Editorial—

National Self-Deception

Inflation becomes a kind of civil war: a no-holds-barred battle between different sections of the community to capture a greater share of the national production for themselves.

There are no clearly defined sides. Employees fight employers, employees other employees and employers other employers, the young are set against the old, debtors against creditors, the poorer against the well-to-do, the rural against the urban interests, and even the people as a whole against their governments.

The war develops out of a small, and even understandable, misapprehension. Lord Keynes called it "the money illusion". This is the notion that confuses mere money with goods, the tokens to wealth with wealth itself. It is generally imagined that one can increase one's wealth just by acquiring more tokens, more dollar and ten dollar notes. At first this may be true. It largely ceases to be true when everyone else gets the same idea, when everyone becomes infected with "the money illusion".

The fight is then on in earnest. In the attempt to increase or even, eventually, just maintain, their portion of what is produced, everyone clamours for more money. As the multiplication of the number of dollars bears less and less relationship to
the goods the community produces, prices rise more and more steeply. The ferocity of the conflict mounts; as the price rise accelerates, the struggle for more and still more dollars intensifies.

As with all wars there are victors and losers. The victors are the powerful, those in the strongest position to enforce their claims for more money; those in the weakest position are callously pushed to the wall. The spoils go, for the most part, to the big battalions, the large, highly organised unions, and groups of key workers able to disrupt the economic life of the community by refusing to work unless their demands are met. The rich, too, can protect themselves and even add to their riches. The weak and the relatively unorganised are compelled to yield some of their wealth to the victors. Mainly, but not entirely, these are the older people of the community many of whom depend on savings accumulated during their working lives. Thus inflation is a process by which wealth is arbitrarily, and unjustly, taken away from some people and given to others.

One of the most significant aspects of the conflict is the battle which occurs between the people as a whole and their governments. All political parties vie for the favours of the electorate. One road to popularity is by increasing welfare handouts and by providing better schools, hospitals, transport services and the rest. Thus governments tend to progressively expand their claims on the nation's production. But this means that less is left for the people themselves. Not unnaturally they resist. Governments raise taxes and charges: the people respond by demanding more dollars. This is a struggle going on all the time (adding to prices) but largely unrecognised by the contestants who seem unaware of what is taking place.

Seen in this light, as a rapacious and ruthless war between various sections of the community to obtain more for themselves at the expense of others, the evil of inflation becomes transparently clear. Inflation is indeed a great evil. It subtly corrupts normal standards of decency, moderation and morality. It divides the community, setting one person against another, one section against another. Thus it tends to weaken and eventually to undermine the foundations of unity on which
all stable societies rest. This is really why fears are being voiced whether our democracy could survive long-continued tear-away inflation.

In the end, of course, there are no real victors in war. Because the community is divided against itself, the energies of each section are concentrated on the mad scramble to obtain more of what is produced rather than on expanding the supply of goods so that all can benefit. The so-called victors, along with the rest of us, could, if inflation went on long enough, find that they are in possession of huge piles of tokens to wealth, but that these tokens are virtually worthless because they are unmatched by goods on which they can be spent. This is not a fantasy. It has occurred not infrequently in nations in which “the money illusion” has taken control over the minds of the people.

Even at this late stage governments and people seem unaware of the magnitude of the crisis which threatens them. We are still not fronting up to the stern necessity of taking action on a scale commensurate with the threat to the stability of our society posed by an inflation that may soon leap the 20 per cent mark, of meeting a crisis with crisis measures. We still seem to imagine that we can go on living pretty well as we have been, with one or two small adjustments here and there. Both governments and people are still indulging in the escapism of self-deception.

We are deceiving ourselves by pretending that inflation can be defeated in a “more jobs than men” economy.

We are deceiving ourselves by thinking that we can pay ourselves every year increases in wages and salaries of 15, 20 or even more per cent without huge jumps in prices.

We are deceiving ourselves by imagining that governments can continue to spend progressively larger sums of money on both welfare and community services, and, at the same time, restrain the galloping rise in prices and costs.

We are deceiving ourselves by thinking that inflation can be stopped or even slowed, by devices with fancy names such
as indexation, devices which are really designed to appease the people when what is needed is a willingness on the part of us all to make a personal sacrifice toward the monster's overthrow. (If indexation could ever have contributed toward a solution, the time was when inflation was 3 per cent; it is too late, much too late, when it is approaching 20.)

We are deceiving ourselves by persisting in the notion — exploded in every country which has harboured it — that inflation can be cured by controlling prices and squeezing profits. Profits are far too small a part of selling prices for reductions to have more than a minimal effect.

We are deceiving ourselves by imagining that inflation is a job for Government and has nothing to do with us.

We are deceiving ourselves by the pretence that rising prices are caused by the other fellow, are something for which we bear no responsibility.

As the price rise quickens, so do these self-delusions become ever more apparent, so, too, do we cast around ever more wildly for gimmicky solutions, for some easy way out of the impasse. There are no gimmicky solutions; there is no easy way out.

