The 1969/70 Budget

Mr. McMahon's record as Treasurer, up to the present, has been very nearly impeccable. The 1969/70 Budget is, however, not beyond criticism. Its pattern has been influenced, inevitably, by the approaching Election. In an election year a budget becomes as much a political as an economic document. It is less a personal product of the Treasurer and his departmental advisers than a synthesis of the views of government leaders forced to consider its appeal to those who will shortly decide the fate of their party. A careful study of the Budget, and its supporting documents, leaves one with the powerful impression that this is not the budget the Treasurer and his experts would have introduced had they had matters in their own hands.

The most curious thing that has come out of the 1969/70 Budget is the complete divergence of view among economic commentators on the economic effects of the Budget. After all these years of almost fanatical devotion to econometrics and mathematical economics, one would have thought that
the modern school of economists would have evolved at least an approximate method for determining whether a budget is inflationary or deflationary in its impact on the economy. With economists differing so widely in their assessment of the economic effects of the Budget, what is the ordinary man to think? The impression one gains from talking to business people is that many have decided that the Budget will do little or nothing to curb the gathering forces of inflation. Intuitive though this judgment may be, it is probably right. It must regretfully be said that the Budget does not impose the restraints called for in a situation of extreme tightness in the labour market, rising prices, a boom in building and private investment, and a highly liquid monetary position.

The very substantial increase in government spending of $526 million, compared with an increase in 1968/9 of $375 million (an increase of 8 per cent as against 6 per cent) simply does not make good economics at the present time. This was a year in which government claims on resources should have been severely restricted and the increase in spending kept to a minimum.

Some economists may argue that an alternative method of restraint would have been to impose increased taxes. The Budget, wisely, does not do this. In a situation where the level of taxes has already approached or passed the limits of public tolerance, further increases — apart from the political disadvantages — might aggravate inflationary pressures by swelling the clamour for higher incomes and by leading people to run down their savings. The correct government strategy can, thus, only lie in a reduced rate of government expenditure. This has not been done. Pensions and cash benefits have been increased by 13.2 per cent in the Budget, compared with only 8.7 per cent in the previous year. Advances and payments to the States have risen by a massive 11.4 per cent, more than double the increase of 5.3 per cent in 1968/9. The customary hand-outs to the farming community include an astounding and inexplicable rise of $4 a ton (a 50 per cent increase) in the superphosphate subsidy, which will be of more benefit to the wealthy than the struggling primary producer. Finally, the Budget provides for a huge jump of 38 per cent in expenditure on education. Of
the $73 million increase, subsidies to the independent schools will cost $16 million.

Not all these increases are necessarily bad. Few, for instance, will want to criticise the major and commendable forward step in provision for the poorer sections of the community. The Government has wisely concentrated on helping those most in need and left the impression that it is opposed to welfare systems which provide benefits for all, regardless of the financial circumstances of the recipients.

The most disturbing item in the increased expenditures provided is undoubtedly the massive rise of $234 million in advances and payments to the States, coming at a time of threatened inflation and over-employment of resources. The damage here was done two months before the Budget at the Commonwealth-State finance meetings when the Commonwealth was in its most generous mood for many years. These are, of course, transfer payments and do not affect the demands the Commonwealth itself makes on goods and services. But in the hands of the States these additional moneys will add greatly to the pressure on total resources. It is not that the States do no need the money. They do, quite desperately. The fact remains however, that such a huge increase in these allocations, at a time when the economy is exhibiting unmistakable signs of over-strain, is, from the stand point of economic strategy, precisely the reverse of what is required. Economists will have no difficulty in recalling that their great mentor, Keynes, prescribed pump-priming government expenditure for depressed, not boom, conditions.

The reason why the States need more money so badly is largely because immigration is reaching near record levels. The Treasurer himself points out, "Migrants are pouring in... net immigration (139,000 in 1968/9) was at its highest level since the 1950's". As far as can be ascertained, not one commentator has mentioned the close relationship between the expanding scale of the migration programme and the massive increase in grants to the States. One would almost thing that migration had no economic effects at all beyond providing additional workers and expanding markets for industry. The reason why Australia is compelled to allocate a higher proportion of its GNP to expenditure on public works
A CRUCIAL issue, and one which has given rise to confusion and disagreement, is whether the Budget is deflationary or inflationary in its impact on the economy.

Those who claim that the Budget is disinflationary rest their case, in the main, on two propositions:

1. The deficit in the Budget (the amount by which taxation and other revenues fall short of total expenditure) is estimated to be a trifling $30 million, compared with $375 million in the previous year. (These deficits have to be met out of proceeds from government borrowings).
2. Total receipts from the Budget will exceed total outlay within Australia by $522 million, compared with $215 million in the previous year.

1. The estimated current deficit this year, $30 million, as against last year's deficit, $385 million, does not permit one to draw the conclusion that this year's Budget will, on these grounds, be much more deflationary than the 1968/9 Budget. From the standpoint of their economic effects, these deficits are meaningless unless considered in conjunction with government borrowings which are used to finance the deficits. Whether this year's Budget will be more "deflationary" than last year's will depend on net loan raisings over the year, both foreign and domestic. The amount by which borrowings exceed the deficit (estimated at $30 million) will decide the extent to which the Government can reduce its short-term debt with the Reserve Bank by redeeming Treasury Bills.

The table below summarises the borrowing results achieved last year, and the position for 1969/70 so far as it can be ascertained from comments in the Budget Speech and supporting statements.

