What should be done about inflation—
A memorandum

1. Inflation will go on until Governments and the community are determined that it must be stopped. Throughout the post-war history of unrelieved inflation, this determination has been lacking. The inevitable quarterly price increases are greeted by the usual wringing of hands, but the will to confront and defeat the enemy is just not there.

2. Throughout the world the people believe that the responsibility for overcoming inflation rests entirely with their Governments. In Australia, both the present Commonwealth Government and, to a lesser extent, its predecessor have, unfortunately, contributed to this belief by their total failure to make clear to the people that they are virtually powerless to halt inflation unless all sections of the community play their part.

   Governments must provide the leadership in the battle against inflation, but without the self-denying support of the people, they can be about as effective as a General with an army which, when it comes to the crunch, refuses to fight. The Commonwealth Government has failed to create a sense of urgency about inflation. It has failed also to tell the people, in unequivocal terms, the responsibilities they must accept if inflation is to be defeated, that unless the various sections of the community play their part the Government’s efforts will be in vain.

3. The Government must address its appeal to all the people, but particularly to State Governments, wage-fixing tribunals, the trade unions, employers, professional groups, public servants and those in control of the media. It should set out, without partisan bias, the underlying, persistent causes of the continuous rise in costs and prices; it should define the various courses of action the Government itself can take; and finally it should make plain that its policies can be effective only if the trade unions, employers, the public
What should be done about inflation?—A memorandum (continued)

service, the media and the rest co-operate with Governments to make them work.

To the trade unions it should say that wage claims which far exceed productivity gains will inevitably result in cost and price increases.

To employers it should say that excessive profits, or demands for a too-rapid rate of economic and population growth, will lead to cost and price increases.

To the media it should say that wrongful, scare interpretation of the state of the economy, as evidenced by the unemployment figures, will impose irresistible political pressures on the Government to follow inflationary policies.

4. The Commonwealth Government and the rest of the public sector — State and Local Governments, and all Government business undertakings — must face and accept the truth, which will be unpalatable to them, that the seeds of inflation lie in their own spending policies.

Through their expenditures, Governments lay claim to a certain proportion of the total available resources of the economy. These expenditures are paid for, almost in their entirety, by taxes in their many forms and by charges for services such as electricity, trams and trains, water, hospital beds, and by the rates of local councils. These taxes, charges, etc., are the means by which the public sector extracts resources for its various purposes from the private sector. When the Government increases its claims on resources, it correspondingly reduces the resources available to the private sector — that is, the resources which the people can apply to their own personal needs and purposes. In other words, when Governments spend more, the individual is left with less to spend on himself and his family and to save or invest in business enterprises.

It is human nature to resist these processes. When taxes, rates and charges are increased to provide more resources for Governments, the people find that their take-home pay is reduced. At the same time, they have to pay more in local rates, or for their water and fares and electricity and cigarettes and motor cars and T.V. licences and a host of other things. They respond by demanding higher wages and salaries. When businesses find they have to pay more for services provided by Governments, or, say, in company or payroll tax, they raise their prices. The higher the level of Government spending, the greater the proportion of the available resources it pre-empts for the public sector, the stronger the resistance of the community becomes.

When the people respond to increased Government spending in the ways just described, it means that they are really trying to avoid paying the bills presented to them by Governments to finance their increased expenditures. Thus there arises what Lord Keynes called “the inflationary gap”. This has been defined as “the amount of the Government’s expenditure against which there is no corresponding release of real resources by the community”.

The community cannot, however, in the event, escape paying the bills (or at least a good part of them) presented to them by Government. The continuing rise in living costs reduces the real value of the people’s incomes (and savings) and thus transfers resources to the public sector. What Government is, in effect, doing, is financing its expenditures by inflation. As Lord Keynes once said, “Inflation is a mighty tax gatherer”.

5. It would be wrong, however, to conclude from this that the sole responsibility
for inflation can necessarily be laid at the Government's door.

Governments are under almost irresistible pressures from the people to provide better facilities in health, education, transport, welfare, and in other fields. To show progress in these directions is almost a condition of political survival.

Moreover, there is a transparent need for improvement in the quality of Government services. Indeed, when one urges restraint in Government spending to combat inflation, one is invariably met with the response, "But we need better schools and hospitals and trams and trains and higher pensions".

There is a confusion here, however, between what is undeniably desirable and what is economically practicable. The great central problem of economics stems from the fact that there are never sufficient resources to do everything we would like to do. We are forced to choose between competing claims. As the Treasury White Paper on Growth pointed out, "In the use of resources there can be no absolutes: every purpose, no matter how over-riding it may appear to be, is ultimately in competition with every other". Expenditure in the public sector competes with expenditure in the private sector. And, within the public sector itself, a Karmel-like expenditure on Education may mean a smaller expenditure on Health, or Pensions, or modern trains, which some people may regard as of equal or even more importance.

This simple truth of economics is often forgotten, even by economists who should know better. There is a widespread idea that we can do everything; that it is enough to establish the need for something in order to justify whatever expenditure is required to meet that need. This is the great fallacy that must be combated if inflation is to be overcome.

6. In view of what has just been said, must Governments, then, reconcile themselves to rather severely limited targets if inflation is to be defeated?

Possibly! But perhaps not before first trying to educate the community in the fact that ambitious programmes of social improvement and better Government services can be provided, without inflation, only if the people are prepared to pay the bills: in other words, if they are prepared to make sacrifices in their own personal living standards in order that community facilities can be extended and modernised. Figuratively speaking, they must choose between a new car and a modern train. In Micawberish terms, a new car or a modern train equals price stability; a new car plus a modern train equals inflation.

Neither the present nor the previous Commonwealth Government has tried this kind of leadership. They have not attempted to educate the people, or called for sacrifices. Indeed, they have done precisely the opposite. They have given the impression that the people can have the best of all worlds: lower (or at least not increased) taxes, along with national Health and Pension Schemes and a multitude of other things. This is simply not honest or intelligent Government; and the people are paying for the lack of frankness and courage in high places in the heavy cost of inflation.

7. Some may question whether inflation is such a heavy cost. If it helps to tilt the balance from "Private Affluence" toward the elimination of "Public Squalor", perhaps it is not such a bad thing after all.

We have explained that inflation is really a "concealed tax" which serves to transfer resources from the private to the public sector. If people were willing to pay the bills for Government programmes in the form of heavier taxes (that is, without agitating for higher incomes) there need be no inflation, or at least there
What should be done about inflation?—A memorandum (continued)

would be a much slower rate of inflation.

