A Brilliant Paper

The Paper on the Australian Balance of Payments released by the Commonwealth Treasury last February is, without question, the finest piece of applied economic analysis produced in Australia since the war. Of special significance for businessmen and economists, it should be read by everyone concerned with the future of the Australian economy. The Paper should be made compulsory study for students in universities and schools as a brilliant and salutary example of how economics can, and should, be used for the elucidation of practical economic issues.

Too many modern economists show an excessive absorption with esoteric techniques and seem to chase after more or less permanent or “ideal” solutions to problems for which, in truth, there are no final answers. The danger of this approach is that it tends to a rather remote, theoretical view of an untidy real world which refuses to conform to neat mathematical formulas.

The ideal economist would no doubt be one who combined a grasp of the most advanced specialised techniques with an intimate knowledge of the market place and an instinct for arriving at helpful conclusions; in other words, one who combined technical mastery with practical flair and philosophic insight. The Treasury Paper commands admiration because
it displays all these qualities. In almost disarmingly simple language (with a kind of art that conceals art) the first three sentences of the Foreword state a profound truth about the balance of payments which is almost invariably overlooked.

"Of its nature, the balance of payments is bound always, though in varying degrees, to be a matter of concern. It is unreal to think that there can be a final 'solution' to the problems it presents from time to time. For these reasons it can hardly fail to be a perennial subject for debate."

The balance of payments has been, and will continue to be, a kind of "nigger-in-the-wood-pile" in the Australian economy and, for that matter, in all other economies. The weakness or strength of the balance of payments decisively affects our standards of living, the rate at which we can continue to develop and expand our industries, the level of migration and even our capacity to achieve the primary economic objective of full employment.

The Australian balance of payments, more exposed than most to the moods of the seasons and widely fluctuating commodity prices, is especially volatile. The Treasury Paper points out that about 1/6th of Australia's Gross National Product is directly subject to the unpredictable movement of external demand. This is one of the inescapable facts of life which we have had to live with in the past and will have to continue to live with in the foreseeable future. In the 1950's it led to the emergence of a school of thought which, impatient to push on with national development, wanted to free Australia from the constraints and uncertainties imposed by an externally oriented economy. A greater degree of self-sufficiency became almost a national goal. The "self-sufficiency" school argued for the more rapid expansion and diversification of secondary industries to produce things formerly imported on the assumption that this would reduce our dependence on a capricious world demand for primary products. "Import replacement" became the fashionable catch-cry.

Experience has served to expose the fallacies underlying the propositions of the advocates of self-sufficiency. During the 1950's, the manufacturing industries, it is true, grew rapidly, even spectacularly. But so, too, did the economy's demand for imports. Thus, instead of becoming less dependent
on exports, we became more dependent. Ironically it was the burgeoning manufacturing industries themselves which comprised the main source of the economy's growing appetite for imports. As these industries expanded, so did their demands for raw and semi-finished materials, for component parts and capital equipment. By the end of the decade, it began to be clearly seen that if the economy were to continue on the path of rapid growth, we would have to devote our efforts to increasing exports rather than to the pursuit of the "will-of-the wisp" of import replacement.

The arguments of the self-sufficiency school had a wide appeal because in the 1950's there was a great deal of uncertainty about the future of exports. In fact many believed that it would be impossible to expand exports at the rate required for continued rapid economic growth. One of the outstanding facts of the economy since the early post-war years, brought out clearly in the Treasury Paper, has been the great increase in exports of the primary industries, and especially of the agricultural sector whose prospects were generally regarded with some degree of pessimism. The Treasury Paper shows that the volume of foodstuffs exported has doubled since 1947/8 and has increased by a remarkable 60% in the last five years. A few years ago, no one would have predicted the massive exports of wheat to Red China, or of meat to the United States; nor the great growth in exports of sugar. It is surprising to read in the Treasury Paper that Australian exports have been more reliant on the pastoral and agricultural industries in the post-war period, than they were, not only immediately before the Second World War but before the First World War as well. While manufactured exports increased fairly substantially, they still comprise only 15% of the total.

Thus, the domestic expansion of manufacturing has been uniquely dependent on the great growth of exports of rural products, without which the continued rapid development of the internal economy could not have been sustained. Moreover, the contribution of the primary industries has been made in the face of a downward trend in the prices of most primary products. Indeed, meat alone could have been said to have experienced a consistently favourable price trend. This means that increases in exports have resulted from what
can fairly be described as a dramatic expansion in the volume of production of the major agricultural and pastoral products, resulting in large measure from great improvements in productive efficiency.

The experience of the primary industries over the last ten or so years illustrates forcibly the difficulty of prediction in economics and, indeed, the absurdity of medium or long-range national planning in the context of the Australian economy.

The dazzling export prospects opened up since 1960 by vast mineral discoveries confirm still further the unpredictability of the Australian economy. The Treasury Paper comments . . .

"Developments now under way in the mineral industry, particularly in iron ore, coal, bauxite and alumina, will lift mineral production substantially within a few years time and even more substantially in the long run. The prospect is for a doubling of last year's exports within five years and, a good deal more speculative, a trebling within ten".

The Treasury document reveals not only the transformation in Australia's exports, but also the striking change in their destination.

"Whereas in 1953/4 some 60% of Australia's exports went to the United Kingdom and member countries of E.E.C., in 1957/8, this total was down to 50%, and in 1964/5 to 33%.

The Treasury comment, "this represents a significant re-orientation of Australia's export trade," seems like a considerable under-statement.

There is a tendency to think that the brightest prospects for Australian exports lie in the great under-developed world with its massive populations. The Treasury document dismisses this conception. It points out that in the last decade imports of the less developed countries have risen relatively slowly; that, in 1964, 70% of total world imports were taken by fourteen highly industrialised countries and that 62% of Australian exports went to these countries. In the ten years to 1964, Japan's imports increased at the amazing annual rate of 12.7%. This has more than small significance for Australia.
The Treasury emphasises that the future growth of the industrialised countries is of primary importance for Australia’s export prospects. The position of the United States in this general picture is heavily underlined because, in absolute terms, it is easily the largest importing country and many other economies (particularly the Japanese) are in turn highly dependent upon it as an export market. The key position of the American economy in the whole world trading picture is emphasized by a remarkable fact brought out in the Treasury Paper: in 1964, the addition to the Gross National Product in the United States was about twice Australia’s total Gross National Product. The Treasury attaches great significance to the recent sustained expansion of the United States economy and says that it now seems reasonable to hope that something of a “break-through” in the use of full employment policies may have been achieved in that country. Because of the interdependence of world trade as a whole and the special dependence of world trade on the United States, this achievement, if sustained, could be a fact of surpassing importance for all other countries.

The Treasury Paper makes some highly pertinent comments on overseas investment in its relationship to the Australian balance of payments. It contemptuously rejects a fairly widely held notion that the net effect of foreign investment on Australia’s external payments is to be measured by the difference between net capital inflow and income payable abroad. “This view of the matter” the Paper says, “is indeed so wrong as to be thought hardly worth rebutting, but for the frequency with which it continues to be put forward in public discussion”. What has to be considered is “the impact of overseas investment on productivity, on imports and exports. These are as much the continuing and increasing results of overseas capital inflow as the service charges on that inflow. . . . it must be remembered that overseas capital need not move directly into export or import-replacing industries (though in many cases it does) to have a beneficial effect on the balance of payments. It is essential to grasp this point.”