Not until we are honest with ourselves, and our leaders are honest with us, will we turn the corner on the road back to stability.
The Budget — Incredible Unwisdom

Like Leroy Brown, a character in a Frank Sinatra song hit, the 1974/5 Commonwealth Budget is "bad, bad, bad". Indeed, it is a kind of madness, a massive flight from common sense, that will push the economy closer to the brink of chaos, and perhaps even destroy the Government.

It is a Budget unique in modern times because it totally fails to address itself to the accumulation of alarming problems threatening the nation. The Government's gaze is directed not at the frightening realities of the moment but at the distant vision of the socialist-welfare state, deep ingrained in Labor ideology.

At a time of rampant inflation, the Government has flouted all the economic rules by deciding on a huge $3980 million, or 32.4 per cent, increase in expenditure — an increase to be financed out of the concealed taxation of inflation itself.

At a time of rising unemployment, the Government chooses to further penalise the private sector of the economy — already in a state of acute concern — which provides over 75 per cent of the jobs of the Australian workforce.

At a time when the external sector is daily growing weaker from loss of blood, it introduces a Budget which ensures that the blood-letting will go on unabated.

The Budget estimates are predicated on an increase in average incomes over 1974/75 of 22\frac{1}{2} per cent, which probably means an inflation rate of some 20 to 25 percent. The irony of it is that an inflation of this magnitude is necessary to the realisation of the Government’s spending programmes — surely a classic example of Keynes’ concept of inflation as “a mighty tax-gatherer”. These embrace increases of 78 per cent on Education, 30 per cent on Health, 172 per cent on Urban and Regional Development, and 38 per cent on Social Welfare benefits. What a beautiful dream world we live in ! ! !

Everyone expected that the Budget would be designed to predispose the community, and predominantly the unions, to modify their demands for more and more money. Such a
strategy would have entailed greater reductions in rates of personal taxation, along with changes in indirect taxes to exert a downward pressure on prices. This the Budget inexcusably fails to do.

Against almost unanimous opinion among economists, indirect taxes remain unaltered. The reduction in rates of personal taxation totalling $430 million will be overwhelmed by a massive increase in receipts from this source of some $2,476 million or 45 per cent. The average income earner (with two dependants) on around $130 a week will benefit immediately, from the change in tax rates, by a little over $2 a week. But, by the end of the financial year, if wages rise as the Treasury expects, he will be paying about 30 per cent more in tax than at present. If prices rise by 20 per cent, his real take-home pay could be slightly less. How this prospect will cause him to modify his wage demands is something known only to the Government.

The Government is banking on the hope that the Budget will cajole the unions into accepting indexation of wages. Indexation has become a kind of propitiation to the Union Gods — offered not merely by the Labor Government, but accepted by a majority of the media and, most surprisingly, by the Victorian Liberal Government. It is hoped that the unions would then take pity on us by curbing their inflationary wage demands. Indexation would be a vain sacrifice. Should the Gods be kind, the continuation of rapid inflation would be guaranteed; indeed during the current year, indexation would quite likely push inflation to even higher levels than those contemplated in the Budget.

If the runaway monster is to be reined in, there is, in the end, no escape from a compulsory ceiling on annual income increases. If that is impracticable, then except in the extreme unlikelihood of a change of heart by the unions, and a return to responsibility, inflation will continue unchecked.

The Budget not only does nothing to deal with inflation, but by its failure to take account of the mood of deep depression in the private sector, it may promote higher levels of unemployment in the coming months than the Government
bargains for. If business spirits were low before the Budget, they are now at the bottom of the pit. This is not merely because of the certainty of continued high inflation, but because of the intensification of the hostile, indeed malicious, attitude that the Government has displayed towards private enterprise since December 1972. There is not a single item in the Budget to encourage the urban, rural, mining or financial sectors of business. On the contrary there is much to discourage them. There is the 10 per cent surcharge on so-called “unearned income”. There is a near 50 per cent rise on ordinary postage along with higher telephone charges, the removal of the special tax provisions for the mining industry, the additional taxes on private companies and life assurance, and the tax on capital gains. The last-mentioned must sound like a death-knell to the ears of the Stock Exchanges.

The resurrection of the phrase “unearned income” is surely indicative of the Government’s almost malevolent attitude toward private enterprise. How can returns of interest, dividends or rent on savings painstakingly accumulated through the exercise of thrift, and carefully invested in shares, bank deposits, Government bonds or property, be “unearned”? If income is “unearned”, it shouldn’t be permitted at all! — perhaps the Government, like Karl Marx, eventually wants to do away altogether with private savings and thus with these forms of income.

The Budget has its roots in an economic and social philosophy that was never really valid in the free societies and, which, in this age of near affluence, has become totally anachronistic.

The improvement of community welfare, which all decent people support, depends on the improvement of productivity. Higher benefits for the aged and non-workers depend on more production by the workers. Expanded education facilities, the improvement of urban environment, likewise. Even larger government bureaucracies can be supported only if those who produce food and clothes and houses, and the things that go in to houses — that is who produce wheat and wool and steel and bricks and chemicals and oil and the rest —
produce more of them. The process of wealth production today depends, fortunately less on human sweat and toil than on capital creation and enterprise. Punitive taxes on the income from savings must surely tend to dry up the well-springs of investment capital. Does anyone seriously think, in the light of experience, that Governments, and the labyrinthine, ponderous processes of their bureaucracies, can do the job of wealth creation as well as private enterprise?