But inflation, unlike taxation, which is levied with some respect to justice and ability to pay, is utterly arbitrary in its incidence. It has no regard to concepts of fairness and equity. It is, indeed, the most unjust, retrogressive “tax” that could be imagined. It penalises the lower income groups and those with little property and tends to favour the wealthy, “the man in possession”. The latter can take steps, and naturally enough usually do, to protect themselves against rising prices. They find their property holdings substantially appreciating in money values; they have the capital and the income to get out of money, which is all the time losing value, by purchasing things whose value is virtually certain to appreciate — real estate, to jewellery, antiques, even wines. They are, in any case, because of their background, usually much more financially knowledgable and adept than the ordinary wage-earner. But even within the wage-earning section, which comprises the vast majority, the workers with powerful unions can shield themselves against inflation, whereas the less organised groups are exposed to the bitter winds of ever-rising living costs.

The section of the community most cruelly affected by inflation is the million or so elderly people in or fairly close to retirement. Those on Government pensions may have their pensions adjusted as living costs rise, but somehow they never seem to benefit as much as they are intended to. Those living on a private pension or on a superannuation lump sum are capriciously robbed of savings put by over a life-time of work. The latter are compelled to hold their assets mainly in fixed income-producing forms which lose value along with the value of the dollar.

If it were understood that, in the main, the least privileged sections of the community bear the brunt of the ravages of inflation, opposition to it would be much stronger and more widespread. Here again Governments have been negligent in not making these facts widely known. They would be greatly strengthened in their efforts to slay the brute if they did.

8. It would, of course, be absurd to suggest that Government spending is the beginning and the end of the inflation problem. We claim that it is the main stream contributing to the torrent and must accordingly attract special attention from the policy makers. But there are many minor streams. Some are important.

Inflation has been around for so long that it has become accepted both by Government and the people as one of the inevitable, if more unpleasant, facts of life. No one really expects that it will be stopped and many are now beginning to wonder whether it can even be reduced from a full gallop to a slow trot. The current attitude is one of almost hopeless resignation. It is also one of apprehension and foreboding.

This in-built belief that inflation will continue is one of the most difficult problems with which anti-inflationary policy has to contend. The general expectation that prices will continue to rise means that practically everyone plans for the future on the assumption of more or less rapid inflation. The belief that, in three months’ time, prices will be 2 or 3 per cent above their present level disposes wage and salary earners to press for larger increases than they would be inclined to do if they thought that living costs would remain constant. Prospective home-owners are prepared to borrow much more heavily to acquire an asset whose value seems certain to rise steeply, when they know that the loan and the interest on it will be repaid in depreciating currency. Businesses will press ahead with capital
investment because management studies of the viability of projects show that to delay and incur inevitable higher costs will reduce the rate of return the investment is calculated to produce. A classic example of this could be the number of office buildings going up in capital cities in Australia which may not be fully occupied perhaps for a period of years.

When all who can, base their plans on the expectation that inflation will continue, then that very fact serves to madden the beast and pushes the inflation rate above what it would otherwise be.

9. How can these expectations be crushed? Only, we suggest, if Governments demonstrate that they are putting the prevention of inflation above all other objectives and are determined to do whatever they can to check the spiral. Something more than normal anti-inflationary measures are required, because these measures, by their very nature, do not produce immediate results and accordingly make little impact on the public consciousness. Some form of "shock treatment" appears inescapable to stun the community into the realisation that the Government means business. The recent tariff decision may have had some attributes of a "shock treatment", because it came as a surprise. But it suffers from the deficiency that if it works at all, it will work slowly.

The best form of shock treatment would be a straight-out freeze on wages and prices — say for 6 months, or at the least 3 months. This would bring home to the people the seriousness of the Government's intentions, provide an assurance that, at least for a brief time, the value of the currency would be stabilised, and would give Governments a breathing space in which to think through their policies and decide upon the best ways to attack inflation at its sources.

Such a measure could only be temporary. A price and wage freeze would introduce impossible rigidities into the economy because market forces would not be permitted to carry out their indispensable function of allocating resources in the most efficient manner. However, when inflation really gets a strong grip on the economy, some kind of shock treatment becomes essential.

10. International influences inevitably play some part in the spiral of domestic costs and prices. Certainly in the June quarter they played a large part. A booming world demand, particularly for meat and wool, forced up prices for these and other commodities on the Australian market and probably contributed about half of the 3.3 per cent increase. But, over the long term, internationally induced inflation does not appear to have been a major influence on the domestic price level. In its 1972 Survey of the Economy the Commonwealth Treasury dismissed it as of no great significance.

It is difficult, and probably impossible, to isolate an economy in which overseas trade represents a substantial element, from an inflationary world. Economists are leaning towards the idea of a more flexible use of the exchange rate, and certainly there are strong arguments in its favour.

11. The most unexpected action against inflation so far taken by the Labor administration is the 25 per cent tariff cut.*

*In early September, interest rates were raised sharply. Recent experience in other countries does not inspire confidence that high interest rates are markedly effective in curbing inflation. When prices are rising at, say, 10 per cent a year, borrowers are not easily deterred by even "punitive" rates of interest. High interest rates are, however, an inevitable by-product of inflation.
It came immediately after the 3.3 per cent increase in prices of the June quarter. Accordingly, it does not smack of a cool, carefully considered plan but rather of a wild, desperate swipe by a frustrated batsman. There has been much speculation as to its consequences but no one really knows where the ball will land.

As far as inflation is concerned, the decision seems to be based on a fundamental misapprehension. The tariff really has little or nothing to do with inflation. It has a lot to do with the general level of prices but not much to do with the rate at which prices are increasing. Countries with tariffs substantially lower than Australia were, in the recent past, inflating much more rapidly than this country. At best, the tariff decision could do no more than temporarily curb the price spiral, but its effect would be once-for-all and, in the absence of other measures, the spiral would soon resume at a rapid rate.

The same argument applies to another measure which Government spokesmen frequently talk about — that is, Restrictive Trade Practices legislation. Again, the degree of competition in an economy may affect the level of prices but has little relevance to the rate at which prices are rising. Most of the Western countries have had trade practices legislation, in one form or another, for many years but this has not protected them from a more rapid rate of inflation than Australia.