<table>
<thead>
<tr>
<th></th>
<th>1968/69</th>
<th>1969/70 (Treasury Expectations)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deficit</td>
<td>$385 m.</td>
<td>$30 million</td>
</tr>
<tr>
<td>Overseas loans &amp; U.S. defence credits</td>
<td>$142 m.</td>
<td>a net outflow?</td>
</tr>
<tr>
<td>— net proceeds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net borrowing and other financing in Australia</td>
<td>$375 m.</td>
<td>much smaller owing to heavy redemptions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total available</td>
<td>$517 m.</td>
<td>much smaller?</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Used for:</th>
<th>1968/69</th>
<th>1969/70 (no estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meeting Deficit (as above)</td>
<td>$385 m.</td>
<td>$30 million</td>
</tr>
<tr>
<td>Repaying I.M.F.</td>
<td>5 m.</td>
<td>(unknown)</td>
</tr>
<tr>
<td>Repaying Treasury Bill borrowing from Reserve Bank</td>
<td>127 m.</td>
<td>(no estimate)</td>
</tr>
<tr>
<td></td>
<td>$517 m.</td>
<td>(no estimate)</td>
</tr>
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</table>
In 1968/9 it will be seen that net borrowings overseas amounted to $142 million, and net financing in Australia to $375 million. The total amount of $517 million not only covered the budget deficit of $385 million, but also enabled the Government to redeem $127 million of Treasury Bills held by the Reserve Bank. By contrast, in 1969/70 the Treasury seems to expect no net borrowings overseas, but instead net repayments because of large redemptions of maturing loans. The Treasury also points out that redemptions within Australia could be very substantially greater this year than last. This could suggest that net local borrowings could be much less in 1969/70 than in 1968/9. With all these factors in mind, the repayments of government short-term debt to the Reserve Bank could, conceivably, be not much greater than the $127 million reduction achieved last year.

2. The increase in the domestic surplus (from $215 million in 1968/9 to an estimated $522 million in 1969/70) in face of a strong rise in government spending, results from the expected very high level of incomes and economic activity during the current year. In other words, the so-called deflationary content of the Budget is dependent on inflationary conditions and the buoyant government revenues which will be the outcome of these conditions. For instance, expected receipts from pay-as-you-earn taxation have been assessed on the basis of an estimated increase in average weekly earnings of 7 per cent (last year the increase was 7.25 per cent). The estimated Budget result is thus based on the expectation of continued inflation. Those responsible for the Budget do not seem to have much confidence that it will exert any pronounced effect in curbing the inflationary drift of the economy. The truth of the matter is that the Budget is likely to exert very little, if any, restraining influence on the economy.

The Treasury itself makes all this very plain in its superb Statement 6 which draws a distinction between budget receipts which emerge as mere by-products of the level of economic activity and those receipts which, depending on changes in rates of taxation, are independent of the level of
economic activity. The Statement says, "The implications of budget transactions, in terms of their initial impact on trends . . . in the economy depend not on total outlays and receipts, but primarily on the changes in domestic outlays and on that part in the change in receipts which is not a mere result of prospective movements in the economy". (The italics are ours.)

Argument about whether the Budget, in itself, as an isolated entity, is either inflationary or deflationary is so much tweedle dum and tweedle dee. The only point that matters is whether the Budget is likely to have a perceptible deflationary or a perceptible inflationary effect on the economy. On this point we are strongly of the view that the Budget will have no perceptible deflationary influence. There are many things that could be said in its favour, but the conclusion is inescapable that it does not grapple strongly with the over-riding problem of inflation and excess demand.

One final point: the Institute has argued for some years that the present income tax scale (basically unchanged since 1955) is a structural anachronism in a young, expanding economy which places national development first among its objectives. In its comment on last year’s Budget, "Review" said, "It will be a red-letter day in public finances when a Treasurer feels himself able to lighten the burden on the taxpayer". We had hoped that this year, the long awaited red-letter day would have arrived and that rates of income tax would be reduced, at least for the lower middle and middle income ranges. In the months preceding the Budget, the Commonwealth Treasurer himself, on numerous occasions, emphasised the need for restoring adequate incentives by modifications of income tax. Also, over the last 12 months growing numbers of thoughtful people, including prominent financial writers in leading daily newspapers, joined the ranks of those clamouring for reduced taxes on the middle incomes.

The Treasurer has now decided that the present is not a propitious time in which to make this major and urgently necessary revision of income tax scales. In this he may be right. In a situation threatening to spill over into excess demand on
resources, a reduction in rates of taxation would have involved elements of risk by adding to spending power.

Against this it might be claimed that reduced taxes would take some of the steam out of the agitation for higher incomes and thus have had an anti-inflationary effect. There is room for argument here. Nevertheless, the need for revising a tax structure which has become palpably absurd and which is unjustly penalising the skilled and enterprising sections of the community remains as urgent as ever. It should undoubtedly be a first priority in next year's Budget.

### MAIN INCREASES IN COMMONWEALTH EXPENDITURE

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<td>$177</td>
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<td>9.1</td>
<td>37.9</td>
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<tr>
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<td>13.2</td>
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<td>—49</td>
<td>3.6</td>
<td>—4.5</td>
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<tr>
<td>Expenditure</td>
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<td>—4.8</td>
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<tr>
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<td>44</td>
<td>7.7</td>
<td>10.5</td>
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</table>
Economics and Politics

It is a popular custom to blame the economist, or the shortcomings of economics, when something goes amiss with the economy. How many times have people been heard to say, "If only economists were any good, this would not have happened."