Ignoring these economic truths, the 1974/5 Budget is a deliberate attempt — as the Treasurer virtually admits — to transfer resources from the private to the public sector. Whatever its intentions, it will further discourage an already dispirited private sector. By penalising savings, it taxes productive investment and risk-taking enterprise. The Budget’s social assumptions are rooted in the pre-war world where the investing class was in a minority. Today the majority of Australian people are investors — albeit most in a small way. How many have no money in a savings account or life assurance policy? Probably around a million people have a few hundred dollars in shares, or company notes or debentures. Official statistics show that well over two million people receive income directly in the form of dividends, interest and rent. Today we are moving into, if we are not already, a middle-class society, in which everyone is in a sense a capitalist.

There is another aspect of the 10 per cent surcharge on investment income. The Treasurer and other Government spokesmen have claimed that this is a Budget to help the under-privileged and to create a fairer society. But who are really the under-privileged? Are they the majority of working people, safely protected by the paternal arms of powerful unions? Or are they the million or more people in retirement, and others dependent, for one reason or another on their savings? The tax on “unearned income” is a tax on those people, not on the rich. The further tax on life assurance, the benefits of which are already sadly depleted by inflation, will further
reduce the value of policies held by millions of people. What kind of “fairness” is this?

Despite the huge increase in government spending provided for in the Budget, a reading of the supplementary attachments to the Treasurer’s speech reveals that this is only a small instalment of what is in store. In the Government’s Pandora’s Box, for early release, are such items as the National Health Service, National Superannuation, the National Compensation Act, the abolition of the Means Test, and the action consequent upon the Henderson Report on Poverty. And no doubt there is plenty more to follow.

The 1974/5 Budget is an incredible essay in political and economic unwisdom. It is the product of men — some arrogant, some well-intentioned, some both — set on a crazy and destructive course, a course, which if pursued to its logical end, would destroy enterprise, reduce living standards, make us all wards of the State, concentrate overweening powers in Government, and undermine the reality of individual freedom. We might heed the words of one of the most revered Judges in the history of the United States Supreme Court, Justice Louis Brandeis —

‘Experience should teach us to be the most on guard to protect liberty when the Government’s purposes are beneficient. Men born to freedom are naturally alert to repel invasions of their liberty by evil-minded rulers. The greatest dangers to liberty lurk in the insidious encroachments by men of zeal, well-meaning but without understanding.’

There are people in the Government without understanding, men who quite fail to comprehend that in its broad essentials, the kind of society we have, in both its good and its bad features, reflects the kind of people we are. We can and will work to improve it, and, in some respects, perhaps to radically reform it, but we cannot change its fundamental nature without changing our own natures.

The ambition to create a Big Brother socialist-welfare society in Australia will not succeed. It will not succeed because it is quite out of harmony with the Australian character. Australians, perhaps more than any other peoples, believe in a “fair go”, but, perhaps more than any other peoples, they resent paternalism and will not be pushed around, even though sometimes for their own good. They want to do it their way.
### AUSTRALIAN GOVERNMENT BUDGET ESTIMATES 1974/75

#### RECEIPTS

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<td>— Other</td>
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<td><strong>Total Income</strong></td>
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<td><strong>Deficit (borrowing requirement)</strong></td>
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<td><strong>TOTAL RECEIPTS</strong></td>
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#### EXPENDITURE

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<td><strong>Economic Services</strong></td>
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<td><strong>General Public Service</strong></td>
<td>C.</td>
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<tr>
<td>(Administration, Overseas aid, Research, Law &amp; Order &amp; other items)</td>
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<td><strong>Payments to/to for States &amp; Local Govt. Auths.</strong></td>
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<td><strong>Defence</strong></td>
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<td></td>
<td>712</td>
<td>970</td>
<td>258</td>
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<tr>
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<td>$12,295m.</td>
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<td>$3,980m.</td>
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New Booklet

"INFLATION EVERYBODY'S RESPONSIBILITY"

Inflation has reached crisis proportions and it threatens the stability of our society. If inflation is to be beaten it is essential for people to have a better understanding of its causes.

The I.P.A. is publishing a new booklet which deals in a simple and popular way with this pressing subject.

The booklet has been designed especially for widespread distribution among office and factory employees, in schools and among people in all walks of life.

It endeavours to show:—

* We are all to blame for inflation because our demands for higher incomes and for more benefits from Governments are more than the economy can afford.

* Wages and salaries increased in 1973 by about 17% but the supply of goods and services increased by only 2%.

* Company profits are a small component in prices. A reduction in profits would have little effect on inflation and it would leave industry less money to finance new projects and provide additional employment.

* Excessive Government spending clashes with personal spending, causing costs and taxes to rise, and inflation.

* That we can beat inflation if we moderate our demands on Governments and provided that increases in wages, profits and other incomes do not exceed the annual gains in national productivity.

The booklet is being sold for 25 cents per copy.

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Australia and private enterprise is facing a severe challenge. We therefore request your enthusiastic co-operation in helping us to achieve the widest possible distribution of this booklet.