12. The 1973 Treasury Survey of the Economy emphasises that “responsible demand management” through monetary and fiscal policies is an essential condition of any success against inflation. Excess demand on resources is really no more than a definition of inflation. In curing one evil we have introduced another. Many would say that unemployment is a greater evil than inflation; but is it not possible to have full employment without inflation? The answer to this may depend on how full employment is defined.

If full employment is taken to be something under a statistical 2 per cent unemployment, then inflation is certain to follow because at that rate a scarcity of skilled workers begins to appear. A shortage of labour first makes itself felt in the skilled and semi-skilled categories and this can co-exist with some genuine unemployment among the unskilled. Once a scarcity appears among a major part of the work-force, the well-known spiral of increased over-award payments, rising costs and prices will be precipitated.

The I.P.A. has maintained that an unemployment figure of 2 per cent does not mean that there is widespread hardship. The Commonwealth Department of Labour seems to agree with this view. However, the media, generally, have invested the figure with such emotional content that the public have been led to believe that 2 per cent is little short of a national calamity.

Unless these attitudes change — and changed we believe they can be by honest political leadership, by proper education and by responsible interpretation by the media — then it is certain that inflation will persist. A heavy responsibility clearly rests on the media if the goal of stable costs and prices is to be achieved.

Hardship should not be tolerated in a democratic society, and when genuine cases of suffering can be proved, measures of alleviation should be introduced.

13. As soon as shortages of labour appear there is a clamour for the importation of foreign workers. This may be an obvious response, but it is an unfortunate one for it cannot do other than add fuel to the inflationary fires. Moreover, it
exacerbates the causes of inflation at their most dangerous point — namely that of public spending.

The amount of capital required to establish a migrant in the community is not precisely known, but is certainly quite staggering. For a migrant family a figure of $50,000 would not be an outrageous estimate. The rate of growth of population generally — because of the demands it imposes across the whole spectrum of public services and facilities — is, indeed, one of the most persistent underlying causes of inflationary pressure. It follows that the intake of migrants should be cut back when the economy is booming, and increased in times of recession.

14. At this point of time the inflation prospect throughout the western world is almost terrifying. As confidence in money continues to weaken, inflation threatens to get entirely out of control and, as one authority has put it, “to wreak havoc in the comfortable post-war world of full employment capitalism”.

In another and entirely different crisis, The Great Depression, Australia exhibited a talent for ingenious, novel, unorthodox thinking, and, aided by good luck, made a brilliant recovery. Something of the same kind will be required if the present-day dragon, inflation, is to be conquered.

The accepted orthodox approaches have proved their impotence to cope with the monster. A whole new range of attitudes and policies, both by Governments and people, will clearly be needed.

It is not too much to say that just as the Great Depression was a test of our democratic good sense and responsibility, so too is the present-day inflation.

The first thing that the Commonwealth Government must do is to make clear that the defeat of inflation is the major national priority, taking precedence over all others. The Government must give inspired leadership; if it does, we believe the people will respond. If the Government does not grasp the nettle, inflation, with all the hardships it arbitrarily imposes on decent, responsible sections of the community, and with the unfair and undeserved bonuses it awards to hard-headed, shrewd manipulators, will continue. Even worse: there must come a point where inflation of 10 per cent a year or more will precipitate a widespread collapse of confidence and undermine the foundations of continued progress and of stable social relationships.

15. To summarise what we believe should be done:

(i) The Commonwealth Government must put stability of prices as its first priority. It must create a sense of national emergency about inflation.

(ii) The Commonwealth Government must explain to the people that it is powerless to halt inflation without the full co-operation of all sections of the community — wage tribunals, trade unions, employers, professional groups, the State Governments, Government business undertakings, and, not least, the media. The media have a vital part to play. The Government must define precisely the responsibilities which all these sections must accept, if inflation is to be defeated.

(iii) The Government must launch a campaign to educate the community on the evils and injustices of inflation.

It must explain that if Government services at all levels are to be improved, then the people must be prepared to make sacrifices in their personal living standards. It should emphasise that if increased taxes and charges required to pay for improved Government facilities are followed by demands for higher wages
and salaries and professional fees, and higher prices by businesses, inflation will result. Inflation will then take from the people — particularly from the weaker sections — the resources which they, in effect, refuse to release to Governments by demanding higher incomes.

(iv) Unless and until these facts are widely realised and accepted, Governments must strictly limit their spending programmes.

(v) The strong and widespread expectation that rapid inflation will continue guarantees that inflation will continue. The Commonwealth Government must destroy these expectations by making plain that it means business and will take drastic measures to stop inflation.

As an initial step the Government should seek the co-operation of the States to impose a 3 or 6 months wage-price freeze. People would then know that prices would not rise for that interval of time. They would also be in doubt as to what the Government might do, and what would happen, after the expiration of the designated period.

(vi) The Commonwealth Government should use this breathing space for the programmes of public exhortation and education suggested above and to strengthen its own defences against the recurrence of rapid inflation.

(vii) Conditions of excess demand, with over-full employment, must be avoided at all costs by appropriate fiscal and monetary policies. The Government must make clear that statistical unemployment under a defined percentage — say 2 per cent — means the existence of labour shortages and rising costs. Individual cases of hardship from genuine unemployment should be assisted. The media must co-operate with the Government by giving a full interpretation of the periodical unemployment figures and cease their emotional concentration on the total figure.

(viii) The migrant intake should be reduced to modest proportions, at least until inadequate public facilities in the major urban centres have been greatly improved.

When shortages of labour threaten, the clamour for increasing migration should be disregarded, as this must add to inflationary pressures. It is better to increase migration at times of under-employment.

(ix) Within defined limits the Reserve Bank should be authorised to vary the exchange rate to provide better protection against imported inflation.

(x) The key to success in conquering inflation lies in intelligent, imaginative and courageous leadership by the Commonwealth Government, and the response that this leadership evokes from the people. The prevention of inflation is being approached too much as a technical question, when the techniques are already well-known. The heart of the matter lies in the psychology of Governments and people.

The cure of inflation will test to the utmost our responsibility as a people and the strength of our democracy.
Labor’s First Budget

THE Labor Government’s first Budget provided it with a unique opportunity to demonstrate its capacity for responsible economic leadership. It has thrown the chance away. From the standpoint of economic strategy, the Budget is a bad one. It could prove to have serious consequences not only for the economy but for the electoral prospects of the Government.