Economists, like everyone else, are fallible and not infrequently make mistakes. Indeed, some of the crassest errors in post-war economic policy-making must be laid at the doors of certain advisers to the British Government who may have been long on economic techniques but were short on practical wisdom.* However, if one looks at the world as a whole and contemplates the last two decades of high employment, extraordinary growth and development in many countries, the great expansion of international trade and the rapid improvement in living standards, one would have to concede that the economics profession has made a quite outstanding contribution.

It would not be exaggerating very much to say that the great central problems of economics in the industrialised societies have now been largely solved. The one gaping crack in the postwar record has been the failure to stop the onward march of inflation. This has been serious enough. Not only has inflation inflicted injustices and hardships on the people least equipped to protect themselves against the persistent yearly rise in living costs, but it has subjected the world monetary mechanism to considerable strain.

*The Selective Employment Tax, introduced a few years ago to assist the balance of payments by diverting resources to export production, has proved to have been a lamentable failure. One absurdity was that it fell with particular severity on service industries catering for tourists which were contributing to overseas earnings.
It must be said, however, that the failure to arrest inflation is hardly one for which the economist can be held accountable. Considered in a strictly economic context, stability of prices — that is, stability of over-all average prices, not of particular prices — does not present an insuperable problem. If all the major factors bearing on the level of prices were subject to the control of a few wise economists, there is not much doubt that the slow attrition of long-term inflation could be prevented. However, giving economists mandatory powers over the economic process could be regarded as highly undemocratic. For example, any cure for inflation would almost certainly involve a higher rate of unemployment than democratic communities have shown themselves willing to tolerate.

The big decisions which generate inflationary pressures in the economy are made not so much by economists as by politicians. And even the politicians are not entirely to blame, because the decisions they make, and the goals they set for the economy, unavoidably reflect the wishes of the people and the pressures of public opinion. The politicians can resist these pressures (if they feel that by conceding to them grave harm would result) but they cannot entirely ignore them. If they do, they will be replaced by others who are more compliant.

Whether or not an economy suffers from chronic inflation ultimately depends on the targets it sets for itself in employment, growth, development and population increase; also on the strength of demands the people make for higher living standards, reflected in the pressure for increased incomes. The final responsibility for inflation thus lies not entirely with the politician, and certainly not, in the main, with the economist; it is to be traced to a very elementary characteristic of human nature, the desire of most of us to have just a little more than we can strictly afford.

In the year following an election, statistics seem to indicate a higher-than-average rate of inflation. This is not surprising. When an election is close at hand, the temptation for the politician to accede to the demands of the voters increases enormously. He becomes more than normally sensitive to public pressures. By making concessions here and concessions there in his imperative need to win favour, he
greatly enhances the likelihood of inflation. In election years, economics has much less say than at other times; politics somewhat more.

Economists themselves are, of course, not immune from political considerations. And they are usually seen at their worst when they let their personal brand of politics enter over-much into their economic calculations. How often have we seen the economic good sense of quite reputable economists thrown to the winds when their political emotions are aroused. This doesn’t mean that the economist shouldn’t have any politics. That would be palpably absurd. It means only that when offering advice, economists should strive to keep their personal politics under the table.

A responsibility the economist cannot escape is that of drawing the attention of the politician to the likely economic results of what he, the politician, proposes to do. This, indeed, is one of his most important functions. Keynes was doing just this when he wrote his historic pamphlet, “The Economic Consequences of Mr. Churchill”, attacking the British Government’s decision to return to the Gold Standard in 1925.

On the other hand, in devising policy recommendations the good economist cannot turn his back on political realities, no matter how unpleasant or how frustrating he may find them. To do so would be to render his prescriptions useless for practical purposes. It is possible that Mr. Churchill may have been able to produce quite an effective reply to Mr. Keynes under the title of “The Political Consequences of Mr. Keynes”. And, in a sense, in another context, he did just this when he criticised Keynes’ famous “Economic Consequences of the Peace”, (written after the Versailles Peace Treaty) for its political naivety.

A common failing among economists is to forget about the real world, the idiosyncrasies and illogicalities of human nature, and to be guided by purely theoretical, or narrowly economic, concepts which take no account of the harsh, irritating, perverse facts of life. One of the greatest living economists, Lord Robbins, wrote some years ago, “It is quite possible for a man to be a most brilliant analytical economist and yet to show the most childish ignorance of both administrative and political possibility”.

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The pattern and functioning of a democratic economy must always reflect, in some degree, the pressures of particular interests and the aspirations and wishes — often conflicting — of the people who comprise it. An economy based on economic freedom will never conform with the "line of perfection" drawn by economists and planners. Economic institutions devised to produce an "ideal" result, such as the Prices and Incomes Board of Britain (to keep wage increases in perfect step with productivity gains) usually lead to disillusionment. They are eventually overpowered by the pressures of the market.

The special virtues of a democratic economic system are not to be found in a neat tidiness or an unvarying stability. They lie in its efficiency and creativity. Authoritarian planned systems may achieve order and stability, or, more accurately perhaps, the appearance of order and stability, but at the expense of efficiency and creativity.

The major mistakes made by economists and governments in the Western democracies in the post-war years have usually had their roots in a failure to understand the essential character of the free economy. In a free economy governments cannot go too far in coercing the people into doing what they think the people should do. Since the people are, by definition, "free", they will exercise this freedom to frustrate policies which do not accord with their wishes or which they believe to be opposed to their interests. This is one of the reasons why increases in taxes have proved to be such an ineffective weapon against inflation in recent years. Tax increases, in these days of "pay-as-you-earn", immediately show up in a reduction in take-home pay, and this automatically leads to a stepping up of the pressure for higher gross incomes, and to reduced savings and increased borrowings.

