased allowances for depreciation and the like. Democrats, on the other hand, are inclined to emphasize as against rising investment the importance of an adequate market for consumers' goods as the means of achieving higher rates of growth. There is no use producing large supplies of goods with an increasingly productive economic machine if the net result is going to be unsold goods in larger quantities.
Another issue during the 50's was that of monetary policy. President Eisenhower right along has taken the position that the Federal Reserve should be an independent organization and there should be no interference from the Executive. A result has been that over the years there have been conflicts between the Federal Reserve, and the Treasury and other governmental agencies, but the President has refused to interfere. Democrats have been especially critical of the Federal Reserve policy with its stress on high money rates, excessive fear of inflation, a tendency to support restrictive policies even when a decline has already begun.

In a few statements on issues of this kind President Kennedy has made it clear that he will not make a frontal assault on the independence of the Federal Reserve. He has also made it clear that a strong president must use all available agencies in times of stress. That means we must have an integration of Federal Reserve policy with that of the other agencies.

Concern over Federal Reserve policy arose clearly when the Federal Reserve in its open market operations concentrated on short-term securities, thus depressing short-term rates. This particular policy has the effect of reducing the short-term rate of interest and not greatly reducing the long-term rate of interest which is essential for increased investments. In a statement to the Congress in early February, 1961, President Kennedy pointed out that the "bills only" policy of the Federal Reserve had increased the differential between domestic and foreign short-term rates and thus had accelerated the outflow of short-term capital and gold.

The President insisted upon the use of monetary policy to stimulate investment without aggravating the balance-of-payments problem. But this requires close co-operation of all government agencies concerned. As a result of the measures already under way, the President pointed out, there would be an increase inflow of funds with concomitant declines of long-term rates to finance productive investment.

The Treasury and the Federal Reserve system already are working together to further the complementary effectiveness of fiscal and monetary policy, the President said. These two will be strengthened not only for their present task but also for restricting inflationary demands on the economy whenever they occur.

In a press conference of February 1st, the President clearly stated the issues. He took in general what was the position held by the Democrats for years, namely that monetary policy under Eisenhower had been used excessively to stabilize the price level, with a resulting large increase in the total amount of unemployment. Wages and prices tended to rise, and refusal to validate the increased need of money could only lead to unemployment. The President said on February 1st, we do have a problem if the only way we can prevent an increase in the cost of living is to have 5 ½ million people unemployed, and a substantial percentage of our capacity unused.

The question is whether we can maintain a reasonable purchasing power for the dollar in the course of doing business with full employment. That is the basic problem.

"I am not satisfied to have the cost of living remain constant only by having the economy restrained."

The parties differ greatly on the use of the budget. Is it a tool or an objective of economic life? President Eisenhower and his advisers as a rule held that there would be a tax increase only in periods of great prosperity so that the tax decline should not unbalance the
budget. This is not President Kennedy's view. He would unbalance the budget in periods of recession. The Task Force on the economy suggested to the President that he might seriously consider a tax cut as a means of treating the recession. In a statement of early February the President was not inclined as yet to accept a tax cut and wanted to see how the economy would develop in the next few months. He made the interesting point that a tax cut of several billions would be dissipated in the hands of consumers whereas several billions spent on education, slums, health, etc., by government would contribute greatly to the health of the economy.

In this same address to Congress, the President said "The Federal budget can and should be made an instrument of prosperity and stability in order to return to recovery. This administration is pledged to a Federal Revenue system that balances the budget over the years of the economic cycle—yielding surpluses for debt retirement in times of high employment that more than offset the deficits which accompany and indeed help overcome low levels of economic activity in poor years."

President Kennedy is clearly on the right track in his position on fiscal policy. He anticipates a budgetary deficit this year (ending June 30, 1961) and this deficit would have occurred irrespective of his new policies. President Eisenhower tended to overestimate revenue in his 1962 budget and he also allowed for increases in tax revenues and of postal rates that were not likely to be forthcoming. Actually the President's proposal to deal with the recession as of February, 1961, are not likely greatly to unbalance the budget. Several of his proposals only involve a redistribution in time of expenditures, for example, for roads, urban redevelopment, veterans' insurance and the like. More would be spent during the recession and less later.