Admittedly, the Government has been singularly unlucky. The introduction of the Budget came at a time when inflation, both national and international, was raging and when the economy was already in a state of acute over-strain. Nevertheless, these were the harsh facts of life which the Government should have confronted. Instead, it turned its back and ran away.

Near the beginning of the Budget Speech, the Treasurer stated that inflation was Australia’s “major economic problem”. A little later he said, “With inflationary pressures intense, we are limited by the over-riding need to bring down a Budget which does not add to these pressures”. What he should have said is, “The over-riding need is to bring down a Budget which substantially reduces these pressures”. What he has done is to bring down a Budget which will do nothing to relieve inflation, but will, in fact, dangerously aggravate it. Few economists, applying disinterested standards, would not feel compelled to condemn Mr. Crean’s Budget in the strongest terms.

The evidence of dangerous over-strain in the economy is plain to anyone who goes around with his eyes open. It is emphasised in unequivocal terms in the crucial document of the Budget Papers, Statement No. 2, reflecting, no doubt, the views of the Commonwealth Treasury itself. The Statement
Labor's First Budget (continued)

says that registered job vacancies are at their highest level for almost 20 years. It points to the alarming fact that in the year to June, 1973, the volume of money expanded by a record 26 per cent. Looking at the situation for the current year, the Statement makes the following predictions:

(a) Real G.D.P. to rise by about 7 per cent.

(b) The non-farm sector to grow by some 6½ per cent, made up of a rise in total employment of 3 to 4 per cent and of productivity by 2½ to 3 per cent. An unusually large increase in employment will result from the much greater employment of women which always occurs at a time of rapid economic upsurge.

(c) Exports to continue to grow, but some more slowly because of strong domestic demands. Imports to expand rapidly in response to strong domestic pressures, relative price movements and the 25 per cent reduction in tariffs.

(d) Average weekly earnings to rise by 13 per cent. This, coupled with a rapid growth in employment, will mean a very high rate of increase in total incomes. High farm incomes and increases in social security benefits will also contribute to a substantial increase in consumption spending.

(e) Private fixed investment in real terms to expand strongly. Home building, although still increasing, to grow more slowly as constraints on the capacity of the industry intensify. Building investment will also respond to demand conditions during the year.

(f) An increase in holdings of stocks to contribute to growth in 1973/4.

(g) Public authority expenditure to grow more rapidly, particularly in fixed capital investment, chiefly as a result of the acceleration in Government spending.

From this assessment of probable trends in the economy over 1973/4, is it conceivable that the Treasury could have supported the Budget which the Government has chosen to introduce? There are a number of sentences in Statement No.
which could be taken as indicating a sharp conflict of opinion between the Treasury experts, who after all know something about economics, and the members of the Cabinet, most of whom would know next to nothing.

Some of these sentences are worth quoting. "All levels of Government are expected to increase their call on resources during 1973/4". In light of the present situation of over-demand, and its almost certain intensification in the months ahead, Lord Keynes would turn in his grave. The Commonwealth Government’s domestic outlays will increase by some 20 per cent, compared with 16 per cent in the preceding year, when the economy was operating at slightly under full capacity. This, of course, refers only to the demands of the Commonwealth: the demands of the States, local governments and government authorities will also certainly increase.

Statement No. 2 draws the usual distinction between those Budget expenditures which represent a direct demand on available goods and services on the one hand and what are known as transfer expenditures on the other hand. It says, "Both net expenditures on goods and services and transfer payments (and net advances) are estimated to increase faster in 1973/4 than in 1972/3". The Statement points out that capital expenditures (which are the most inflationary) by the Commonwealth on goods and services are to rise by over two-fifths in 1973/4 compared with little change in 1972/3. Net advances (other than to the States) which are also of a capital nature, are estimated to increase by two-thirds compared with little change in the preceding year.

For technical reasons, Payments to the States are classified as transfer payments. In fact, the great bulk of these payments represent a direct demand on available goods and services when they are spent by the States. Statement No. 2 comments, "The very rapid increases in Payments to the States are particularly noteworthy because of the absolute magnitudes involved". These payments will increase from $3,427 million in 1972/3 to $4,178 million in 1973/4. Cash benefits, both on an absolute and percentage basis, will rise strongly in 1973/4, although at a somewhat slower rate than in 1972/3.
In an interesting paragraph, the Statement draws attention to the ominous fact that the stimulatory effects of a Budget continue to influence the economy for some time after the year to which they apply. "The stimulatory effects of last year's Budget, for example," it says, "will continue to bear on economic performance in 1973/4. Similarly, measures taken in this year's Budget will have effects in 1974/5 and beyond".

In a concluding paragraph, Statement 2 points out that whereas in 1972/73 outlays increased at about twice the rate of receipts, "in 1973/4 the Government has seen as appropriate a Budget in which increased receipts more than cover increased outlays. In short, in the context of the very different circumstances that now prevail compared with those of a year ago, the 1973/4 Budget is designed to be much less stimulatory than its predecessor". The Statement, significantly, does not say the Budget will not be stimulatory; it says it will be "less stimulatory than last year's. But why on earth should the Budget be "stimulatory" at all, when clearly it should be precisely the opposite? It should be designed to reduce not increase the temperature of the economy, which is already threatening to crack the thermometer.

That having been said, it must be questioned whether the Budget is, in fact, "less stimulatory" than the 1972/3 Budget. Some of the sentences quoted from Statement No. 2 surely suggest that it will not be, and particularly, the sentence (and it is worth re-quoted) — "All levels of Government are expected to increase their call on resources during 1973/4". In assessing its economic impact, this is the crucial feature of the Budget and indeed of Government expenditure generally. The fact that Commonwealth receipts, largely as a result of inflation but aided by the new tax measures, will grow more rapidly than expenditures has really nothing to do with it. Indeed, the tax increases, which are expected to realise an additional $330 million of revenue in the current year, and $648 million in a full year, are of the kind that will almost certainly add to rather than subtract from the upward movement in living costs. The main new revenue measures are the 5 cents increase in excise on motor spirit and diesel fuel and a
similar increase in sales tax on cigarettes. The additional duty on transport fuel will have the unfortunate effect of adding to transport costs and thus to prices throughout industry — as well as to a less extent will the rise in postal charges. The 5 cent addition to the tax on cigarettes will be a daily irritation to the mass of income earners and hardly likely to encourage them to restrain their wage demands.