Economists should be the implacable enemies of vested or special interests. The politician cannot afford to take such a lofty stance. The prime aim of the economist is to see that scarce resources are used in the most effective manner possible in order to maximise material welfare. When he feels that resources are being used inefficiently, and that they could be used more effectively by being put to other purposes, it is his responsibility to say so. Few, if any, economists, for instance, would support the growing tendency for governments to
award massive subsidies to industries which cannot stand on their own feet. It is interesting to speculate whether, if economists had had their way, the present crisis of over-production in the wheat industry would have occurred. It seems unlikely. Economists have also been unanimous in their opposition to the Little Desert scheme in Victoria, which the State Government seems so determined to promote.

But the politician is seldom in a position to view these and similar issues with the same impartial, dispassionate calm as the economist, much as he might like to. He has to consider his votes. He cannot reject out of hand the wishes of his constituents. He is in a much more exposed position than the economist working in the sheltered seclusion of his study. Unless the politician keeps his ear to the ground he won’t survive very long. If a government ignores the whispers in the wind, it may soon find itself in the midst of a catastrophic political typhoon. But that having been said, and conceded, one might express the hope that the mix in policy decisions would have rather more economics and rather less politics.

The economist has one vital thing in common with the politician. Ultimately, they are both concerned with the same thing — unpredictable, paradoxical, not always rational human nature. Alfred Marshall’s monumental “Principles of Economics” commences with the statement that economics is concerned, on the one side, with the study of Wealth and, on the other, and more important, side with the study of Man. Too many of the moderns forget this. There is a quaint delusion abroad that a mastery of the mathematical techniques and other tools of the trade is all that is needed to make up a good economist. In fact, this, while necessary, is the least important part of the matter. Economics would pose no great problems if everything could be reduced to adding up and subtracting, so to speak. Because it is concerned, in the final analysis, with the way human beings act and behave, the word “economist” should really be reserved for those who, in addition to the techniques of the trade, have acquired, through broad study, reflection and experience, some knowledge of the world and of people. In this respect the politician has some advantage over the economist. His vocation makes him more wordly-wise. He is in closer touch with the people and knows, better than
the economist, what they are thinking and what they really want.

Economics is a strange subject. It is unlike the more familiar professions. A man may conceivably be a good engineer or doctor or scientist if he has mastered the techniques of his profession. One can imagine, for instance, a surgeon carrying out successfully a most complicated, intricate operation, without any knowledge of such things as history or philosophy. But a good economist, one equipped to advise on great and difficult issues of national policy, needs to know much more than economics, and its mechanics and techniques. He must be an amalgam of many metals. Ideally, he should be a man of broad, far-ranging culture, a man of rounded education, who has thought about, and even dabbled in, many fields of interest. Besides knowing a lot about such things as savings, investment, consumption, taxation, interest rates, he should have developed certain attributes of wisdom, imagination, intuitive judgment. He should, in other words, have acquired some understanding of the whole complicated human situation. The great Alfred Marshall emphasised that economic science, without the aid of common sense, is useless in the practical sense. Some contemporary economists seem to think differently.

This is the point where economics and politics meet. Both deal with Man and Man cannot be properly or adequately defined in narrowly economic or political terms. The first-rate politician requires much the same educational background as the first-rate economist. He cannot be a good politician unless he knows a great deal about things other than politics, any more than an economist can be a good economist unless his knowledge encompasses a broader canvas than economics.

It was considerations of this kind that led Lord Robbins to say that if economists are to contribute to solving leading questions of the day, “they must transcend themselves as economists”; ¹ and an even greater economist, Lord Keynes, to give his renowned catalogue of the attributes of the master economist. ²

¹ and ² See next page
LORD ROBBINS

1. Lord Robbins goes on to say: "If we are to throw helpful light on the great problems of our time, still more if, like Plato’s philosophers, we are from time to time to serve our term of public service, we must be prepared to go beyond our subject. We must be prepared to study not merely economic principles and applied economics; we must be prepared also to study many other disciplines. We must study political philosophy. We must study public administration. We must study law. We must study history which, if it gives no rules for action, so much enlarges our conception of possibilities. I would say, too, that we must also study the masterpieces of imaginative literature, that priceless heritage in which the best experience and the best aspirations of the race receive imperishable expression; a man will learn more which is relevant to the study of society from the great dramatists and novelists than from a hundred textbooks on psychology — valuable as these may sometimes be."

LORD KEYNES

2. "Good, or even competent, economists are the rarest of birds. An easy subject, at which very few excel! The paradox finds its explanation, perhaps, in that the master-economist must possess a rare combination of gifts. He must reach a high standard in several different directions and must combine talents not often found together. He must be mathematician, historian, statesman, philosopher — in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician."
World-Wide Inflation

In the last year or two the continuous slow march of world-wide inflation has accelerated in some of the main Western countries — particularly in the United Kingdom and the United States. In 1968 consumer prices in the U.K. rose by 5.2 per cent, and in the U.S.A. by 4.9 per cent. This compares with average annual increases for the 1960/67 period of 3.1 per cent and 1.7 per cent respectively. The rate of inflation in Australia has also speeded up in recent years — from an annual average of 2.2 per cent in 1960 to 1965, to 3 per cent in 1966 to 1968. The Consumer Price Index in Australia rose by 2.9 per cent in 1968/9 the same as in 1967/8, but, if food is excluded, the rise becomes 3 4 per cent as compared with 2 1 per cent the previous year.