Copies of the booklet may be obtained from:

Institute of Public Affairs,
289 Flinders Lane,
MELBOURNE, 3000.
Telephone: 63 6558.
A Crisis That Should Not Have Been

Australia is facing a grave crisis. Inflation is now of such a magnitude that it is not merely robbing people of their carefully garnered savings, imposing arbitrary injustices on large sections of the community, and undermining expectations, but is threatening to destroy the confidence, trust and self-discipline on which all stable societies, in the last analysis, rest. It is not too much to say that our proud democratic institutions might not survive long-continued inflation of over 15 per cent a year.

The best way to deal with a crisis is to see that it doesn't happen. Given foresight, responsibility and common sense, most crises in human affairs can be prevented. It is when common sense deserts us, when responsibility and moderation give way to irresponsibility and extremism, and when men live for the day and thumb their noses at the future, that crises occur.

The crisis of inflation which now confronts us could have been prevented. It has occurred because our governments would not face up to doing the small unpleasant things that were needed to avoid it, because they believed that to do these things would weaken their popularity and lose them votes. Now they have no alternative but to do very unpleasant things.

People who say "I told you so" can be extremely irritating. We intend to risk this reaction in order to substantiate our point that the present crisis was avoidable, and would have been avoided, had the many warning signs been heeded.

The following extracts are from articles published in "Review" over the last four years.

April/June, 1970 — “Curbing Inflation”

‘Inflation is the crucial problem facing the economy. It is the crucial problem because the Australian economy, with its unique dependence on exports, cannot contemplate a price and cost rise moving at the rate of 4 or 5 per cent a year.’
July/September, 1970 — “Sweet and Sour — 1970/71 Budget”

‘The core of the Australian inflationary problem is located in the growing size of government spending.’

January/March, 1971 — “Editorial — The Core of Inflation”

‘If, as a community, we are earnest in our desire to overcome inflation — and it is certainly in the interests of us all to do so — then all sections must accept their share of the sacrifices required and must work together to conquer the common enemy. Unless there is a change of heart right through the community, inflation will persist.’

“Responsibility for Inflation”

‘The leadership in moderating inflation must clearly come from the Commonwealth. The prevention of inflation is simply not consistent with an ever-increasing tide of government spending and ever-increasing claims by governments on the resources of the community. Members of the Government have questioned the wisdom of the Arbitration Commission. They might do better to start by questioning the wisdom of their own economic policies.’

April/June, 1971 — “The Forthcoming Budget”

‘In view of the inflation-prone structure of the economy, it is a tribute both to economic management in Australia and to the self-restraint of the people that over the last decade inflation has been kept to comparatively modest proportions. The signs now suggest that the self-discipline is breaking down and that the conventional approaches in economic management are becoming increasingly ineffective. The wisdom of increasing taxes, for instance, is clearly open to grave doubt. Taxes have been pushed up over the years, bit by bit, to levels that the public feels less and less disposed to tolerate. Thus further increases, far from being disinflationary, end up by being inflationary.’

July/September, 1971 — “Undermining the Rich Possibilities of Growth”

‘Governments, which should be giving leadership in the battle against inflation, and taking decisive measures to arrest the quickening price rise, are failing to do so.

The Premiers’ Conference last June and the Commonwealth and State Budgets all shied away from the essential step needed — a substantial cut in the rate of increase of public sector spending at all levels of government. On the contrary, the combined effect of the Commonwealth and State Budgets and the spending programmes of government business undertakings will almost certainly mean that government, as a whole, will make a bigger claim on the national resources than in 1970/71, or indeed in any previous year — this at a time of dangerously rapid inflation. Established Keynesian doctrine for the cure of inflation has thus been rejected.’

... ‘The conclusion is inescapable that governments, considered as a whole, are failing in their duty to curb inflation, which, in the Com-
A Crisis That Should Not Have Been (continued)

monwealth's own words, will "if allowed to develop unchecked . . .
undermine the rich possibilities of growth which our future unques-
tionably holds."

. . . 'The pressures both on industrial tribunals and private employers
for wage and salary increases will intensify as a result of these recent
actions of governments. The outlook for the second six months of
1971 is for continued, sharp increases in costs and prices. Should the
Commonwealth Arbitration Commission award any substantial in-
crease in wages in the National Wage Judgement toward the end of
the year — it will need an act of courage not to do so in face of
steep cost-of-living rises and industrial pressures — then rapid infla-
tion will carry well into 1972, at least.'

'Governments, either out of economic ingenuousness or obstinate
refusal to confront stern economic realities, are failing in 'their prime
responsibility to the nation to do battle with and defeat inflation.
The problems which a continuation of rapid inflation would eventually
create for Australia beggar the imagination.'

October/December, 1971 — "Editorial"

'The prospects of continued rapid inflation are so ominous that
the Prime Minister should endeavour to create a sense of emergency
in the minds of the people through a special national television address.
This address could outline the grave consequences which would occur
if inflation is not curbed; spell out the responsibilities of all the key
sections of the community in the battle against inflation — trade
unions, employers, professional groups, wage-fixing tribunals and so on;
call for the full co-operation of all these sections and make clear that
the success of any measures the Government might undertake would be
undermined unless this co-operation were forthcoming. In other words,
the Prime Minister should set the stage for a determined, co-operative
national effort to defeat inflation.'