Economists and others may ask, "Where else could the Government have obtained increased revenues?" With the economy at over-capacity, the answer is that it should not have imposed new cost-inciting revenue measures at all. What it should have done was to curb its expenditures by postponing the implementation of some of the promises it made during the heady days of the election campaign. If the Treasurer had been perfectly frank with the people and explained that, in view of the marked change in the economic situation since last November, the Government felt compelled to delay the carrying out of some of its proposals, it would have won not only the plaudits of financial and economic experts but the admiration of the majority of the electorate. As it is, it has chosen recklessly and irresponsibly to persist with its spending programmes, regardless of the fact that this will worsen the inflation which the Treasurer himself referred to as the major problem of the economy. When will Governments learn that the great bulk of the people will be far better served, in the end, by policies which curb the month-by-month rise in the cost of living than by seeking political popularity through prodigal expenditures of public moneys in every direction under the sun?

What the Labor Government fails to recognise is that its own supporters benefit least and eventually suffer most through inflation and its aftermath. How on earth a Government that prides itself on its concern for the under-privileged, then grants pensioners a whole $1.50 a week while those who are "fast on their feet" (to use Galbraith's phrase) can make thousands of dollars as a result of its policies, is one of the mysteries of modern democratic socialism.
Since the Budget estimates are based on a rise in average weekly earnings of 13 per cent, and, since productivity is expected to rise by 3 per cent, an inflation rate of 10 per cent over 1973/4 has been widely canvassed. But should food prices continue to rise, it is possible to visualise an inflation of substantially more than 10 per cent. It is incredible that the Government can view this alarming prospect with so little concern, if only because inflation will affect poorer and less privileged people much more acutely than the more fortunate. If, for instance, the Budget estimates are correct, average weekly earnings will rise to $120 by June, 1974. Thus, if the Government's target of raising pensions to 25 per cent of average earnings is to be reached, pensions would have to be increased by something like $7.00 between January and June of next year.

One would gain the impression that the Government is gambling on the notion that the long-term community benefits of the improvements it is attempting to bring about in education, transport, health and the rest will outweigh in the minds of the people the ever-present frustrations of steep and continuously rising living costs. This is an extremely dubious political assumption.

There seems no doubt that the Government will attempt to impose a monetary squeeze by bringing the non-Bank financial institutions under control by compelling them to invest in Government securities. This can only lead to an increase in costs to the consumer expressed through higher premiums and interest rates. It is common knowledge that "cheap" money is dear to the heart of the Treasurer, yet because of his fiscally irresponsible Budget he could soon find himself over-seeing the highest rates of interest in Australia's history. Present indications are that we could soon be following in the footsteps of the United Kingdom where borrowers now have to pay something like 16 per cent for housing loans.

If the inflation rate turns out to be less than the figure on which the Budget estimates are based, Commonwealth receipts would fall and the deficit would accordingly be greater than the anticipated figure. This would present a strange paradox
— namely, a lower rate of inflation would be accompanied by a more inflationary Budget.

One is forced to wonder just how much credence can be placed on the concept of the domestic deficit (or surplus) as a measure of the economic impact of the Budget. We believe the figure has little meaning. After all, the deficit of $162 million is minuscule set against total National Expenditure of some $40,000 million.

We have condemned the Budget in strong but not, we believe, unfair terms. Over the years the I.P.A. has criticised the budgets of non-Labor administrations, often quite harshly. By and large Liberal Governments did not wield the fiscal weapon as ruthlessly as they should have done against the menace of inflation. Most governments today in most democracies are too concerned to hand out costly favours to their electors without making clear that whatever the people receive, the people must pay for. In this lies the seed-bed of the modern inflation. There is an old Spanish proverb which says, “Take what you wish, said God, take it, but pay for it”. The people will pay for Mr. Crean’s first Budget in the heavy cost of a near-record annual inflation.

*Since the article went to press, interest rates have been raised.
New Booklet

"PROFITS and PRICES"

THE I.P.A. has just published an illustrated booklet which deals, in an easily understood way, with company profits and their effect on prices. It has been designed for wide distribution among factory and office employees and in the schools.

There has always been a great deal of misunderstanding about profits and it is important that the facts be widely known.

The booklet discusses the following matters:

- Are profits necessary?
- Who benefits from profits?
- How do profits compare with wages?
- Are high prices due to profits?
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Concealed Costs

The emphasis of the Labor Government's anti-inflation policy is on the curbing of price rises by squeezing profits. There is no indication yet that the Government intends to impose serious restraints on incomes, and, indeed, in the National Wage Case the Commonwealth supported quite substantial increases in wages. Pressure on profits is to be applied through the Prices Justification Tribunal, punitive trade practices legislation and tariff policy.

It must be strongly questioned whether a counter-inflationary policy directed mainly at company profits could, in the outcome, have any material effect on the general price level, unless it were carried to such lengths as to do serious harm to investment and future growth. After all, in 1971/72, company profits after tax amounted to only about $1,600 million in a Gross National Product of $36,000 million, or about 5 per cent.

It is interesting, and perhaps a little surprising, to note that official circles have given little or no consideration to the large burden of additional costs imposed on industry by four factors: absenteeism; labour turnover; industrial accidents; and industrial disputes.

Estimates by various competent authorities, both public and private, suggest that the total loss in national production due to these causes could be of the order of $2,000 million a year. This represents about one year's economic growth at the average rate of around 4 to 5 per cent. In 1971/72 the losses in production were distributed as follows:

<table>
<thead>
<tr>
<th>Lost Production in 1971/72</th>
<th>$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absenteeism (including industrial accidents)</td>
<td>1,500</td>
</tr>
<tr>
<td>Labour Turnover</td>
<td>100</td>
</tr>
<tr>
<td>Industrial Disputes</td>
<td>150</td>
</tr>
</tbody>
</table>

The costs of absenteeism, labour turnover and work stoppages are, of course, reflected in prices. While business managers are acutely conscious of this problem, by and large the general community is unaware of the impact of these "concealed" costs on the prices they have to pay for goods and services.

A good proportion of "concealed" costs are, admittedly, unavoidable. Much absenteeism, although by no means all, is legitimate; people cannot help being ill and there are other good reasons for occasional absences from work. Some labour turnover is part and parcel of a market economy in which workers are free to change jobs in search of increased pay or more congenial employment. Industrial accidents cannot be entirely eliminated, although there is little doubt that they could be greatly reduced. Strikes, too, will always exist in a democratic economy, but in recent years they have been quite excessive.