Perhaps the part of the Paper that will most attract the attention of the reader is its examination of the balance-of-payments prospects up to and beyond 1966/7. This assumes
special interest in view of the heavy drain on Australia’s overseas reserves, over the last year or two.

Since so much depends upon the balance of payments, it is the most natural thing in the world that we should want to know what is going to happen to it in the future. This is why more or less precise arithmetical forecasts of the state of the balance of payments, a year, five years, or even ten years ahead, exercise such a fascination over politicians, economists and businessmen. If we could predict, with some reasonable degree of accuracy, the condition of our external payments in the medium and long range future, we would take a big step toward becoming the masters of our economic destiny. But, unfortunately, balance-of-payments forecasts amount to attempts to predict the unpredictable. Indeed, if the forecasts cover a period of more than twelve months ahead, they become little better than guess-work. And even the many predictions of the course of the balance of payments during a single financial year are more often than not far wide of the mark by the 30th June. (The current financial year affords a striking confirmation of this. A few months ago, it was thought, even by the Commonwealth Treasury itself, that overseas reserves would show a substantial decline over the 12 months. In fact, owing to unpredictable occurrences, the run-down is likely to be insignificant.)

This does not mean that forecasts should not be made. Indeed, an intelligent weighing-up of the future possibilities of exports, imports, capital inflow and the other items which comprise the external accounts, may afford some general guide as to the direction in which the economy appears to be moving. And that is important. The danger occurs when these necessarily rough estimates are taken to be more or less accurate projections of what will actually occur, and are used as a basis for economic or business policies which could do serious harm to the economy. This was the cardinal error of the Vernon Report. There is a great temptation for economists, or for that matter for members of other professions, to pretend to a greater knowledge and a deeper wisdom than they do in fact possess or, indeed, in the nature of things, can hope to possess. Too many of us succumb to this temptation. The Treasury Paper resists it, and this is what makes the Paper
such a praiseworthy document. In their appraisal of the immediate and longer-term future of the balance of payments, the authors make no arrogant pretensions of clairvoyance.

On the subject of economic forecasts in general, the Treasury Paper has some things to say which should be taken to heart by all economists.

"There is no essential virtue in long-term forecasting as such. The purpose of forecasting is, in the last analysis to serve as a guide to action; but there are indeed few areas of the economy in which to avert a feared situation ten years hence, action is necessary now. Some areas of that kind exist; but they are the exception, not the rule. The balance of payments as such is not amongst them."

The Treasury therefore refrains from making any arithmetical projections of the balance-of-payments future. It does, however, canvass in comprehensive fashion the factors bearing on the prospects of imports, exports and capital inflow. In view of the understandable concern about the drain on Australia's overseas currency reserves through 1965, the Treasury assessment is encouraging. The Paper points out that the large deficits incurred over the last eighteen months have resulted from influences that might fairly be regarded as of a transient or temporary character. The decline in export income, for instance, though not great, has resulted from a fairly steep drop in export prices — which now show signs of recovering — and from a fall in the volume of rural exports attributable to the drought. The steep rise in imports has also been due to rather abnormal factors such as the sharp increase in defence spending, the re-equipment programmes of major air-lines, the Mount Isa strike, and a level of total internal demand verging on the excessive.

In looking to the immediate future, the rapid recovery of the volume of rural exports will clearly depend on good rains in the coming months. The world wheat position is at present highly advantageous from Australia's standpoint. Exports of minerals will soon begin to increase sharply, particularly as deliveries of iron ore to Japan get under way. Finally, there does not seem to be any grounds at the moment for a pessimistic outlook towards capital inflow. In weighing up all these factors, the Treasury feels that by the end of 1966/7
the economy could be within sight of achieving balance in its external accounts.

As far as the longer-term prospect is concerned, the Treasury sees many hopeful portents. Among these are: the scope for continuing productivity gains in the traditional rural industries; promising new markets, particularly for meat opening up in the United States and Japan; the rising demands of countries benefiting from the rapid growth of the American economy; and, above all, the glittering prospects ahead for minerals, even without any new discoveries or the development of new markets. Provided Australia maintains a sound, growing and aggressive economy, the Treasury seems confident about our long-term external competitiveness and our ability to cope with any short-run balance-of-payments problems that may arise from time to time.

To repeat: it would be difficult to conceive of a sounder or more thorough survey of the critical external area of the Australian economy than the Treasury has provided in this document. In addition to the great contribution it makes to better understanding of our economic problems, it affords a superb lesson in the proper use of economics.
Sir Arthur Warner

It is with deep regret that we record the death of Sir Arthur Warner.

Sir Arthur had been a member of the I.P.A. Council from the time of its formation. He was one of a number of far-sighted businessmen who, in the turbulent political climate of the early 1940's, saw the need of an organisation to conduct research into national economic policies affecting business enterprise and to inform the public of the contributions of business to the progress and welfare of the community.

Throughout the years he retained an enthusiastic interest in the Institute's work. He was one of the more outspoken and provocative members of the I.P.A. Council and this, combined with his incisive intelligence and uncompromising realism, gave him a special place in Institute affairs.

Paradoxically he was, in many ways, a reserved man and consequently was not easy to know. But the closer one got to Sir Arthur, the more one respected him for his blunt honesty of approach and his highly individual character.

His business and political achievements are well known. From small beginnings he built, by force of personality and shrewd vision, what might fairly be described as an industrial empire. As a senior Cabinet Minister in the Victorian Government, he made a notable contribution to the affairs of his State.

Sir Arthur Warner will be missed by many and not least by those closely associated with him at the Institute. We extend our deepest sympathy to the members of his family and to his colleagues in business, politics and public affairs.
NOTWITHSTANDING recent measures by the United States and Britain to restrict the export of capital, the current decade seems certain to be the greatest era of international investment in history. Over the last four or five years, the scale of international investment has been increasing at an astounding rate. It now far exceeds the level achieved during the 1950's.

An important, although not the only, reason is the multiplication of giant international corporations, with advanced scientific and technological "know-how", seeking to extend their operations on a global scale. The activities of these corporations have now gained such momentum in the Western World that it is not easy to brake them back, even if this may seem desirable for short-term balance-of-payments' reasons.

Economists have long recognised the rationale of overseas investment: that in the early stages of economic expansion, no country has sufficient savings of its own to finance development. It must, therefore resort to importing capital from abroad. Traditional economic thinking has largely concentrated on the role of foreign capital in the under-developed, non-industrialised countries, and on government loans and private portfolio investment, rather than on that of direct private investment with managerial control. Even such an authority as Professor Arthur Lewis of Manchester University in his well-known book, "The Theory of Economic Growth" (published only in 1955) said: "It is entirely erroneous to think that direct investment (ie. investment in new plant and capital facilities) ever has been or could be the most important form of private investment. Direct investment is only the fringe of the foreign investment problem hardly relevant outside the spheres of manufacturing and mining." Ten years later this looks more than a little off beam.

Foreign assistance has played a vital part in the process of industrialisation of practically all modern nations. Britain herself borrowed from Holland in the 17th century to supplement her own meagre savings. But she in turn came to lend to many countries throughout the world, providing about three-quarters of all overseas capital in the 19th century. The United States borrowed heavily in the 19th century, but has now become the richest country in the world and the major international investor and lender of the 20th century. Since World War II, the United States has extended Government loans amounting to over $30,000 million; granted about $50,000 million in economic aid, and invested abroad over $50,000 million in private long-term capital.