The quickening of inflation has led to vigorous counter measures: taxes in some countries have been sharply increased, monetary policies have been tightened, and interest rates are at their highest level in forty years. But the seeming inability of these measures to stop prices rising is arousing concern and leading many people to re-examine long-accepted notions.

The latest Economic Report of the President of the United States says that the immediate task of the Government in 1969 is to take a decisive step towards price stability. It states that reconciling price stability with high employment is the nation's most important unsolved problem. Prior to 1965 the United States had one of the best records of any country in combating inflation. Since then, as the percentage of unemployed has decreased, the rate of inflation has increased.

Of the 53 nations which have been supplying cost-of-living figures to the International Monetary Fund over the past 20 years, only three industrial countries — United States, Belgium and Switzerland — have been able to keep their
annual rate of price increase below 2 per cent. Above this figure, Fund economists classify a country as suffering “mild” (2 to 5 per cent price increase), “moderate” (5 to 10 per cent) or “high” (over 10 per cent inflation). The comparative record of the 16 advanced economies of the Western World, and 31 other economies, over the period 1948 to 1968, is summarised in the table below. (Korea and five South American republics have been excluded because the excessive rate of inflation in these countries distorts the picture).

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<td>3.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.3</td>
<td>2.9</td>
<td>4.7</td>
<td>7.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Norway</td>
<td>6.3</td>
<td>3.1</td>
<td>3.5</td>
<td>3.8</td>
<td>4.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>5.4</td>
<td>3.1</td>
<td>3.6</td>
<td>4.1</td>
<td>4.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>0.7</td>
<td>1.1</td>
<td>3.0</td>
<td>3.6</td>
<td>1.9</td>
</tr>
<tr>
<td>Average — 16</td>
<td>6.1</td>
<td>2.5</td>
<td>3.2</td>
<td>3.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Average for 31 other countries</td>
<td>5.1</td>
<td>3.4</td>
<td>3.0</td>
<td>4.2</td>
<td>3.8</td>
</tr>
<tr>
<td>All 47 countries</td>
<td>5.4</td>
<td>3.1</td>
<td>3.1</td>
<td>4.1</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Source: "International Financial Statistics" published by International Monetary Fund.

This table clearly shows the effect of the Korean War on world price levels between 1949 and 1953. By 1949 most countries had absorbed the “suppressed” inflation of war-time into their price level. But then a further wave of inflation was triggered off by the devaluation of sterling in September, 1949, and by the Korean War. 1951 proved to be the worst
year for inflation in the free world for the past two decades. Prices in Korea itself rose by an astronomical 300 per cent, and in inflation-prone countries such as Argentina and Bolivia by 33 per cent. Worst hit of the Western countries was Austria with a price rise of 27 per cent, not all of which was due to Korea. (The Austrian economy had still not recovered from the dislocation of war). Next was Australia with 20 per cent. Other badly affected countries were Finland with a rise of 20 per cent, France 17½ per cent, and Japan 15½ per cent. 1951 was the only year Sweden, Norway, New Zealand, Canada, the Netherlands and Italy suffered "high" inflation (by the I.M.F. classification), and also the only year the United States, Belgium and Switzerland incurred "moderate" inflation.

The industrial economies were able to brake back the 6 per cent average annual increase in prices in the years 1949 to 1953 to 2½ per cent in 1954 to 1959. From 1959 to 1968 inflation accelerated and prices rose on average at a rate between 3 and 4 per cent a year.

Over the whole of the 20 years to 1968, Australia has a relatively poor record — only 3 other advanced countries, Austria, France and Japan, also fell in the "moderate" inflation category. But since the huge 12.6 per cent average annual increase over the years 1949-53, our performance has been better than the world average.

Contrary to impressions often held, many of the less developed countries have been more successful in containing inflation than the advanced economies. Comparisons are, of course, subject to the limitations inherent in price index numbers. Methods of compiling price indexes vary from country to country, depending on the variety of goods and services included in the sample, the policies of governments in freezing the prices of items that are heavily weighted in the index (by subsidies or outright price control) and revisions in the composition of indexes to allow for changes in consumption patterns and tastes. With these reservations in mind, it is nevertheless almost incredible that a country such as Iraq could have achieved a slight deflation in prices since 1949. Prices in Panama are only 2 per cent higher than in 1948. Panama, incidentally, is practically the only country in the world which does not print its own paper money — it uses the American dollar.
Other undeveloped countries which have managed to contain inflation (with an average annual price increase of less than 2 per cent) are the Dominican Republic, Ceylon, Guatemala, the United Arab Republic and Venezuela. Tunisia, Iran, Nicaragua, El Salvador, Thailand, India, Costa Rica, Pakistan, Ecuador and the Philippines also ranked with the majority of the advanced economies in restricting price increases to less than 5 per cent a year.

It is clear from the statistics that rapid inflation is not necessarily the inevitable destiny of under-developed countries, and that relative price stability is not confined only to economically advanced countries. In the under-developed countries, the problem of inflation arose partly from their inability to expand food production at a rate sufficient to keep up with population growth; but unbalanced budgets and liberal use of the printing press to finance government expenditures were an aggravating cause.

* * * * *

The persistence of inflation, in face of the vigorous use of the normal anti-inflationary measures, is leading many people to re-examine the accepted orthodoxy. These weapons are fiscal policy (mainly through tax increases), monetary policy (involving credit restraints) and incomes policy (limiting wage and salary increases to productivity advances). These measures seem to have been of limited effectiveness in combating inflation since the war, especially in recent years.