However, steps to bring about an increased public awareness of the considerable economic costs of avoidable lost time could lead to remedial measures by industry and government. A detailed official investigation of these "concealed" costs would be well worthwhile and suggest approaches to the reduction of the economic losses they entail.

Surveys already conducted by the Department of Labour highlight the seriousness of the absentee problem. The conclusions of the Department have recently been supported in an independent study by the Rural Bank of New South Wales. Both suggest that at any one time about 4 per cent of the Australian labour force is away from work because of sickness, accidents and other reasons. In addition to this (and as a matter of interest), on the assumption of 3 weeks annual leave, another 6 per cent are absent from work over the year as a whole. This means that at any point of time only 90 per cent of the Australian
work force is actually contributing to production.

Quite apart from direct production losses due to absence from work, idle equipment, office and factory space, all add to expenses. Because of lower outputs, these overheads are reflected in higher unit costs and thus in prices. Moreover, the absence of key workers can reduce the productivity of other personnel. Relief workers, when they can be obtained, are unlikely to possess the particular job experience or skills of regular employees. And in an endeavour to maintain levels of production, overtime or higher rates may have to be paid.

A significant amount of absenteeism is attributable to accidents. Sir Henry Bland, a former head of the Department of Labour, stated that, in 1969, 400 fatalities occurred in Australian industry through accidents. In addition, 270,000 employees suffered injury resulting in absences from work amounting in all to 680,000 man-weeks. Nearly one in three of the fatalities was the result of a motor vehicle accident connected with work. Sir Henry Bland estimated the consequent losses in output to be at least $75 million a year. In 1969/70 workers' compensation claims amounted to over $117 million and last year reached $132 million. Sir Henry Bland said “we don't need to be reminded of all the staff of, and all the office space occupied by, insurance companies that could be put to better use. We don't need to be reminded of the 600 or more hospital beds that are occupied the year round by the victims of industrial accidents, nor of the resources of medical and other personnel devoted to the treatment of the victims of industrial accidents”. Unfortunately, there has been little perceptible improvement in the industrial accident toll since 1969.

Sickness is unavoidable and a legitimate cause of absence from work. On the other hand there is no doubt that general sick leave provisions in awards, along with government welfare policies, are encouraging people to stay away from work for reasons that are other than bona fide. Taking a "sickie" has become almost an accepted part of the Australian way of industrial life, but that does not make it right. Surveys show that absenteeism is highest on Mondays and Fridays, or on days immediately preceding public holidays. Attendance is at its peak on pay day. One writer dryly comments, “The greater activity of germs on Mondays and Fridays is a phenomena long observed in private industry as well as in Government circles".

While much absenteeism is genuine, steps should be taken to counter malingering without harming those who are really ill. It is, admittedly, easy to urge employers to reduce illegitimate absenteeism by "firm managerial action". But in conditions of over-full employment, the disruption caused by firing and hiring may be far greater than that of absorbing the unwarranted absenteeism of the full-time “casual” employee.

Labour turnover throughout the economy imposes a heavy cost burden on industry but its extent is probably impossible to measure with any precision. However, an estimate by the Department of Labour suggests that it could be of the order of $100 million a year. Although international comparisons are difficult, Australia appears to have a higher rate of labour turnover in manufacturing than Japan, Great Britain and New Zealand. Both males and females in Australia have a labour turnover twice as high as Japan. For “all industries” Australia’s rate is again double that of Japan, and significantly greater than New Zealand. Within Australia, manual workers have a turnover rate approximately double that of non-manual workers in both manufacturing
and industry as a whole.

Surveys by the Department of Labour show that labour turnover is greatest in the early period of employment — 50 per cent of the turnover is accounted for by people with less than 3 months service. For example, in a survey on woman employees 70 per cent of women who left within the first six months, left within the first month. The young, understandably, are especially prone to drift from job to job; in banking those under 25 years of age account for 80 per cent of the total turnover of staff, while those with less than one year's service contributed 45 per cent of total turnover. Two-thirds of all job changes are accounted for by 30 per cent of the people making the changes. According to the Commonwealth Statistician, industries such as building and construction, and food, drink and tobacco experience a high labour turnover rate. It is perhaps significant that these two industries have been in the forefront of the recent rises in the consumer price index. Part of these increases may be due to excessive labour turnover. The Joint Parliamentary Committee inquiring into the causes of rising prices might investigate the costs of labour turnover in these industries.

In a sellers' market for labour, employees can pick and choose and change their jobs without the fear of lengthy unemployment. But, unfortunately, these frequent changes in occupation add to the costs of the goods and services being produced. How to deal with the "habitual job changer" will continue to pose a difficult problem for industry in the full employment economy.

A more newsworthy cause of hidden costs is industrial disputes. From 1960 to 1967 the loss in wages due to industrial disputes rose only from $5.5 million to over $7 million per annum. Yet from 1967 to 1971 the figure jumped to $45 million per annum — an increase of 640 per cent. In the same years average days lost per worker rose from 1.4 to 2.3. The total number of working days lost quadrupled from 732,000 to 3,068,000.

The Minister for Labour, Mr. Clyde Cameron, recently revealed that Australia lost more days per worker in 1971 through industrial disputes than any other country except the United States and Finland. Fortunately, there was a slight decline in 1972 but in the five months to May this year $17 million in wages had already been lost.

The loss of production arising from disputes inevitably finds its way into the price structure: it is the mass of consumers who really pay the cost and the overwhelming majority of consumers are unionists and their families.

Another very substantial cost to industry is the growing extent of fringe benefits — superannuation, education and training allowances, housing and car concessions and a host of others. These costs also tend to be ignored in discussions of inflation, although they inevitably affect the level of prices. In the last National Wage Case, the Acting President of the Commonwealth Arbitration Commission, Mr. Justice Moore, expressed surprise about the minimal discussion during the hearing on possible increases in unit costs brought about by the spread of non-wage benefits. Now that the significance of non-wage payments has been officially recognized, the public is entitled to a more detailed explanation of the role these payments play in increasing costs.

In an attack on cost inflation, a determined effort must be waged by both Government and industry to pin-point avoidable losses of working time.

A multitude of small streams contribute to the torrent of inflation and a "cure" that focuses on one or two, such as company profits, is surely one-sided and likely to be ineffective.