U.S. private capital investment has rapidly accelerated in recent years to an annual rate four times that of the early 1950's. Among the reasons for this remarkable development are:
First, the rapidly growing wealth of the United States which has brought about a great surplus of savings available for foreign investment, particularly by large corporations.

Second, the notable advance in living standards in Western Europe, Canada, Australia and Japan which has helped create a tremendous demand for consumer goods of the type which the American economy produces in abundance.

Third, wage rates lower than those in the United States have encouraged the establishment of American plants overseas in preference to exports by the parent company.

Fourth, the gradual elimination and reduction of tariffs between the countries comprising the European Economic Community and the Free Trade Area. The creation of a large and expanding mass market, rivalling even the United States itself, has attracted huge investments by American corporations in European countries in order to dodge the tariff penalty.

Fifth, the concentration on scientific and technological research of many types in the United States, where vast sums are available for pure and applied research and where a great deal of specialisation is possible. Overseas industries are tending to become increasingly dependent on patents, trade names, equipment, know-how and materials which can be provided only by the United States and, to a lesser degree, by other advanced countries.

Sixth, the expansion of American industry leading to enormous demands for oil, minerals, wood pulp and other raw materials is resulting in large U.S. investments in Canada, South America, Australia and Middle East countries to guarantee future sources of supply.

The export of direct private capital to start new industries in countries already in an advanced stage of economic development provides a striking contrast with the 19th and early 20th centuries. During this era, the savings of the Old World were used to open up the underdeveloped lands of North and South America and Australasia, rather than for the development of manufacturing industries. About 40% of British overseas investment before World War I was in railways, 35% in government bonds and only 15% in industry, finance and commerce.

Another important aspect of the vigorous expansion of overseas investment has been its association with the trebling of world trade since 1950. Without these funds, international trade would have been very much less.

The share of manufactured goods in world trade has risen from 43% in 1950 to 56% in 1962, and machinery and transport equipment, which absorb a great deal of the money provided by overseas investors, has risen in value from 32% of total world trade in manufactured goods to 41%.

A great deal of useful information about the extent of international investment has been provided by the Surveys of the United Nations Economic and Social Council. The table on page 44, largely extracted from a study entitled "The International Flow of Long-Term Capital and Official Donations", indicates the expansion in net capital exports since the beginning of the 1950’s.

It should be noted that the figures of capital movements are "net" i.e. capital inflow is deducted. This greatly understates the actual world movement of capital. For instance, the contribution of the Western European countries to world capital flows is far more significant than
### NET CAPITAL EXPORTS 1951-1965

<table>
<thead>
<tr>
<th>Year</th>
<th>Private</th>
<th>Governments &amp; Official Agencies*</th>
<th>TOTAL</th>
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<tr>
<td></td>
<td>U.S. $U.S. thousand</td>
<td>U.K. million</td>
<td>Switz., Japan</td>
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<td></td>
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<td>Common Mkt. (excl. Italy)</td>
<td></td>
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<td>1951/5 An. Av.</td>
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<td>1956/9</td>
<td>1.3</td>
<td>0.5</td>
<td>0.1</td>
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<tr>
<td>1960/1</td>
<td>2.9</td>
<td>0.6</td>
<td>0.1</td>
</tr>
<tr>
<td>1962</td>
<td>3.0</td>
<td>0.1</td>
<td>—</td>
</tr>
<tr>
<td>1963</td>
<td>2.9</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>1964</td>
<td>3.7</td>
<td>0.2</td>
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<tr>
<td>1965</td>
<td>4.7</td>
<td>0.4</td>
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<td>1951/5 An. Av.</td>
<td>2.2</td>
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<td>1956/9</td>
<td>2.3</td>
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<td>1964</td>
<td>4.3</td>
<td>0.3</td>
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<tr>
<td>1965</td>
<td>4.4</td>
<td>0.3</td>
<td>n.a.</td>
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</tbody>
</table>

*including donations.

The table above suggests. There is a large two-way traffic, principally in private capital, between the advanced industrial countries. North America, Western Europe and Japan not only export their surplus savings to the rest of the world, but themselves attract considerable amounts of direct and portfolio investment from one another. Britain, for example, invests heavily in Australian and Canadian primary industries to secure raw materials for her manufacturing complex. On the other hand, she receives vast amounts of capital from America for industries such as motor vehicles and petroleum refining, and for industries where technology is advancing rapidly. Thus, while assets held abroad by British companies (excluding oil, insurance and banking) exceed $10,000 million, overseas interests have invested about $4,000 million in British industry.

Even the United States receives large amounts of capital from abroad. Foreigners own business assets in the United States worth $14,000 million as against $50,000 million held by Americans in overseas countries. Although the extent of American investment in Canada has been the subject of criticism and misgiving on the part of Canadians, it is not widely known that, on a per head basis, the Canadians own almost twice as much in the United States as the Americans do in Canada. Canadians have ready access to Wall Street and other American stock exchanges and most of their U.S.
holdings are portfolio investment. American investment in Canada on the other hand is mainly direct.

Statistics compiled by the United Nations on a gross basis show that, over the years 1958 to 1960, total world gross private investment averaged between $12,000 and $13,000 million a year (with "gross" investment, capital inflow is not deducted from capital outflow). The advanced industrial countries of North America, Western Europe and Japan received 40% of the total, and the rapidly developing countries of Australasia and Canada, together with Italy, a further 35%. Only one-quarter went to the under-developed countries, where well over two-thirds of the world's population lives. And most of this was invested in the Latin American countries and the Middle East to develop oil and other minerals. Densely populated countries such as India, with low per capita incomes and lacking important resources, relied almost entirely on loans from the World Bank and similar agencies, or on direct governmental aid from the United States and other countries. Over the period 1956/60, Latin America, with only one-sixth of the population of all under-developed countries, received two-thirds of total exports of private capital to them. By contrast, South-East Asia, with almost two-thirds of the world's population, received only 6%. However, over the past decade, the inflow of foreign aid, which has risen three times as fast as the export earnings of the under-developed countries, contributed about one-sixth of their total foreign exchange receipts in 1960.

The grand total of world overseas investment is now estimated at around $150,000 million. Of this, the United States has contributed about $100,000 million and Britain $30,000 million. Of the American holdings, about one-quarter is official debt, and three-quarters private investment. Over 85% of American private investment is long-term and, of this, two-thirds represents direct investment in overseas subsidiaries. Recent estimates suggest that about 200 multinational corporations account for four-fifths of all U.S. private direct investment overseas. The rise in U.S. direct investment abroad since 1950 is set out in the following table:

<table>
<thead>
<tr>
<th>Continent/Country</th>
<th>1950</th>
<th>1964</th>
<th>1964</th>
<th>1964</th>
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<tbody>
<tr>
<td></td>
<td>TOTAL</td>
<td>$U.S. thousand million</td>
<td>Mfg.</td>
<td>Mining</td>
</tr>
<tr>
<td>North America</td>
<td>3.5</td>
<td>13.8</td>
<td>6.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Canada</td>
<td>3.5</td>
<td>13.8</td>
<td>6.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Europe</td>
<td>11.8</td>
<td>44.3</td>
<td>16.9</td>
<td>17.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.8</td>
<td>4.6</td>
<td>3.0</td>
<td>0.9</td>
</tr>
<tr>
<td>Common Market</td>
<td>5.4</td>
<td>3.1</td>
<td>1.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Other</td>
<td>0.9</td>
<td>2.1</td>
<td>0.4</td>
<td>0.7</td>
</tr>
<tr>
<td>Total Europe</td>
<td>1.7</td>
<td>12.1</td>
<td>6.5</td>
<td>3.1</td>
</tr>
<tr>
<td>South &amp; Central America</td>
<td>4.7</td>
<td>8.9</td>
<td>2.3</td>
<td>4.2</td>
</tr>
<tr>
<td>Africa</td>
<td>0.4</td>
<td>1.6</td>
<td>0.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Asia</td>
<td>0.8</td>
<td>3.1</td>
<td>0.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Australia</td>
<td>0.2</td>
<td>1.5</td>
<td>0.8</td>
<td>0.2</td>
</tr>
<tr>
<td>All Other</td>
<td>0.5</td>
<td>3.3</td>
<td>0.4</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: U.S. Department of Commerce.
In 1964, direct American investment abroad rose by $3,800 million. Investment in Western Europe, amounting to $1,700 million, accounted for nearly half. The largest share, $900 million, went to the Common Market, while $400 million was invested in the United Kingdom. U.S. investment in Australia increased by $186 million during 1964, compared with $750 million in Canada—an abnormally low year—and $108 million in Japan.

The magnitude of American investment abroad in recent years, along with her other international commitments, has not surprisingly, created short-term difficulties for the United States balance of payments. However, most American economists are confident that this situation will soon resolve itself. Dr. William Butler, economist of the Chase Manhattan Bank* maintains that the deficit of the United States is so small in relation to her total international transactions, and even smaller in relation to her Gross National Product, where it is only 1 1/2%, that the position will work itself out somehow or other. He confidently expects U.S. direct foreign investment to double over the decade ahead. Dr. Butler also believes that the United States will be called upon to supply at least $6,000 million of Australia's estimated requirements of $80,000 million of new capital over the next ten years. He points out that American private capital flows with ease "down-hill into nations, where it is treated fairly and where markets are growing", but will not "flow up-hill into nations which treat it badly and pursue other policies which stultify economic growth". Dr. Butler says:

"A nation which encourages local initiative and investment will attract foreign investment. These factors are important in explaining the fact that three-fifths of U.S. private direct investment has gone to Canada and Western Europe. They also go far to explain the attractions of Australia. . . . If investment prospects in Australia, including the favourable climate there, continue to attract U.S. investors, even larger flows of capital from the U.S. would be possible. Indeed, I believe that in the final analysis the question is not the ability of U.S. investors to support Australian growth, but rather the willingness of Australia to accept capital on reasonable terms. Granted a continued hospitality to foreign investment, I am convinced that Australia can count on an inflow of capital fully adequate to her needs."

The extraordinary rise in American investment in Western Europe in recent years is not widely realised. It provides a striking illustration of the fact that venture capital no longer flows primarily between the developed and under-developed world, but largely between the developed countries themselves. This capital has become a means whereby the technology of the already advanced industrial countries is maintained at the highest world standards. The Atlantic Council of the United States, a group of prominent American businessmen, recently reported that, despite Gaullist-type opposition, U.S. capital is needed and welcomed in Europe more than ever for specific investments or for enterprises requiring advanced complex technology. "American technology", the Council says "is the unquestioned key to Europe's strength, security and prosperity. Europe still lags far behind the United States and in truth the gap—the real gap—is increasing. Even greater masses of money are going to be added to the $12 billion in American capital already invested in Europe."

Australia, of all countries, can least afford to pursue, narrow self-regarding policies of economic nationalism. Among

*In a paper recently delivered at a Symposium on Australia organised by the University of California.
other things, we are faced with the problem of finding sufficient capital for the development and exploitation of exceptionally rich natural resources, widely spread over a vast continent. We are endeavouring, too, to maintain a rate of population expansion which is among the fastest in the world. At the same time, the small Australian home market makes it difficult for us to achieve levels of industrial efficiency comparable with North American and European countries enjoying the advantages of a huge mass market. Moreover, we have to face the fact that, for a long time yet, industrial research in Australia must necessarily be on an insignificant scale measured against that of the United States and Western Europe, whose scientific resources, skilled personnel and money we cannot hope to match.

For all these reasons Australia, at this crucial stage in her economic development, should eagerly welcome the import of foreign capital and the technology and skills which go along with it. If this means, as it no doubt does, increasing overseas ownership of Australian industries, that may be a small price to pay for the tremendous long-range advantages that we stand to derive. Even Canada, where American capital is predominant, has come round to the view that the question of ownership is not so important as the rate at which her standards of living are improving and the development of her national resources is being accomplished.
The Intellectual
and the Businessman

[“The intellectual” is a term often heard, but difficult to define precisely. It is used here in the sense given to it in modern usage. “The intellectual” we take to be someone who is occupied mainly in the pursuit and dissemination of knowledge, and in the arts and cultural pursuits. The great proportion of “intellectuals”, naturally enough, are to be found in the universities and higher educational institutions. Many businessmen, whilst not “intellectuals”—in the meaning attributed to the word here—nevertheless have intellectual interests.]

Generally speaking, it is hard to discern much sympathy or understanding between the intellectual and the businessman. The friction that so often exists between the two is, indeed, a prominent feature of present-day society. Each seems to act as a kind of irritant on the other. The intellectual rarely sides with the businessman in any conflict where business interests are involved; and, on the other hand, the businessman is often to be found in the vanguard of the harshest critics of the intellectual.

It would be no exaggeration to say that each is absurdly suspicious of the other. The intellectual frequently questions the businessman’s motives; he is inclined to see him as a materialist, as a self-interested seeker after his own personal gain and profit, not averse to riding roughshod over the public interest or general welfare of the community. The businessman, on his side, thinks of the intellectual as someone a little “out of this world”, largely ignorant of human nature, an impractical dreamer living in sheltered seclusion, absorbed with abstractions and theoretical notions that bear little relationship to the cold realities or demands of every-day living. Some businessmen feel that the intellectual places too much
value on sheer mental development and too little on qualities of character, persistence and leadership necessary in the higher levels of business.

It would be fair to say that each vastly under-rates the contribution of the other to the affairs and well-being of our modern society or, for that matter, to the well-being of one another. The debt of modern business to the intellectual is, by any reckoning, a substantial one. The almost miraculous improvement in the "economic climate" in which the businessman operates today over that of twenty or thirty years ago, is largely attributable to the ingenious work of economists, of a theoretical as well as practical bent. The virtual elimination of the dreaded trade cycle, the achievement of full employment and the removal of the chronic condition of underemployment, which not so long ago (let it be recalled) was accepted as part of the natural economic order, have not only greatly reduced the risks of doing business but, more important, have wondrously increased the opportunities available to the businessman. Few businessmen today would be prepared to settle for a stable market for their products — a condition which would have seemed like an economic Heaven to the businessman of a few decades ago, plagued by large and unpredictable fluctuations in demand almost from year to year. The modern businessman wants, and expects, the market for the products of his particular industry to be rapidly expanding. He is not satisfied for 1967 to be as good a year as 1966; he wants, and expects, it to be better. Many of us forget that the most used word in today's economic vocabulary, "growth", is of very recent origin. That the businessman is now able to look forward, with some degree of certainty, to the prospect of rapid national growth and rising demand, is largely traceable to the labours of economists all over the world, often working far from the market place itself.