January/March, 1972 — "Inflation — Confusion Over Causes"

'From this diagnosis it follows that to curb inflation, we must
create an economic climate in which the pressures for wage and salary
increases — which will always exist — are reduced to a minimum.
This means, first, keeping total demands in the economy from exceed-
ing supplies with acute shortages of labour and increasing over-award
payments. And, second, it means avoiding conditions in which gov-
ernments feel compelled to make expanding claims on the resources of
the community and, in so doing, leave less resources for satisfying the
improvements in standards of personal consumption which are the
natural wish, if we are to be frank, of us all.'

"Inflation Battle"

'The trade unions have a clear responsibility to moderate their
wage and other cost-increasing claims. They should face up to the
truth that wage and salary rises far in excess of productivity gains are
really not genuine rises at all: or, if some sections gain benefits, others must lose. Those who lose are, in the main, not employers or investors but fellow workers (including the hundreds of thousands of those in retirement) less favourably placed to enforce their demands. Whatever they are saying for public consumption about wage rises bearing no responsibility for price increases, trade union leaders know in their hearts that this is not true.


‘... what is needed is, first, strong, firm leadership from the summit and then, an acceptance by the key sections of the community of their responsibilities. Without this, rapid inflation will in all likelihood continue.

One thing is certain: we can't go on the way we are going, sliding year after year down a path that can lead only to a morass. Unless inflation shows strong signs of easing off in the coming months, the Commonwealth Government may have to contemplate something quite unorthodox to shock the public into a realization of the seriousness of the situation and to make clear its determination that the present mad course must be stopped.


‘By far the most important domestic task of the new Commonwealth Government is to confront inflation with all the forces at its command. Yet in its first hundred days the hated word has been barely mentioned. Indeed, one would be justified in thinking that inflation is near the bottom of the list of Government priorities.’

‘Over the last two or three years, wages and salaries have been racing so far ahead of productivity that Australia stands in clear danger of drifting into the kind of chaos which has overtaken the British economy.’

‘Australia is now strongly infected with the disease of “cost-push” inflation which is playing havoc with Britain's economic system and is causing alarm in the United States and in most European countries. Trade unions of both blue and white collar workers are, almost as a matter of habit, making extravagant, irresponsible demands for higher incomes, many verging on a figure of something like 20 per cent or more in a single claim. Under those pressures, and faced with the actuality and threat of widespread direct action, wage authorities, not surprisingly, have shown signs of wilting. They now seem disposed to grant much bigger increments than they would have contemplated for most of the 1960's and to ratify, without adequate regard to the public interest, collective bargaining arrangements in lieu of, or in addition to, customary conciliation and arbitration procedures.’

... 'The victim, for the most part, of exorbitant wage and salary rises is, in any case, not company profits. It is largely people in retirement, people without jobs and less tightly organized workers. If it were
possible to "take it out" of profits, to any large extent, then those penalised most would, ironically, be the great mass of wage and salary earners themselves — a group to which most of us belong. If profit margins were severely cut — say, as a consequence of punitive price controls — expansion plans will be curtailed, businesses will struggle along with outdated equipment, the rate of productivity improvement will be slowed, and the living standards of the community — including the quality of government services in education, social benefits and the rest — will be that much worse.

A great part of the difficulty in getting to grips with inflation is that these truths about the modern economy are simply not understood.'

"A Kind of Madness"

`A significant lesson that emerged from this period was that a major break-through in wages or salaries has only to be achieved by one section of the community, and, as sure as night follows day, it will rapidly spread throughout pretty well the entire range of wage and salary earners. The attitude of everyone, quite naturally enough, is summed up in the words, "They are getting it, why shouldn't we?" Thus, if a disastrous chain-reaction of inflation is to be avoided, it is clear that the initial breaching of the dam must somehow or other be prevented.'

... 'If the nation's leaders do not set an example of self-restraint — even to the point where it hurts — they can hardly expect the mass of income earners to do what they themselves have failed to do.

There is an undoubted danger that the recent substantial salary increases for Commonwealth members of parliament and department heads could open the floodgates to a spate of irresponsible demands. Unless this madness is stopped there is no prospect whatever of overcoming inflation let alone of curbing it to a reasonably moderate (although not necessarily acceptable) pace.'

April/June, 1973 — "What Would Keynes Have Done?"

'A rise in wages which has its seeds in a high level of government expenditure is somewhat different from a wage increase which is an automatic consequence of excess demand, that is, a shortage of labour. Nevertheless, it can be equally catastrophic so far as its effects on inflation are concerned. This helps to explain why inflation can persist after excess demand pressures have been removed and even when there is some unemployment. We have become familiar with this phenomenon in the last few years. How much of our recent "cost-push" inflation has its source in the heavy and increasing claims of the public sector?'

July/September, 1973 — "What Should Be Done About Inflation — A Memorandum"

'The difficulty, however, is that 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 pay-roll 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".

"... 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."

"... 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 Government must recast its political approach and strategy towards inflation. The Prime Minister, in a nation-wide exhortation, should make clear the gravity of the developing situation. He should state to the nation the terms on which inflation can be overturned. He should define in precise detail the responsibility of every section.