Other programs put no burden on general revenues in the sense that they will be financed out of payroll taxes. The President, for example, proposes to increase the weeks of unemployment compensation temporarily by 50% and he expects to finance this by increasing the wages subject to unemployment compensation. He also would liberalize certain benefits under Old Age and Survivor's insurance. But here again the extra funds required would be financed by an increase in the payroll tax. However, this does not mean that the President does not have in mind some long range programs that may cost billions of dollars. He is, for example, committed to an educational program, and would provide 1 billion additional per year; the subsidies would be not only for school construction but also for salaries.

In agriculture, the advisers of President Kennedy during the campaign were inclined to emphasize a program which would have given the farmers higher incomes, but on the theory that they would be subjected to control of marketing. But more recently the President's advisers, at least the last Task Force on agriculture, took a somewhat different position and doubted that farmers would submit to such close control of marketing. They, therefore, tended to emphasize the need of getting land out of cultivation and paying the farmers for taking this land out of cultivation. This is also a costly program but it is doubtful if it will be more costly than the cost of the Republican agricultural policies, which did not bring rising, but in fact declining, farm income. Much emphasis is being put on improved markets through food stamp programs and through disposal of commodities abroad. My guess is that these programs are likely to increase in importance rather than be reduced, for they have the support of both parties. President Kennedy is aggressively pushing these programs.

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Perhaps the toughest problem that confronts the Kennedy administration is the fact that for the first time in a generation the government is hampered in its domestic policies by the need of taking into account the effects of policies on its international reserves. It is indeed unfortunate that a country which depends for 96 per cent of its income on its domestic economy may have to modify domestic policies in response to fluctuations in reserves. Many in this country were very much embarrassed that a country with a gross national product of about 12 times that of Germany, and an average per capita income three times as great, and a country that spent about $80 billion abroad since 1945, two-thirds for aid and one-third for defence, has to send its top men to beg the Germans to increase their contribution to defence by $600 million a year, and then be refused.

In a period of three years the United States has lost about $11 billion; 5 billions of gold and the remainder in short-term dollar debts. Actually the reserve position has been deteriorating for about 10 years.

In 1960 a large rise of exports and of excess of exports was not as effective as it might have been in stopping the decline of international liquidity because this was a year in which there were large exports of short-term capital to Europe. These exports partly resulted from more favourable short-term rates of interest in Europe, and partly because of more favourable economic conditions generally in Europe, and partly because with these large losses of gold there was a great fear that the United States might devalue and, therefore, there were speculative movements from the dollar into Western European currencies.

In the midst of the 1960 Presidential campaign the gold problem became so serious that President Kennedy had to make his position clear. He would certainly try to balance the budget except in periods of great recession or national emergencies. He tried to discourage excessive increases of wages not justified by rising productivity and inflationary price rises. He would do everything possible to increase the productivity of the American economy so that more goods could be sold abroad. In this statement Senator Kennedy made it clear that we have not improved our competitive position sufficiently to make the large payments abroad for aid and defence without adverse balances. He also pointed out that there were serious restrictions on American exports abroad and everything possible should be done to remove them. He could not understand why foreign countries with adequate reserves were putting restrictions on the exportation of capital to the United States, and he hoped that our allies would assume a large share of the cost of maintaining our overseas military establishments and the cost of aid to under-developed countries.

The programs initiated by the Eisenhower Administration and continued by the Kennedy Administration which urge the rest of the world to finance a larger part of military expenditures abroad and aid are not so far yielding large returns. Greater pressure could be brought upon the International Monetary Fund to lend currencies other than dollars and require repayments of dollars already advanced. Furthermore the United States might draw on its accounts on the International Monetary Fund and thus strengthen its position. There is some fear that this might result in reduced confidence in the dollar.

Many in this country also would like to reassess the EEC (Common Market) and the EFTA (Free Market) and demand that they should not be used as barriers to exports of the United States and other countries to Western Europe. The strong push for the common
market by the United States Government was made before there appeared a problem of dollar saturation.

It is certain that the United States will insist upon tying its loans and defence outlays to United States exports increasingly. In other words, when the United States provides aid it will demand that purchases be made in this country unless the excess of price is very much above the prices available elsewhere.