Indeed, tax increases and incomes policies are, with some, already becoming discredited. The tax weapon seems to have been singularly unsuccessful in the United Kingdom and, more recently, in the United States. Nor has it been notably effective in Australia. Contrary to the expectations of the majority of economists, higher taxes have had little success in curbing private spending, particularly spending on personal consumption. The conventional theories have clearly failed to take sufficient account of the insistent desire of people to maintain and improve their current living standards. After-tax incomes can certainly be reduced by raising taxes — at least in the short run — but spending on consumption does not fall in anything like the same proportion as the reduction in incomes. People draw on their accumulated savings, and bor-
row more, knowing that in a fully committed economy they can expect to retrieve their finances by exacting, in one way or another, pay rises from employers, who in turn increase their prices.

Faith in policies intended to keep wage rises within the limits set by productivity also seems to be on the wane. Both the American and British authorities show signs of becoming disillusioned with Incomes Policies and to be in the process of dispensing with them. The celebrated guide-lines policy for wage increases in the United States has collapsed, and this year's Budget suggests that the British Government, too, is losing confidence in such measures.

The disillusionment with fiscal and incomes policies has led to a renewed emphasis on the importance of monetary measures. Many economists have been advocating much closer attention to the regulation of the supply of money through the central bank. A leading figure in this school of thought is Professor Milton Friedman of Chicago University, who contends that the money supply has been allowed to increase far too rapidly in most Western countries, and that this has been a major factor behind continuous inflation. However, it must be doubted whether even a more vigorous use of the monetary weapon would be successful in conquering inflation in the economic environment of the post-war world. Raising interest rates, for instance, seems to have little effect on borrowing because borrowers, convinced that inflation will go on, expect to repay their debts in depreciated currency. Direct restraints on the quantity of credit are so unpopular with all sections of the community, that they are almost impossible to apply with any severity.

At root, inflation seems to be the inevitable consequence of the central economic goals pursued by most countries since the War. The orthodox methods of containing inflation have been relatively impotent in the post-war economic environment of full employment and rapid growth and development. In these conditions, fiscal and monetary policies are to a large extent at the mercy of the basic objectives the economy is pursuing. In response to political pressures, full employment tends to become over-full and rapid development over-rapid. This leads not merely to an excess of total demand over total supplies, but to an imbalance between consumption and capital
expenditures (notably in Australia), and between private and public expenditures (notably in Britain).

A moderation of, or in some cases as in Britain a drastic change in, these goals, might restore the effectiveness of the orthodox anti-inflationary measures. As public expenditure grows to meet the increased demands of the Welfare State (for example, in Britain) and to finance the huge capital expenditures made imperative by rapid development (for example, in Australia) it comes more and more sharply into conflict with private expenditures. Spending on capital projects — whether public or private — which appropriates an over-large proportion of available resources, cuts into the share left to satisfy the irresistible demand for increased consumption and improved living standards. In this situation tax increases are a weak brake on inflation because the people are able to negate them by various means, particularly by exerting pressure for higher incomes. In the interests of industrial harmony this pressure becomes difficult to resist.

The United States is now learning the painful lesson that tax rises of themselves do not curb consumer spending. The 10 per cent surtax imposed on personal incomes in June, 1968, cut in half the growth rate in after-tax incomes, but consumer outlays accelerated, particularly for new cars, furniture and appliances. Personal savings dropped from 7½ per cent of all incomes for the first half year to 6 per cent of all personal incomes in the second half. A year ago Britain increased taxes by $2000 million and imposed new restrictions on bank and hire purchase credit. “All such restrictions reckoned without the canny determination of the British consumer who ran up his personal debt and ran down his personal savings to get rid of his money before rising prices and taxes further reduced its value” (Time, April 25, 1969). Instead of declining by 2 per cent as the Government planned, consumer spending rose by 1½ per cent. The wholly human desire for higher living standards in the present, inevitably wins out over the exhortations of political leaders for greater government expenditures on capital developmental projects or on welfare.

The traditional economic orthodoxy can become really effective only where there is a proper balance between all sectors
of the economy. This means that if price stability is to be achieved, governments must moderate their ambitions in regard to rates of growth, levels of employment and expenditures on welfare.

INFLATION IN A MAN'S LIFETIME

Whereas in the pre-war world when there could be a sudden surge in prices over one or two years and an equally sharp decline when the boom burst, in the post-war era prices keep on rising year by year. Whilst this doesn't have catastrophic consequences, at least in the short-term it does have serious implications for the long-term. During a man's lifetime (75 years), creeping inflation at the rate of 3 per cent a year will raise prices to a level roughly eight times their original level.
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A graduate of Columbia University where he majored in statistics and mathematics, Mr. Hagedorn is an acknowledged authority on the American business cycle, having done extensive research into problems related to the expansion of the American economy. He contributes a regular column to the Weekly Newsletter, "NAM Report", on economic matters, and has appeared before Congressional Committees on numerous occasions to present the business viewpoint. Since 1953 Mr. Hagedorn has served as an NAM representative on the Business Research Advisory Council to the U.S. Bureau of Labour Statistics. He was Chairman of the Council in 1962 and 1963.

Mr. Hagedorn's views on the prospects ahead of the American economy will be read with widespread interest in this country because of our close investment and trade links with the United States.
THIS is a time of great uncertainty as to the direction the American economy may take in the immediate future. The purpose of this article is to share the writer's uncertainties with those who may be observing events here from the outside.