Without this kind of leadership, a grave economic and social crisis will almost certainly eventuate. And even more certainly the Labor Government will not survive because inflation will destroy it."
Life Assurance
Today

by

P. C. WICKENS

Mr. Wickens, who is the General Manager of The City Mutual Life Assurance Society Ltd., is the current chairman of The Life Offices' Association of Australia. He is a Master of Arts and of Law of Melbourne University, and also a Fellow of The Institute of Actuaries.
Before being appointed to his present position with the City Mutual he was its actuary, and is a past president of the Institute of Actuaries of Australia and New Zealand and a member of the Council of the International Actuarial Association.

Life assurance has, over the last twelve months, received more publicity in Australia than it has ever achieved in a corresponding period of time. People who should have known better have expressed themselves to the effect that life offices were not sufficiently taxed, that they were not justified in lowering bonuses when the income tax levied on them was dramatically increased, that their new business was falling off, that inflation was rendering their policies valueless and that they had ignored the true needs of the country in investing part of their funds in city buildings. Strangely enough, life offices gain something from publicity of this kind, as it causes the fair-minded individual to think about what he has been taking for granted, namely the social benefit provided by life assurance. The purpose of this article is to assist him in assessing the effect on life assurance of changes that have occurred in the economy and the possible effects of others that are mooted.

Forty-nine free enterprise offices are transacting life assurance in Australia today. The number of policies in force with them is about 8.5 million and the total of the sums assured under these policies approximately $45,000 million. It is difficult to ascertain how many people are covered by life assurance, as some are assured under more than one policy while a single superannuation policy may assure hundreds. However, the figure certainly exceeds 3 million and it follows that life policies are held in the great majority of Australian homes.

The growth of life assurance in Australia since World War II has been spectacular. The following tables shows the development from 1953 and gives
TOTAL LIFE COVER (EXCLUDING BONUSES) IN FORCE IN AUSTRALIA

<table>
<thead>
<tr>
<th>Year</th>
<th>Assurance in Force at End of Year</th>
<th>New Assurance for year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Policies ('000)</td>
<td>Sums Assured ($m)</td>
</tr>
<tr>
<td>1953</td>
<td>6,613</td>
<td>3,569</td>
</tr>
<tr>
<td>1958</td>
<td>6,919</td>
<td>6,220</td>
</tr>
<tr>
<td>1963</td>
<td>7,124</td>
<td>11,545</td>
</tr>
<tr>
<td>1968</td>
<td>7,565</td>
<td>20,994</td>
</tr>
<tr>
<td>1973</td>
<td>8,450</td>
<td>44,915</td>
</tr>
</tbody>
</table>

the assurance in force with the above-mentioned offices at the end of specified years, and the new assurance written in each of these years.

Total premiums received by the life offices increased from 134 million in 1953 to $1,070 million in 1973 and total assets from approximately $1,100 million in 1953 to $7,458 million in 1973.

Australians carry more life assurance per head of population than do the residents of most countries of the world. The most recent statistics available show that only in eight countries does total life cover exceed national income, Australia being one of these while if the average amount of life assurance premiums per head is taken as the criterion of size, Australia ranks fifth behind U.S.A., Switzerland, Canada and Great Britain.

Governments in Australia have taken the view that the individual should be encouraged to make provision for his future, and for the protection of his dependants, by means of life assurance. The encouragement takes the form of an income tax allowance. A taxpayer may claim a deduction from his assessable income of up to $1,200 in any one year in respect of premiums paid by him for assurances on his own life or on the life of his spouse or a child, contributions to superannuation funds and a couple of other similar payments. The most recent information issued by the Commissioner of Taxation shows that over 3 million Australians take advantage of this.

The concession, insofar as it relates to premiums paid under life policies, is long established. It dates back to 1799 in England, and has existed here for as long as the Australian Government has levied income tax. The justification for granting it was clearly expressed by a Royal Commission set up to consider the workings of the British Income Tax Act in 1920. The report of this Commission stated:

"The distinguishing feature of Life Insurance which probably accounts for what would otherwise seem to be an unfair preference, is that by no other means can the less wealthy taxpayer, who has not accumulated capital in his earlier years of productive effort, secure a proper provision for his dependants. Viewing the matter in a broad and rational way, we consider that this reason is sufficient to justify the State in looking with favourable aspect upon Life Insurance, and in treating income that is saved and applied in this manner with special indulgence. Notwithstanding the facilities for borrowing on the security of policies, there is an element of permanency in Life Insurance which is not possessed in equal degree by any other form of thrift."
There have, however, over the last twelve months been suggestions in the Press that this particular concession might be modified. Prior to the last elections the Federation of Public Service Associations submitted various questions to Mr. Whitlam and Mr. Snedden and advertised their replies in the Metropolitan dailies in all States on 14th May. One of the questions read as follows:

"Does your Party support an increase in the present deduction of $1,200 for superannuation/insurance?"

The replies to this question were:

Mr. Whitlam:
"We will retain the present deduction."

Mr. Snedden:
"The Liberal and Country Parties will retain the present superannuation/insurance deduction."