IPA Review—July-September, 1973
A GREAT many people call themselves liberals these days. As political labels go, 'liberal' is probably the most fashionable of all. Most of our politicians, on both sides of politics, would call themselves 'liberals', with only a few 'socialists' and a few 'conservatives' proudly defending their right to be different.

Yet liberalism means different things to different people. To some, the term is almost a synonym for the 'permissive society'. To others it stands for a belief in an active reformist government. To others again, for traditional policies of 'laissez-faire'. To most people it is probably just an attractive label which they associate with something good, however vague and ill-defined. The one thing 'liberal' usually does not signify is belief in a thought-out philosophy of government called 'liberalism'.

Confusion over the meaning of the term 'liberal' presents particular problems, of course, for a political party such as the Liberal Party in Australia, which claims to have a liberal philosophy. It is one thing to claim to have a philosophy. It is quite another to be able to say: "Here is our philosophy and this is what it means for policy".

In practice, a politician with a philosophy is a very rare bird indeed. For the most part our political leaders (and our businessmen for that matter) like to think of themselves as practical men who have no need for such rarified things as 'philosophies'. 'Philosophy for the philosophers' might well be the thought of our political leaders, accompanied, of course, by that knowing chuckle which suggests, "We know better than that". But do they?

A political philosophy worth its salt is not just a few fine phrases which can be used to embroider some rousing speech. A useful political philosophy should both suggest policies and help to choose between them. It should not be something abstract which only philosophers can understand, but a way of looking at the world and thinking about problems which is of practical assistance to the policymaker. Without such a philosophy a policy-maker is at the mercy of events, pressures and prejudices, for no issue can be decided solely 'on the facts'. Men who believe that this is how they do things are fooling themselves. Everyone has some criteria for making choices. The only difference is that some are able to make their assumptions explicit, and hence continually submit them to re-examination.

The Need for a Public Philosophy

Australia is going through a difficult time. Economically, inflation has become a grave problem, with no clear solution in sight. Socially, moral values are changing, violence is spreading, and many people are feeling that our society has lost its way. Politically, government appears to be playing a larger and larger role in our national life, and, regardless of which party governs, power seems to be becoming more and more centralised. There is an uneasy feeling that all is not well, and despite the hopes which many have placed in the new Labor Government in Canberra, one looks in vain for the national leadership which may help
us through these difficulties. Perhaps the most important single ingredient of effective leadership is the ability to see the needs of the situation and to communicate a sense of purpose and direction. Only a political philosophy of some kind can provide this.

Without the guidance of a philosophy, policy becomes simply a series of unco-ordinated reactions to events. The world remains mysterious and beyond control.

At present public debate does not enlighten. National policy drifts from issue to issue and from crisis to crisis. A clarification of our values, assumptions and principles of action, and their implications for policy, is thus desperately needed. The philosophy of liberalism might offer some help in meeting this need.

Liberalism

There is no single authoritative statement of liberalism yet there is wide agreement on its central goal: the achievement of dignity and fulfilment by each individual. As a philosophy, liberalism seeks to spell out the conditions under which this goal is likely to be attained. The best-known, and most fundamental, claim of liberalism is that people cannot achieve dignity without the freedom to take their own decisions and assume responsibility for their own lives, free from subjection to the wishes of others.

At the risk of being somewhat abstract, it is important to know why freedom is valued so highly, for often choices have to be made between freedom and other things which we also value. Among the many justifications which have been offered for freedom, four seem particularly important:

(1) Self-esteem and self-respect depend on having responsibility for one's own life. The more people feel that their lives are controlled by others, the more they are likely to feel helpless and frustrated, and in the end, resentful. Psychologists tell us that self-esteem is one of the most important character traits, for it is the foundation of tolerance and achievement. Freedom may not be the only source of self-respect but it is surely a necessary condition.

(2) People know their own best interests. This may not always be so, but it is true in the vast majority of cases. Allowing remote officials to take decisions affecting, deeply and personally, the lives of the people, makes it almost certain that the individual's best interests will not be realised.

(3) Unless they shoulder responsibility, men can never learn to act responsibly. To put it bluntly, without responsibility, men never grow up, and, as John Stuart Mill put it, "With small men no great thing can be achieved".

(4) If we believe that men gain in moral stature by facing difficult decisions, and surmounting challenge, freedom is a prerequisite for morality. The man who has little choice can claim little virtue.

The simplest principle to be derived from these assumptions is that it is better for individuals to take the important decisions of their lives themselves, rather than have others do so on their behalf. What work a person does, how he does it, how he spends the income he earns, whom he will marry, how many children he will have, where he will send them to school, what sort of education they will have, are all examples of such decisions. A person unable to take decisions such as these on his own judgement can hardly be called 'free'. We all applaud this no doubt. Yet for years we have accepted, in relation to the aborigines, policies
which violate this principle. In an earnest desire to ‘protect’ these unfortunate beneficiaries of our goodwill, we created systems of domineering welfare which effectively robbed them of any chance to assume responsibility for their own lives, and the dignity that goes with it. Nor have aborigines been the only sufferers of this illiberalism. Our treatment of criminals has been based on similar notions. Our hope — so we say — is that criminals will be reformed by the experience of prison, and so learn to take their place as ‘responsible’ members of society. Yet it is still radical to suggest, what every liberal knows to be true in other contexts, that only the experience of responsibility can inculcate responsible behaviour. ‘Open’ prisons and reformatories are still regarded with suspicion and fear. Without the freedom to choose, no one can learn to choose wisely.

I have selected these two examples deliberately. The advocates of freedom are often mainly concerned with the freedom of the businessman, or perhaps the doctor, from government direction. Some go so far as to confuse liberalism with support for ‘free enterprise’. A free enterprise market economy may indeed be the most liberal way of organising economic life, but it is far from being the sum total of the philosophy. If the opponents of government control look closely at their assumptions, they will see that their relevance extends far beyond the strictly economic sphere.

Take education, for example; the principle of freedom of choice means that liberals will give wholehearted support to the existence of independent schools, and, more broadly, to parents who believe that a certain form of education is desirable for their children and are prepared to organise a school to provide it. Naturally, the importance of education to the whole functioning of our democracy means that some public supervision of standards is probably necessary, but, within this very broad limit, the maximum freedom of choice is desirable — for parents, teachers, and of course, children. Yes, children. For surely what has been said so far has implications for the content of education, as well as its organisation. In a free society education must not simply impart knowledge and impose discipline. We do not simply want informed and obedient citizens. We want citizens with minds of their own, able to choose responsibly. Education must therefore be, in part, education in choice and responsibility.