This may seem a poor excuse for any piece of economic writing. Presumably when an economist puts his views in cold print, it is the hope of his readers that he will, at least to some small degree, reduce the area of uncertainty in their minds. If even some minor point which previously had been obscure becomes a little clearer, they may feel that the time spent reading hasn't been totally wasted.

But an economist can serve a useful function when he expands, as well as when he reduces, uncertainty. We have an old joke in this country about the man whose trouble was, not that he was so ignorant, but that he knew so many things that weren't so. And, let's confess it, the same has been true of all of us at times. Looking back we can all say that some of our worst mistakes were due, not so much to having guessed wrong in the face of an uncertain situation, as to our having been fairly certain of things that turned out not to be true. Sometimes negative education can be as useful as the positive kind.

There is another point to be made in praise of uncertainty — it has its social usefulness. Doubt and hesitation can be troublesome but their complete absence, in the minds of those who make decisions, can be even more devastating. In part the present continuation of inflation in this country is the result of a widespread conviction that it will continue. People are buying and building and borrowing in the apparent belief that there will be no tomorrow — at least no non-inflationary tomorrow. And by their actions they make their own inflationary expectations come true, at least for the time being. If some of their certainty could be replaced by doubt, we might be better off.

And so I have not considered it amiss to dwell, often and at length, on the uncertainties in the economic situation in this country. Businessmen in other countries have a certain interest in, and impact on, developments here and it should be appropriate to write in the same vein for them.
When one examines the present problems and prospects of the American economy, the first word that comes to mind is, of course, "inflation." But that is only one part of a larger syndrome of economic symptoms.

There are some parts of the present picture that all of us in this country like. Production and employment are at record levels. Order books are full, and business people like that. Jobs are easy to get, and working people like that.

But there are other aspects of the present syndrome that are deeply distressing to us. Prices continue to climb at an accelerating rate. Interest rates are higher than they have ever been in living memory. By contrast with activity in other fields, construction of new housing is sharply curtailed because of the credit shortage.

The overheated state of the American economy has important effects on our transactions with the rest of the world. Imports are drawn into this country in a huge tide, as demand rises faster than the potential of our own economy to satisfy it. Exports have been growing, but at a much slower rate. Undoubtedly the lush markets here have somewhat restrained the efforts of our producers to expand their markets in other countries. Our customary substantial surplus on international merchandise trade has, as a result of these tendencies, virtually disappeared.

The syndrome I have been describing also has profound effects on the flow of investment both ways across our borders. We continue to have a net outflow of private investment funds, but one greatly reduced from earlier levels. The expansion-mindedness of American business, and the high level of interest rates, has tended to keep our capital at home to a greater degree than formerly.

All of these conditions, good and bad, are part of a complex which, for lack of better words, I will call the "American inflationary boom." While it goes on all of us here have decisions to make and we would like to know "what happens next." We have commitments to make that extend into the future trends in prices, interest rates, employment and pro-
duction. I would assume that businessmen abroad also have decisions to make whose rightness or wrongness depends on trends in the American economy.

At the moment of this writing, attention is riveted on events in Washington. Will the 10% income tax surcharge be extended for another year? What will be the economic consequences of enacting, or failing to enact, that legislation? To judge by statements of government leaders and others, "what happens next" is thought to depend largely on these questions. By the time you read this the legislative issue may be settled, but not the question of its economic consequences.

They are, of course, not the only questions which are generally considered critical at this point. There is also, for example, the question of Federal Reserve policy action in response to enactment or non-enactment of the surcharge extension. Monetary policy is to a degree an independent variable. It is the large national policy questions of this type which presently seem to be regarded as determinative of near-term economic trends.

But such concentrated focus on Washington developments may miss an important point. It may be worthwhile to turn our attention elsewhere for the moment and consider an entirely different set of questions. First: to what extent is the boom self-propelled, with its direction more or less independent of the fiscal and monetary decisions being made in Washington? Second: is the future fate of the inflationary boom already built into its own past history?

I will give very briefly my own answers to the questions I have raised. First: Yes, the inflationary boom is very largely self-propelled at this moment. It is kept going forward by the inflationary expectations in the private sector generated by earlier fiscal and monetary excesses of government. It is in itself confirming the inflationary expectations on which it is based and thus keeps itself going.

People buy, build and borrow because they expect inflation, and inflation continues because they are buying, building and borrowing at such a tremendous rate. This is what I mean by a self-propelled inflation. Current fiscal and monetary
policies have relatively little to do with this process, although what people believe about future policies has a great deal to do with it.

The second question, relating to the future fate of the present boom, requires a more cautious answer. This much I will say: a boom, especially one which has reached the proportions of the present boom in the U.S., inevitably brings about its own termination. Sooner or later, and somehow, the present boom will end. Since the inflation results from boom levels of demand, it too will come to an end but, unfortunately, that will be a slow process. Economic self-propulsion can’t be the equivalent of economic perpetual motion.

We are told — and it is undoubtedly true to some degree — that people are buying and building in anticipation of future needs. The thought that “it will be cheaper this year than next” seems to have become a guiding principle. Accordingly there is a tendency to buy what one might otherwise have waited until next year to buy.

But even if the inflationary assumption on which this is based turns out to be true, buyers can’t continue indefinitely getting ahead of their own needs. Eventually they must find themselves with enough of everything, by any conceivable test, and that is when the boom comes to an end. Neither ongoing fiscal and monetary choices, nor the psychological reaction to them in the private sector, can change that conclusion — hedged as it is with the word “eventually.”