But there is an even deeper sense in which the modern businessman may be said to be indebted to the intellectual. It is, to say the least, doubtful whether the system of free business enterprise would have survived had the intellectual not been successful in finding cures for the recurring mass unemployment and chronic under-employment by which the system was afflicted before World War II. Indeed, the political
consequences of the work of intellectuals, directed toward the abolition of the trade cycle and the provision of full employment, have been even more profound than the economic. In helping to make the system of free enterprise work better, the economics profession not merely transformed the climate in which the businessman operates, but probably saved the system itself from extinction. Those businessmen—today, they are probably dwindling in number—who are over-ready to criticise the economist might pause to reflect on this. In 1935, Keynes wrote, “It is certain that the world will not much longer tolerate the unemployment which apart from brief intervals of excitement is associated—and, in my opinion, inevitably associated—with present-day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease while preserving efficiency and freedom.”

On the other hand, without the special talents of the businessman, his restless enterprise and drive, his constant seeking after new and improved products and better methods and techniques, the intellectual, along with the rest of us, would have had to content himself with a very much lower standard of life and comfort than he now enjoys. Intellectuals, as much as anyone else, derive pleasure and benefit from their modern car and T.V. sets. Their homes are as likely to be as well stocked with the amenities and gadgets of contemporary living as those of more ordinary mortals. There is a touch of irony in the fact that the intellectual owes his improving standard of welfare and comfort quite largely to the system with which many are perhaps over-ready to find fault.

The intellectual benefits in other ways from the contribution of the businessman. The experience of the latter in matters of human relations, finance and organisation is widely applied to good purpose in many of the higher educational institutions. In the raising of money for universities, public schools and research foundations, the businessman’s special talents are invariably called to the aid of finance and management committees. The prominent businessmen of the modern era give time, energy and money to numerous activities which, in one way or another, enlarge the opportunities available to the intellectual.
Perhaps one of the things the businessman finds so irritating in the intellectual, is the tendency of the latter to adopt the posture of being not merely cleverer, but “holier than thou”. Too often, it is true, the intellectual assumes that he observes a higher standard of morality than the businessman whose “unethical conduct” he frequently censures. When the intellectual attacks the so-called “restrictive practices” of business, he does so not only because he contends that they lead to economic inefficiency and put a brake on progress, but also because he regards them as an affront to ethical conceptions of right and wrong.

The businessman, he says, is motivated primarily by self-interest. His over-riding concern is with profits and the making of money. He spends huge sums on advertising, much of which, the intellectual contends, is misleading and some of it false. He points out that the businessman sometimes markets shoddy goods concealed in deceptively attractive packaging. Many intellectuals deplore capitalist competition as the rule of “tooth and claw”, the law of the jungle in which dog eats dog.

But is the motive of self-interest any less in evidence, the pursuit of personal ambition any less pronounced, in the academic than in the business sphere? Some men who have spent much of their lives in universities don’t seem to think so. Professor George Stigler of the University of Chicago somewhat ruefully observes: “Competition in scholarship is in some ways more violent than in business; the law sets a limit on the disparagement of a rival’s product, unless it is done in a book review in a learned journal”. C. P. Snow the famous English scientist and writer, in his widely read novel, “The Masters”, was concerned to demonstrate that competition for position and prestige within the walls of a university college can be equally as fierce and merciless as competition in the world outside. The aversion of some intellectuals to business competition has led them to advocate socialist and other forms of economic organisation designed to reduce or even eliminate it. The intellectual would be on sounder ground, and gain in frankness, if he were candidly to admit the truth that it is not possible to remove the element of competition from human affairs. If competition is eliminated from the field of competing goods and services it may merely be transferred to a
bureaucratic hierarchy within which men will continue to compete strenuously, and at times unscrupulously, for power and prestige.

The antipathy the intellectual feels towards the businessman may arise partly from envy of the higher rewards which business appears to offer by comparison with the rewards available in academic or intellectual pursuits. The intellectual may resent the fact that his neighbour, who is say a successful businessman, has two cars in his garage when he can only afford one. That he may, and very likely does, regard himself as mentally superior to the businessman serves to aggravate his sense of the unfairness of things.

To this attitude the businessman may be apt to retort that the intellectual is where he is because he is really horribly impractical, that he would be a hopeless failure if he emerged from the calm waters of his sheltered harbour to test himself in the rough open seas of the real world. The truth is that the businessman finds in this belief a feeling of reassurance. For, deep down, he may be envious of the greater knowledge and book learning of the intellectual. In the company of the intellectual he, not infrequently, has a sense of inferiority. In serious discussion, the intellectual may be much more adept in the use of words, a more fluent conversationalist, a more agile debater. This, after all, is his home ground and it would be surprising if he did not usually have the practical man at a disadvantage. Even when the ideas of the latter may be superior, or his knowledge of the subject under discussion greater, he may not be able to take advantage of his superiority because, by comparison with the intellectual, he is relatively unpractised in the arts of exposition and argument.

On the other hand, when it comes to "getting things done", to the world of action, it is the intellectual who is usually at a disadvantage. Here the businessman is "playing at home". Business calls for the ability to organise, for orderly planning, for readiness to take risks and capacity to make quick decisions, and these are matters with which the intellectual may have little familiarity. The intellectual's disrespect for the so-called "practical man" is partly a response to his own inadequacies in matters in which the business-
man may excel. It is one of the most common and least admirable of human traits to down-grade those qualities or attributes which we ourselves do not possess.

But even though the intellectual exhibits no overwhelming desire to know the market place at first hand, he is often not backward in telling the businessman what he should do and how he should run his business. Like everything else, business looks very different from the outside to what it does from the inside and the man sitting behind the desk of a top executive would be more than human if he did not feel at times a sense of annoyance at some of the observations about business that proceed from academic quarters.

It is, in fact, a fair criticism that too many modern economists and social scientists look at life from afar. They write about and prescribe policies for a world constructed too much out of the materials of their own imaginings, and too little from the intractable materials of real life. This cannot fail to arouse irritation among men who have to deal with the complex and often hard realities of everyday business affairs. The failing, of course, is not due to any innate intellectual deficiency on the part of the economist. Far from it! It is attributable to his neglect to get to close quarters with the real world. And this neglect is unfortunately something of which he is not acutely aware himself; otherwise he would take pains to correct it.

Lord Robbins (Lionel Robbins) one of Britain's most eminent economists said recently: "... the contemporary teaching of economics fails conspicuously to convey the vivid realities of business. What a pitifully inadequate picture is given in the textbooks of the rich and varied life which is business life in the 20th century". He went on to say that it was not always thus. "I recently looked again at Marshall's 'Principles of Economics' and read the chapter on business organisation, and then turned to his 'Industry and Trade' and read sundry remarks... As regards the way businessmen work and think it is roughly all there..." Lord Robbins proceeded: "To listen to a good deal of talk nowadays among literateurs and, I am afraid, some academics, one might suppose that the business world today was populated entirely by
characters who have walked out of a book of Samuel Smiles or in a rather more sinister guise, out of something by Jack London. What an extraordinary misconception this is”. Robbins then asserts: “Lunch in the boardroom of a good firm today is likely to be quite as intellectually exciting as lunch in most senior common rooms that I know of”.