That we do not have more vitality and variety in our schools is a reflection of how little our present systems encourage experimental endeavour, and how much they discourage choice. Under both Liberal-Country Party and Labor Governments, methods of financing education have penalised parents who have sought something different for their child. State bureaucracies have centralised decision-making and discouraged local interest and pride. The recently adopted ‘Karmel classifications’ open up interesting possibilities for the funding of new schools, but the abolition of aid to the wealthier private schools will have the undesirable effect of making them still more exclusive — a sad paradox which arises from disregard of the principle of freedom of choice. Surely the right way to increase the freedom of choice of both middle-income and poorer parents is to fund the parents rather than schools, so that the parents themselves have greater choice as to where and how their children will be educated.

The major argument usually advanced in favour of restrictions on freedom in the area of welfare policy is that such restrictions are necessary in the interests of the needy. This is a compelling argument
— on the face of it. While freedom is a necessary condition for the achievement of dignity and respect it is not a sufficient condition. Poverty exerts its own compulsions — with similar but not identical effects to the compulsions of human tyranny. It may be possible to achieve dignity in poverty, but it is very difficult to achieve fulfilment, and the alleviation of material need must therefore be a central objective of liberals. The question is, how should this be done? The one crucial requirement for a liberal policy is that need should not be alleviated by serious infringements on freedom. This would simply be to swap one evil for another.

There is, however, no clear guiding principles in this area. Often policy will be a matter of balancing a gain in material well-being against some loss of freedom. The important thing is that policy-makers should be aware of what they are doing, and should seek the solution which minimises losses of freedom for gains in security.

The new National Health Scheme is an excellent example of a policy that puts security above freedom — for the poor as well as for the wealthy. The scheme will be financed out of compulsory contributions, the amounts of which it will be very difficult for citizens to influence. There will of course be no incentive whatever for individuals to plan ahead for medical expenses. The government will assume this responsibility. Within the scheme economic penalties will tend to drive all but the wealthiest into public wards where choice of doctor is virtually non-existent. By a variety of pressures doctors will be compelled to participate in the scheme, though remaining legally ‘free’. The morale of a profession may seem of little importance at the moment. In the longer run, the self-respect of doctors is of very considerable importance to us all — as is our own self-respect. And all this is said to be necessary because under the present scheme less than 20 per cent are not insured!

It is impossible to believe that there are not ways of making adequate provision for this 20 per cent without applying compulsion to the remaining 80 per cent. What net gain is there for individual dignity here?

Taxation, is, of course, a most convenient means of helping not only the needy but any group which can attract the support of the legislators. And there is scarcely an interest which does not feel that it has some claim on public funds. There are endless opportunities in democracies to bid for new votes by the promise of fresh programmes of aid. There are, it seems, fashions in aid. At present, dairy farmers are moving out of fashion and novelists and the theatre are moving in, but there is never any shortage of causes to be assisted. The politician seeking support will look benignly on ‘needy’ young couples on $10,000 a year who find their mortgage payments pressing, or ‘needy’ university students with parents on $20,000 a year whose need is a ‘free’ education.

Yet in this distribution of largesse, one fact often seems to be overlooked: every increase in public expenditure is at the expense of private expenditure. The more heavily people are taxed, the less able are they to finance their own needs: the education of their children, care for aged parents, payment of medical bills, and so forth. If we want a nation of responsible citizens who can decide for themselves how they will allocate the money they earn, we must tax them no more than absolutely necessary. Every interest group which obtains a grant of tax revenue to finance its schemes is at the same time reducing the ability of individuals and families to provide for their own needs.
Perhaps some of our politicians would feel less proud of some of their schemes if they kept this crucial fact in mind. The task of a liberal government should be to create the framework within which individuals can choose widely, and wisely (or foolishly), not to continually replace their judgement with its own.

At present, a tussle is going on between government and citizens. The point at issue is how much of the income earned by citizens should be left in the pockets of those who have earned it, and how much should be spent on their behalf by politicians and officials. On the one hand, representatives of wage and salary earners demand increased real wages. On the other, the government seeks to draw off an ever-rising proportion of income through the combined effects of inflation and progressive income tax scales. These aims are quite incompatible. One symptom of their incompatibility is inflation. Although voters may at times appear to approve more costly government programmes, in the event they are not prepared to surrender income to pay for them. The evil of inflation is therefore, in part, a symptom of the fact that the role of government in society is still a matter of keen dispute. Liberal politicians of all parties could do a great deal to alleviate this tension by taking their courage in both hands and making the incompatibility clear.

Free Enterprise and the Market

Not the least of the evils of inflation is that it eventually destroys the main instrument available to ordinary people to influence and regulate producers: namely, the price system. The very core of the liberal economy is the market — the most potent means known of voluntarily coordinating the activities of millions of individual producers and consumers. The first essential of a liberal economic policy is to make the market work. This may involve requiring, by law, adequate information to enable consumers and producers to make wise decisions. It may involve control of some business practices or supervision of monopolies. It may involve means of adding social or 'environmental' costs to the prices of products. It will certainly include responsible management of the value of money to encourage rational choices. Liberalism is not a synonym for laissez-faire. The government has an active and creative role to play. Freedom of enterprise means not freedom from legal restraint, but freedom to enter the market. The crucial difference between liberal and socialist intervention in the economy is that liberals will always seek to establish markets where none exist, make imperfect markets better, and to locate control as far as possible in the hands of individuals. To the extent that inflation leads to the disruption and eventual destruction of the market place it transfers control over what is produced from consumers to officials, and, in doing so, creates frustration, bitterness and irresponsibility.

* * * *

At the core of liberalism is the vision of a mature, tolerant and responsible free people, one that can only emerge in a society in which individuals are trusted with the responsibility to run their own lives. The very nature of modern democratic politics works against this goal, for it is endowing governments with great authority to encroach on individual freedoms and democratic politicians with a personal interest in doing so. In the end, we will need political leaders of sufficient courage to resist these pressures, and to prevent us becoming, as de Tocqueville feared, a nation 'reduced to nothing better than a flock of timid and industrious animals, of which the government is the shepherd'.