One of the tough problems which is likely to receive considerable attention is that of the increase of subsidiary corporations of large American corporations operating abroad. By creating these subsidiary corporations, the American corporations obtain certain advantages. They can combine American techniques, management and capital with low European wages. They then tend to deprive Americans of potential exports and also to some extent tend to send their goods back to the American market as imports. The immediate effects are to increase the unfavourable balance of payments, though later on the return of profits would help the balance of payments. The fact that these subsidiary corporations have certain tax advantages has resulted in considerable agitation to change our tax laws. Any subsidiary, but not a branch, is not taxed on profits abroad until they are brought back to the United States. This, of course, discourages the exportation to the U.S. of part of the gains of foreign capital abroad.

Two other approaches are possible and may be helpful. One is an increase in international liquidity as had been suggested by Lord Keynes many years ago, and more recently has been pushed so effectively by Professor Triffin of Yale. Despite Triffin's skilful handling of this problem, there is a considerable amount of opposition to any such program in the United States. The IMF itself is opposed, the Eisenhower Administration was opposed, and so far the Kennedy Administration has given no indication of being enthusiastic about this approach.

Another solution is the control of exports of capital from the U.S.A. A good deal can be said for this approach and there was considerable consternation when the Ford Corporation invested over $300 million in order to obtain complete control of its British operations. Though this dollar crisis is serious, there is considerable opposition so far to any attempt on the part of the government to control exports of capital even though this may be desirable from the point of view of solving our balance-of-payments problem and making it easier for the United States to pursue the appropriate monetary policies here.

Finally, there is the solution of devaluation. A good deal can be said for this policy as a means of bringing about increased liquidity. The fact is that when the prices of goods in dollars have more than doubled, the dollar price of gold has not changed at all. A doubling of the price of gold would greatly increase total reserves and increase total liquidity so that any particular country confronted with temporary embarrassment, e.g., the situation confronting the United States in recent years or the excess of imports of the British in the last year or two—such episodes could be treated if there were adequate liquidity. The objections are partly the fear of helping the South Africans and the Russians excessively, though Sir Roy Harrod, who has been the strongest supporter of devaluation, contends that the largest gains would not go to South Africa or to the Russians but to the rest of the world. Another objection is, of course, that this has become a matter of prestige. Political considerations are much more important in determining the gold price of a dollar than they used to be. President Kennedy has had on several occasions to assure the
United States and the world that there is no intention of devaluing the dollar and that everything will be done to support the dollar. Many experts believe that some drastic measures like important changes in international liquidity along the lines of the Triffin plan or a devaluation may be necessary, but it would require a tremendous crisis in the dollar to bring the latter about.

In short, the Kennedy Administration is likely to demand a larger participation of government in our economic life. The extent of this advance is not likely, however, to be along extreme lines. The advances would be slow and moderate.

In treating the recession the Administration might be much more vigorous than was the Eisenhower Administration in dealing, for example, with the 1957/8 recession. The Administration will do whatever can be done through executive measures and then will appeal to the legislature for vigorous action from that quarter. If necessary, the Administration would not only increase expenditures temporarily, but it also would deal with the tax problem and would reduce taxes in order to stop a decline. But it must be sure that the reduction in taxes is needed.

It is clear that this Administration will not be concerned over short-term budgetary deficits. It considers budgets the means of achieving high activity. It does not consider the balanced budget as the first objective of economic life. It hopes, however, over the years to balance the budget, and even to some extent to repay debt. The Kennedy Administration has not gone as far as many economists have who believe that a continued rise in the national debt is not a disaster provided, of course, that the rise does not get out of line with our national income.

This Administration will also pay increasing attention to welfare programs, and President Kennedy expects that out of the expected rise of gross national product of $200-275 billion in ten years that the Administration will be able to finance increased programs in education, urban redevelopment, resource development, the treatment of depressed areas, and the like. It is anticipated that substantial advances can be made in these programs as well as in defence, without incurring deficits over the years.

Finally, there is every indication that every attack possible will be made to strengthen the dollar abroad in the hope not only to achieve some equilibrium once more in our balance of payments, but also especially as a means of allowing the nation to use every possible domestic measure to reduce unemployment, achieve maximum growth, and yet prevent substantial inflation.

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