The income of life offices is taxed under a division of Part III of the Income Tax Assessment Act. The life offices are not alone in receiving particular treatment; Part III contains provisions relating to partnerships, to trustees, to private companies, to co-operative companies, to superannuation funds and to a number of other groups. The individual treatment of life offices is not evidence that they are being granted concessions, but arises from the fact that regard must be had to special features of their business. In particular, they are allowed a deduction of a specified percentage of their actuarial liabilities. This is in recognition of the fact that from the nature of their business they must build up large reserves to enable them to meet claims as they occur and that, as their premiums are calculated on the basis that they will earn interest on these reserves, they must earn interest at a moderate rate to remain solvent. While no corresponding deduction is allowed to other organizations, life offices on their side do not receive any deductions in respect of such expenses as those related to obtaining new business.

The Australian Treasurer was unfortunately one of those who did not think that life offices paid sufficient income tax. In consequence of this the 1973 Budget brought about three changes in relation to their taxation, these being:

1. an increase in the rate of tax on their mutual income which, as will be seen, means the great part of their investment income, from 42\% to 47\%;
2. an alteration reducing the deductions they can claim by the proportion that their income from dividends bears to their total investment income;
3. a reduction in the percentage of the actuarial liabilities allowed to them as a deduction from three to two.

The Government obtained an additional $3 million in tax from change (1), an additional $9 million from change (2) and an additional $23 million from change (3). Different life offices were affected to different extents, as some had higher proportions of their investment incomes in the form of dividends than did others. The over-all effect was to increase the income tax being paid by life offices to an amount two and a half times what they were previously paying.

The Government may have taken the view that it was imposing additional taxation on mammoth institutions. Figures relating to total sums assured encourage this thought. However, life offices in Australia are co-operative enterprises. They are either wholly mutual or very substantially mutual. All the profits of the former, and about 97\% of the profits of the latter, accrue for the benefit of the policyowners. It follows that the enormous increase in taxation had to fall on the individual policyowners or, to be
more exact, those other than the holders of superannuation policies, the income of superannuation funds being exempt from tax irrespective of whether the scheme in question is underwritten by a life office or in some other manner. The great proportion of those affected are people of average means at best, as can be deduced from the fact that the average sum assured under the relevant policies is only $3,598 and the reserves held in respect of each only $632.

The increased taxation has resulted in a reduction of the relevant bonuses by an amount of from 15% to 20% of what they otherwise would have been. For most offices the financial year is the calendar year and policyowners of these suffered the reduction when their bonuses from him. It results in the accumulation of capital from moneys that would not be saved if this system were not available. This must commend itself to any government that appreciates the need for investment capital in this country and the desirability of having Australia developed by private enterprise.

Notwithstanding this, our present Government has exacerbated the position by its 1974 Budget and proposes to double the effect of change (3) in its 1973 Budget, which cost the industry $23 m. per annum, by bringing the percentage of the actuarial liabilities allowed to life offices as a deduction down to one.

The first duty of the life office in respect of its funds is to its policyowners. It gives them the opportunity to invest for 1973 were declared. Some offices, however, have income tax years which do not coincide with the calendar year and their policyowners will not feel the effect of the change until bonuses for 1973-1974 are assessed.

Life assurance serves a dual purpose. It affords cover against the economic consequences of death and also provides a means of saving. The system under which it operates involves the regular billing of the individual policyowner for his premiums or regular payments by his bank or his employer under authority on a scale far broader than they could possibly enjoy if they were left to handle their savings individually. However life assurance as a medium for saving will be attractive to the community only if the investment performance of life offices is as good as or better than the performance of other investment media with which life assurance funds are in competition. Nevertheless, life assurance also has a responsibility to the nation in the manner in which it invests these funds. Almost the whole of the Australian funds of life offices are invested in Australia and the

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**DISTRIBUTION OF ASSETS OF AUSTRALIAN LIFE OFFICES**

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>Percentage of Total Assets as at 31st December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Securities</td>
<td>35.9</td>
</tr>
<tr>
<td>Local &amp; semi-governmental securities</td>
<td>16.0</td>
</tr>
<tr>
<td>Debentures &amp; Notes</td>
<td>*</td>
</tr>
<tr>
<td>Loans on Mortgage</td>
<td>27.5</td>
</tr>
<tr>
<td>Preference/Ordinary Shares</td>
<td>8.3*</td>
</tr>
<tr>
<td>Loans on Policy</td>
<td>4.0</td>
</tr>
<tr>
<td>Fixed Assets — Property, etc.</td>
<td>3.5</td>
</tr>
<tr>
<td>Other</td>
<td>4.8</td>
</tr>
</tbody>
</table>

* "Debentures & Notes" and "Preference/Ordinary Shares" not given separately for 1953. The total holdings in both categories in 1953 amounted to 8.3% of Total Assets.
percentages of assets held in different classes of investment, and the changes in these percentages since World War II, are of interest.

It should be remarked that in 1961 legislation was introduced which virtually compelled life offices to hold at least 20% of their assets in Australian Government securities and at least 30% in either government or semi-governmental securities.