It is unreal to expect that the businessman and the intellectual will ever see the world through the same pair of spectacles. Indeed, it would not be a good thing if they did.

The searching criticism of the intellectual may serve a highly valuable purpose in directing attention to some of the more questionable aspects of practical affairs, and in compelling those engaged in them to justify what they are doing. No one should expect the intellectual to conform. He is right to attack those standards and values which he conscientiously believes to be opposed to the interests of the community. He is right to denounce the evidence of ugliness and vulgarity and bad taste in our society and to urge improvement. The modern world is far from perfect and only a purblind fool or hypocrite would maintain that what is, is best.

The intellectual, at all costs, should jealously preserve his position as a commentator on, and a critic of, the mundane world of affairs. He must be free to speak his mind and to speak it plainly.

But intellectual freedom carries with it intellectual responsibility. And the businessman is entitled to expect that those disposed to be critical of him should take pains properly to inform their minds and should state their judgments moderately and without conscious bias. What one would wish to see in the relationship of businessmen and intellectuals is a little more generosity, a little more impartiality and a greater effort at understanding.
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Mr. Jossleyn Hennessy, who wrote this article for "Review", is the European Editor of "The Eastern Economist". Few men are as well-informed on economic affairs in Western Europe, to which he has devoted special study. He is well-known in British economic circles and has been a prolific contributor to prominent journals such as "The Economist", "The Statist", "The Spectator", "Lloyds Bank Review", and to "The Institute of Economic Affairs". He was sometime Director of Public Information to the Government of India, a lecturer at Princeton University and has travelled widely in Europe, Asia and North America.

In the article Mr. Hennessy probes, in depth, the causes of the recurring difficulties which have plagued the British economy since World War II.

HOW "Socialist" is the U.K.'s new Labour government likely to be? Do the 1964 and 1966 elections reveal a fundamental change in British political thinking and economic attitudes? What are the immediate and longer term economic implications? What will the Labour government do about the Common Market?

The best way, perhaps, to try to answer these questions is to outline postwar political and economic developments in the U.K., from which may emerge (a) the basic problems that face any British government, of whatever party, and (b) the conditions which limit its choice of solutions.

ORIGINS OF WELFARE STATE

Labour won the 1945 elections, because the masses indentified the Tories with the sterile policies of the 1929/36 depression, when unemployment had
dragged on around 17%, and because they thought that Socialists were more likely to be wholehearted in inaugurating the Welfare State that both parties offered. The Labour Government’s prolongation of wartime controls and rationing, the fuel crisis, the forced devaluation of sterling, disillusion at the failure of nationalisation to produce the millennium for the thousands of employees in the nationalised industries, and other misfortunes and ineptitudes, enabled the Tories to win in 1951. A combination of the end of difficulties of initial postwar reconstruction, plus avoidance of doctrinaire policies, plus the better luck that attends the successful, consolidated the Tories in 1955 and 1959. It took some years for the contradictions between the economic and social aims of Welfarism gradually to become more apparent.

Both Labour and Tories believed that the Beveridge plan, based on Keynes’ theories, provided the key to maintaining full employment. Both overlooked that Keynes had formulated his theories in the interwar years when demand was deficient, and that Beveridge postulated a 3% margin of unemployment.

The Welfare State should, theoretically, have been acceptable to Conservatives and obnoxious to Socialists, because it combines democratic government, sponsoring social benefits and security to all citizens, with the maintenance of a free enterprise system, i.e., the factors of production remain the private property of employers, who should be spurred by the hope of profits to produce what consumers want. In fact, the Socialist wing in the Labour party originally accepted it as a move towards state control; the Labour radical wing saw in it a means to promote egalitarianism generally through the re-distribution of wealth and, in particular, to destroy “privilege” in private education and medicine. The Conservatives originally accepted Welfarism from traditional Tory humanitarian motives as a means to maintain a safety net at a level beneath which no citizen should be allowed to fall.

SOCIAL JUSTICE CREATES DISSATISFACTIONS

Although the Welfare State seeks to combine collective social security with free enterprise as the means of multiplying wealth, British experience since 1946 has been that, in any conflict of aims, the aim of social justice takes precedence over the aim to multiply wealth. This is because where, as in a free enterprise society, a man’s earnings are settled by the objective tests of the combination of custom and circumstances, the impersonal working of the laws of supply and demand, and his personal efforts and skill, he feels that in so far as he earns more than others, the difference is in some measure due to his own skills and merit, while in so far as he earns less, it is not his fault, but “just the way things are”. His dissatisfactions are tolerable. But where, as in a Welfare state, his earnings are supposed to be “socially just”, the test becomes man-made, subjective, open to group pressures, and he feels that with his union to push and his constituency M.P. to shove, he too ought to secure any higher pay “justly” accorded to his neighbour. Failure to obtain it rankles: it has no connection with increased productivity; it is an injustice.

The prevalence of what is socially just over what is economically possible, or desirable, accounts for a large part of the U.K.’s postwar “Stop and Go”.

By 1964, public opinion had become increasingly uneasy about the Tory Government’s management of the economy. Output and employment had indeed been maintained, but prices had risen continuously, balance of payments crises always seemed round the corner, other countries, like Germany and Japan, had managed to grow much faster, and frequent alternations between Stop and
Go had led industrialists, business men, and workers, to feel that they were subjected to unnecessarily frequent reversals of policy. Rab Butler’s "dash to freedom" in 1951 was forgotten. The Tories seemed to have lost their sureness of touch. Chancellor Selwyn Lloyd sought to promote faster growth by introducing planning (Neddy—the National Economic Development Council) and to counter inflation by an incomes policy. After this theft of the Labour Party’s clothes, it was hardly surprising that the electors came to the conclusion that if the Tories were so uncertain of their own professed belief in free enterprise as to experiment with planning and incomes policies, they had better be replaced by a party which believed wholeheartedly in these “socialist” measures and could therefore be expected to make them work more effectively.

U.K. PIONEERS OF MANAGED ECONOMY

Public discontent with Stop and Go is understandable but overlooks that alternating cycles of rising and slower economic activity are among the inescapable facts of life that face any government. Growth cannot go on indefinitely, especially if it is rapid, because supply conditions change, production bottlenecks develop, and labour needs to be redeployed. In Communist countries, such adjustments take the form of spectacular revisions of Five Year Plans. A free market economy uses monetary, fiscal, and budgetary measures to cause investment programs to be modified and labour to be redeployed. The Tory failure in economic management has been relative. By pre-war standards, economic fluctuations have been minor. Growth, at around 3% a year, has been faster than ever before in the U.K.’s history—in the palmiest days of the 19th century, when she set the world pace, it averaged less—and the standard of living has risen every year. The Tory Chancellors and their Treasury advisers pioneered the testing out of the wholly new concept of maintaining a level of employment, never previously systematically applied in any other country. They had everything to learn about the timing, strength, and direction of fiscal and monetary measures, and to build up new statistical sources and weapons, which their labour successors will have to continue to elaborate and to refine.