Of course, the end of the boom can come in the form of a gentle readjustment, which we here (and you in the rest of the world) will hardly notice, or a great catastrophe, which we will never forget. It is the questions of how and when (rather than whether) the present boom will be ended that will be determined by national economic policy decisions in the present and near future.

This is not meant as a warning that our doom is sealed. There are some resemblances between 1969 and 1929, in the sense that both are at the peak of a boom. But I surely don’t read from this that we must expect a decade of depression like
the 1930's. It now appears that, in 1929, earlier events had made some downturn in business inevitable. But the severity and duration of the ensuing depression were the result of policy mistakes, largely in the monetary field, that were made after 1929. It was definitely not a case of the excesses of the 1920's having made the prolonged disaster of the 1930's inescapable. And we are not in any such trap now.

This is by way of reassurance, but let's return to the theme that an end to the present self-propelled boom is inevitable. I can't say when the end will come, although I suspect it will be soon. The proximate cause of the boom's termination might be some random minor event. When we see a top-heavy structure we conclude that it won't stand up very long, although we can't know what chance event might push it over. I can't say just what the ending of the boom will be like in severity, but I believe it is wishful thinking to hope that it will be totally painless.

National policy decisions presently being made can have some influence on the timing and nature of the ultimate demise of the present boom. The wrong decisions might stretch out the boom at the cost of making its ending more painful. But we may be approaching the point where even the timing of the downturn becomes independent of current fiscal and monetary decisions.

This is not to say that the national policy decisions made as we go along have ceased to be important. But their importance increasingly lies in the fact that they will determine the course of the post-boom adjustment. In this writer's judgment they can have no influence on whether the boom will come to an end and, as time goes on, less and less influence on when it will come to an end. Mostly they will affect what happens thereafter.

So much for my views on the future of this inflationary boom. I believe the whole inflationary syndrome will come apart some time in the near future. That includes prices, interest rates and, to some degree, production and employment. It is a safe bet that a supercharged economic situation like the
present one must bring about its own ending. What you will also want to know is what will happen thereafter. What are the longer-term prospects for the American economy?

This is the point on which I have to let you down and confess that my own uncertainty is very large. Nevertheless I will give you my best judgments, and the reasons for them. You will have to decide for yourself whether they add to or detract from, your own stores of uncertainty.

First, inflation is so much on everyone’s mind as the national economic problem that I wouldn’t want you to get the idea that, in predicting the end of the inflation, I foresee a golden era of stable prices, low interest rates, and happy people, stretching out into the indefinite future.

The likeliest prospect is that a new kind of economic syndrome will emerge — in many respects the opposite of the present inflationary boom and with unpleasant features of its own. Prices may continue to drift upward, but at a slower rate generally considered tolerable. Interest rates will be moderate, although by no means low compared with some periods we can remember. Unemployment will be somewhat higher than politicians in power like it to be but not disastrous. Business will find that sales are harder to make and profit margins are squeezed. It will be something like the five years between 1958 and 1963, which were described here as a period of sluggishness. This too was the after-math of a serious inflationary episode in the mid-1950’s.

Developments of this type would of course have important effects on the transactions of the U. S. with other countries. The growth of our imports would be much more restrained than during the present inflationary boom. And American producers would become more aggressive and eager in their search for outlets abroad. The net outflow of private capital should be greatly stimulated as the boom subsides and is replaced by this new syndrome.

Obviously, a syndrome of sluggishness such as I have been describing also contains the seeds of its own termination. It
becomes politically intolerable after a while. Unfortunately the cure for it usually gets us back into the inflationary boom syndrome.

I am tempted at this point to forecast an endless alternation between periods of inflationary boom and periods of price stability accompanied by general sluggishness. I don’t think that is likely either, if only because people are catching on to what is happening. They will refuse to accept the view that economic sluggishness is the only cure for inflation, or that inflation is the only cure for sluggishness. In asking for perpetual full employment without inflation they may be asking for the unattainable, but they will still ask for it. There will surely be some political response to this demand, and that will determine the kind of economic future we will have in the longer run.

What the ultimate outcome of this longer-run process will be is in the area of my greatest uncertainty. I suspect there will be a long period of groping and following of false leads. We might fall into an extended era of chronic inflation of the Latin American type, but that won’t be viable either. The end result of this national groping will, I think, not be achieved in the lifetime of any of us. I will drop the discussion at this point, since speculation on what will happen after we are all dead seems as pointless as it is distasteful.

I have tried, in these remarks, to make clear at all stages the degree of certainty I attach to each statement. About all that I am reasonably sure of is, first, that the present inflationary syndrome will come to an end fairly soon and, second, whatever set of conditions replace it will, in its turn, come to an end.

This may amount to nothing more than saying that nothing lasts forever, and I guess that isn’t a very profound thought. But it may be worth saying nevertheless, because I hear so many people here expressing the contrary opinion. There’s a kind of pseudo-realism in the air that advises us to accept continuous inflation as inevitable. Many people seem to be acting on this assumption and they thereby both prolong
and worsen the inflation — although they can’t keep it alive indefinitely. The self-styled realists who expect continuous inflation will, I think, shortly be revealed as dreamers. Meanwhile they do a certain amount of economic damage.

A high degree of popular certainty as to coming events can be just as disturbing to the economy as a high degree of doubt. I’ve been trying to move the balance a little bit in favor of doubt, and I hope these remarks may make some small contribution.

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