Outstanding among the causes of the U.K.’s jerky Stop and Go is that insistence on social justice has come to mean that any number of unemployed over 1.5% (half of Beveridge’s margin) is politically intolerable. This means in effect no unemployed at all, since there are about 180,000 elderly or disabled persons classified as unemployed who are unemployable. Part of the trouble was that for nearly ten years after the war, British Chancellors, their Treasury advisers, and above all the trade unions, were not sure that they had found the secret of full employment. By the mid-fifties, however, Chancellors and officials (but not the trade unions) had been compelled to connect balance-of-payments’ difficulties with the creeping inflation which accompanies over-full employment and creates a sellers’ market, in which virtually all rises in costs can be passed on. Rising domestic demand diverts goods from export markets, and exports tend to price themselves out of foreign markets. Among inflation’s transiently euphoric effects are that it enables a country to draw on foreign resources by means of the current account net deficit in the balance of payments, which allows a corresponding addition to internal investment and consumption. But there comes a point when foreigners begin to be nervous about the mounting tide of their customer’s debts. If the credit restrictions of a “Stop” are not applied in good time, foreign creditors demand cash, and a balance-of-payments’ crisis occurs.
ESSENTIAL CONDITION FOR GROWTH

A margin of unutilised capacity is an essential condition for growth. Where capacity is fully employed, rising demand creates inflation and stagnation. Where an unutilised margin exists, rising demand evokes expansion. Unfortunately in the U.K., as in many other industrial countries, economists have hitherto failed to persuade politicians to educate electors in the vital importance of this point. If competitive conditions were enforced and created realistic mobility of labour in the U.K., the number of unemployed required at any one time to prevent inflation and to allow a margin of unused capacity in the economy, would be only 2%. Moreover, in an expanding economy, requiring steady redeployment of labour, the 2% unemployed would not be continuously the same individuals, but a reserve changing constantly in individual identity.

MR. CALLAGHAN’S NEW TAX

Since the U.K. borrowed about £900 millions to tide over the 1964/65 balance-of-payments’ crisis and the currently continuing deficit, the foreigners who lent this money look to the Labour Government for policies combining deflation of internal demand with incentives to boost exports. Mr. Callaghan seeks to meet these reasonable expectations by a selective employment tax, which aims to re-shuffle the demand for labour instead of reducing it by orthodox measures. Employees in “non-productive” service industries are to be taxed, while manufacturers will receive a subsidy per head of their “productive” employees. This, Mr. Callaghan hopes, will redeploy labour from services to manufactures, will increase export production, and deflate the economy painlessly by raising £240 millions from a previously untaxed area. I readily concede the principle of Mr. Callaghan’s new tax, which shows imagination in broadening the basis of the monetary and fiscal measures necessary to manage the economy. Unfortunately, the tax has been rushed into action with inadequate study and Mr. Callaghan seems deaf to criticisms that service industries (distributors, financiers, bankers, salesmen, retailers, etc.) are vital to the prosperity of manufacturers, that services to tourists are one of the U.K.’s biggest export earners, and that since all industries are suffering from labour shortage, there can be no guarantee that services will release workers, or that manufacturers, now actually to be subsidised to employ more, will not hoard more than ever. Nor does the tax guarantee that manufacturers will increase exports. Some of the categories exempt from the tax are among the worst hoarders of labour, not least the nationalised industries and local government. Other outstanding hoarders include large sections of the manufacturing industry: steel, motors, aircraft, printing, etc. . . . Far from alleviating the labour shortage the tax is likely to maintain over-full employment. The government’s hopes emerge clearly from Mr. Callaghan’s peroration: “The government pins its faith on the willingness and understanding of the British people to make the policy of productivity, prices and incomes succeed, and so secure our triple objective” (a strong £, a steady growth rate, and full employment). This is not a policy: it is an incantation.

WHAT IS AN “INCOMES POLICY?”

Just as between the wars too many politicians concealed their fear of the realities of the relations then existing between nation states by insisting that “collective security” would solve all conflicts, so today too many conceal their fear of the realities of the relations between over-full employment and inflation by insisting that an “incomes policy” will solve all conflicts between employers and the public interest.

But what is an “income policy”? Exhortations to workers to exercise wage
restraint, informal undertakings with unions to refrain from wage demands for a stated period (cf. Selwyn Lloyd's "pay pause"), government intervention to secure a compromise in a dispute—all these are incantations. An income policy can only be attempted if the government sets up a statutory authority to decide periodically by what total sum incomes can be allowed to rise without causing inflation, how this sum is to be shared out among millions of applicants, and how employees can be compelled to accept as "fair" the share allocated to them. Holland is the only country in which such a genuine incomes policy, enforceable by statutory sanctions, has been tried out—and failed, because the productivity of an industry cannot be calculated accurately and the margin of uncertainty gives full scope to wage negotiators. Dutch and French experience is that incomes policies inevitably end in official price freezes, which solve nothing and can only be temporary. The basic fact is that if inflation is avoided an incomes policy is superfluous because, without excess demand, wages increases cannot be passed on in higher prices beyond a certain point without causing sales to fall and unemployment to rise. If excess demand exists, no incomes policy can work.

LABOUR'S ORTHODOX ECONOMICS

Mr. Callaghan's budget estimates for a current surplus of no less than £1,047 millions in 1966/67. This is orthodox deflation, but whether Mr. Callaghan becomes the first Chancellor in U.K. history to achieve so large a current surplus depends on whether he can hold down the level of demand. The government does not seem to realise that the more that employers observe the letter of the incomes policy rules, the greater the inflation created: to the extent that the new tax is passed on to consumers it is deflationary; to the extent that employers listen to the government's appeal to absorb it, their resources for re-investment and expansion will fall, and capacity to meet expanding demand fail to rise. Ironically enough, if the Budget does induce some deflation, it will counter Labour's election promise to secure expansion without putting a man out of work and will slow the growth rate to 1 or 2% (thus hammering a final nail into the National Plan's proclaimed 4% p.a. growth target). It would then be vital that wages should not rise by more than this. Nothing in the record up to now, however, suggests that they would be held down. The National Health Service doctors, for example, have just had a "socially just" initial rise of 35%, which (together with dentists' rises) adds £40 millions a year to consumers' demand. The 330,000 state-employed teachers have hastened to express their hearty agreement with the "social justice" of the doctors' pay rise, providing that is, that they get the same. And a score of other "socially just" rises have been, are being, or beyond doubt will be, granted. If a government were determined to win the battle against excessive self-defeating demand, it could do so by organising spectacular resistance to a spectacular strike, and the present government would be in a stronger position than the Tories to attempt this.

BRITAIN AND EUROPE

An example of the significantly similar thinking that the realities of office induce in Tories and Labour alike is their attitude to the European Economic Community. In opposition, Labour were hostile, fearing that diminished U.K. national sovereignty would mean that a future Labour government would not, in the face of the EEC's commitment to a free market economy, be free to promote Socialism. The Tories were also initially suspicious, fearing that diminished sovereignty would hamper the U.K.'s relations with the Commonwealth and her overseas responsibilities east of Suez and
elsewhere. But as the years went by, the Tories came to the conclusion that outside the EEC, the U.K. would be excluded from the world’s biggest agglomeration of political power—third only to the U.S.A. and the U.S.S.R.—and from one of the world’s areas of fastest growth. In such circumstances, national sovereignty over domestic economic policies means nothing at all. For a long time, they thought that the U.K. was growing more slowly because she was investing a smaller proportion of GNP, but deeper analysis of EEC experience eventually suggested that growth comes less from the volume of investment and much more from improved techniques and new technologies, and that this depends on human habits and attitudes. The comparative slowness of U.K., and rapidity of EEC, growth has been due to the lesser degree of competition influencing the attitude of British managers and workers and the greater degree stimulating EEC manager and workers. A high rate of demand should lead to expansion of capacity in anticipation of higher profits, but U.K. Welfare ideology condemns “excessive” profits. To this must be added the widespread restrictive practices that the British unions enforce in order to spread the work among as many as possible (a doctrine written into the union rule books in the interwar depression.) Finally, far too many employers have been encouraged to take life easily, to uphold informal cartel agreements, to avoid “too aggressive” competition, to regard efficiency and productivity as unimportant, because with creeping inflation no firm (it seemed) could fail to make profits, while during “Stop” credit squeeze periods, they could continue to coast cosily along behind one of the world’s highest tariffs. All this goes far to explain, on the one hand, the U.K. demand, and, on the other hand, the conversion first of the Tories, and now of Labour, to the view that entry into Europe might be the least difficult way to force the changes in social habits and attitudes needed to speed the growth rate. Abolition within the EEC of the U.K.’s high tariffs would hasten, and the addition of the EEC’s 170 million consumers to the U.K.’s 54 millions would ease, the abandonment of restrictive practices that would be forced on British workers and employers if they were to survive in the Common Market.

U.K.’s BASIC PROBLEM NOT INSOLUBLE

The U.K.’s basic problem is how to reform an outmoded Welfare system, which had some justification in the “pre-affluent” 1940’s. The Welfare services were set up to enable the “below the net” majority to obtain a minimal old age pension and a share in the redistribution of existing education and health facilities.

A system in which the government undertook to supply, in return for a negligible flat rate weekly contribution, social services without limit, lowered quality and promoted inflation. State organised education and medicine created a bottomless demand for experts and depressed their financial rewards. Under free enterprise, increased demand for a service raise the rewards offered and so attracts a greater supply.

Not only was this against egalitarian doctrine, but since national expenditure cannot be raised faster than the growth of real wealth, the real amount that can be spent on doctors, nurses, teachers, university professors, scientists, etc. is limited. The original Welfare doctrine, as preached by the Labour party, could not admit that recruitment of experts should be limited to the number available for a given cost, because this would have limited the range of benefits promised to one and all, and would have opened doors to differential treatment of patients, or students, who could afford to pay more. Since the politicians of neither party dared to launch a publicity cam-
A campaign to connect rising “free” social benefits with the need of rising taxes to pay for them, the solution was to provide a constantly increasing quantity of benefits, but to lower the quality of the services provided, and to meet higher costs mostly by inflation, because this enabled the myth that the social services were “free” to be kept up. Inflation, besides being a disguised tax on all social service beneficiaries, lowered the real salaries of all state employees, thus initiating the “brain drain” to the United States and elsewhere. In the 1940’s, the average weekly wage was £3 and, for the sake of social justice, income tax began on incomes around £500 a year. But in the 1950’s average incomes began to rise—from £9 a week in 1953 to £17 in 1965. In some industries they are now twice or thrice as high. But although the lowest tax bracket was raised periodically, take-home earnings (especially when shared out in a family in which father, mother, son and daughter may each be earning their £15 to £30 a week) have now reached levels at which workers prefer more leisure to higher, more steeply taxed, pay. The present income tax structure is a powerful disincentive to higher productivity.

While in office, Tory voices began to be heard arguing the need to raise welfare standards above the level attainable in a universal hand-out, and to take care of real poverty, now for the first time the poor are a minority. In ten years time, the lowest paid workers should be earning £25 a week and the high paid £100 or more. But they will not work at rates of productivity needed to justify such wages if income tax still aims at punitive redistribution, and if the social services still offer impersonal assembly line rather than quality services, and personal attention. The party that will win the elections in the 1970’s will be that which secures the votes of the man with £2,000 to £4,000 a year. How to do this?

**WEST GERMANY POINTS THE WAY**

As far back as 1955, West Germany, Europe’s fastest growing economy, reduced the progression of income tax from a maximum of 95 per cent to 55 per cent, and transferred the main burden of taxation to indirect taxes, which account for about two-thirds of budget revenue. Germany offers tax reduction to encourage saving, including: insurance premia (in toto), savings banked for five years or over, “capital accumulation contracts”, sums invested in approved securities, investment trusts, building societies, wages paid to domestic help by parents out at work who have children, bonuses for inventions and for suggestions for improvements, and many others. Germany’s tax structure bears lightly on the creation of income (income taxes) and the possession of wealth (property taxes), and weighs on the use of income (business transactions, sales, consumption taxes). Contrary to widespread belief, expenditure on social security benefits in Germany is twice that of the U.K., but whereas flat rates are paid in the U.K., in Germany benefits and contributions are related to wages and salaries. The average maximum deducted from the worker is 13% of his earnings, and the employer’s maximum average is 15.5% of each worker’s earnings. The Federal Ministry of Labour has supervisory responsibilities, but individual insurance schemes are run by over 2,000 independent “friendly societies”, self-administered by the elected representatives of contributors (workers and employers). Although insurance is compulsory for all wage earners with a salary of less than £60 a month, insurable persons can shop around for the society whose combination of benefits seems to them to offer best value for contributions paid. Competition ensures a wide variety of societies, with differentiated services, which avoids the emergence of the dead level of routine that characterises so much of the U.K. National Health Service. In the U.K., the
limit to what doctors can earn is set by the interaction of the militancy of the doctors and what the government thinks that the taxpayer will stand in taxes or inflation. In Germany, the limit is set by the demand of the "societies" (based on their contributed resources) in relation to the supply of doctors.

WILSON AND CALLAGHAN PRAGMATISTS

There is evidence that suggests that Mr. Wilson and Mr. Callaghan are thinking along some such lines. The selective employment tax is inadequately thought out, but it implies readiness to experiment with new ideas contrary to Labour ideology. If, however, Labour is to reform the U.K.'s obsolete welfarism, its leaders will have to resist the inclination of the rank and file of the party to widen state control and further restrict private enterprise, not from any surviving doctrinaire belief in nationalisation but because—like a number of non-party people you and I could name—they are busybodies—they know what is good for other people—they are dirigistes by temperament. The housing shortage is a typical consequence of dirigiste distortion of the free market. The more that subsidised houses are provided below market prices in over-crowded areas, the bigger the shortage must be in those areas. (The current incantation for this is "Landlordism has failed"). Subsidise me to sell cigarettes below market price and I will guarantee to create a shortage of cigarettes in any country.

If at this point the reader complains that he is in a muddle, unable to distinguish Tory from Labour policies, he has all my sympathies, because this has been my difficulty throughout. The economic observer's problem is that while British politicians talk in the ideologies of socialism and free enterprise, they are pragmatists and differ in emphasis and temperament more than in principle. And the British electorate hang about and judge by results. From 1951 till around 1960 they were content with Tory results. From then on, the Tories having lost confidence in their own policies, the electorate pragmatically turned to Labour. Labour's tenure of office will depend on an equally pragmatic electoral judgement of their results and the duration of their self-confidence.

NOTE OF SOURCES

Since the ideas outlined above are controversial, readers are recommended to:


FREEDOM or Free-For-All: essays on welfare, trade, and choice (Institute of Economic Affairs, London, 1965).

Fiscal Policy for Growth Without Inflation: (J. Hopkins Press 1963) by F. G. Reuss describes West Germany's system of taxation, incentives, and social security.

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