An interesting feature of the table is the increase in the percentage holding in shares and in properties. Unfortunately the official figures available for the whole period do not divide ordinary from preference shares, but the latter represent only a small proportion of the total. The percentage holding in mortgages has declined markedly, while there has also been a decline from 1953 in the percentage of the amounts loaned to governments and local and semi-governmental authorities. The latter percentage built up to a very high figure during World War II and the run down in times of peace was not surprising.

The growth in equity holdings of all kinds evidences the attempt made by life offices to cushion their policyowners against the effects of inflation. Their entry into property ownership, and particularly into the development of city properties for leasing as offices, has been criticized. It must be remembered, however, that very few office buildings were erected in our capital cities in the quarter of a century succeeding 1930. This meant that a great demand for office accommodation developed. The life offices played a major part in satisfying that demand. If they had not done so there would have been no difficulty in obtaining overseas capital for the purpose, and the cry today might well have been to “Buy back the city” rather than to “Buy back the farm”. The life offices consider that they have acted in the national interest in providing first-class office accommodation and believe that the investments that they have made have been in the interests of their policyowners.

About twelve months ago the Government introduced legislation to expand the scope of the Australian Industry Development Corporation. This body had been established in 1970 for the purpose of marshalling loan funds from overseas and putting them at the disposal of Australian companies to help the latter undertake or participate in new developments or in the expansion of their current developments. The proposed expansion was to give the A.I.D.C. access to Australian as well as overseas loan funds and to set as an objective that it should obtain majority Australian ownership and control over existing and future enterprises of all kinds. Australian life offices have always believed that Australians should hold substantial interests in enterprises that operate in this country and have supported this belief by investing over $400 million in developmental operations. A number of matters in relation to the proposed legislation disturbed them however, the most serious from their point of view being a suggestion that, in addition to the 30% of their funds they currently have to invest in government or semi-governmental securities, they should be compelled to invest a further 10% in the A.I.D.C. Other objections were:

(1) They were to be given no say in the form of investment into which any moneys made available by them might ultimately pass.

(2) The form of security suggested carried no guarantee either of income or capital.

(3) The A.I.D.C. might invest in projects that would not become pro-
ductive for many years and that would accordingly be unsuitable for the investment of life office funds, as they would afford little return to the present generation of policyowners.

These objections have subsequently been discussed with the appropriate Minister and discussions are at present proceeding with the A.I.D.C. to ascertain whether some voluntary co-operation as between it and life offices is feasible. This co-operation would give life offices the opportunity of accepting or rejecting individual investment propositions and would involve investment jointly with the A.I.D.C. rather than through it.

The proposed legislation also provides for investment by the public at large and gives the A.I.D.C. certain exemptions from taxation and other charges. Life offices consider it essential that, if the A.I.D.C. is to compete with other savings media it should be compelled to do so on equal terms and should not enjoy privileges of this kind.

In the last few weeks two reports that could affect the future of life assurance in Australia have been published, these relating to national superannuation and to compensation and rehabilitation.

National superannuation must have the support of the great majority of thinking people in this country. Australia is almost the only developed country in the world that has no scheme of this nature. While this must to a considerable extent be due to the excellent coverage that has been given by the so-called "occupational" schemes, namely those introduced by employers for the benefit of their employees, substantial sections of the community are not covered by these. Life offices have played a large part in underwriting these occupational schemes, and superannuation represents about 35% of the total business in force with them. The effect of the introduction of national superannuation on life offices will depend on the size of the benefits to be provided. If these are moderate there will remain a vast number of people who will wish to make further provision for their retirement. The relevant report refers to the place of occupational superannuation in a national scheme at p.310 where it said:

"The removal of the means test for age pension can be expected to lead to an extension of occupational cover. The Committee regards occupational superannuation as complementary to, rather than competitive with, an adequate national scheme. Because there will always be many people who have little or no opportunity to achieve occupational pensions, we regard it as essential for the national scheme to provide pensions sufficient for old people to live in modest comfort. But occupational schemes have a role to play in the achievement of other goals, including income maintenance."

The outcome of the report of the National Committee of Enquiry on Compensation and Rehabilitation more usually known as the Woodhouse Report, is likewise problematical. This Committee was set up to consider compensation and rehabilitation following upon accident, but during the course of its enquiry had its terms of reference extended to bring compensation for sickness within its purview. It proposed, inter alia, that a lump sum and a very adequate pension for widows and dependants should become payable on death. While this would leave life offices to satisfy an obvious demand for larger sums at death to meet the many expenses, including death duties, that then arise, the report if fully adopted would undoubtedly affect their business. However, the costs of fully
adopting the report would be high and it remains to be seen how these will appeal to the Australian people.

The question that arises in relation to both these reports is this— to what extent should a man retain freedom to decide what to do with his earnings? As is pointed out in the report of the National Superannuation Committee of Enquiry, the cost of social security must ultimately fall on the worker. Should the latter be compelled to subscribe for very large benefits, or should he be given a degree of choice, with a lower compulsory subscription for social security and the option to provide more generous benefits for himself and his family if he wishes to spend more money for this purpose?

Probably the most serious problem that life offices face today is continuing inflation and the high rate it has attained. This the industry shares with all other savings media. Only the borrower gains as a result of inflation. Unfortunately the government is the largest borrower in our community, and so gains the most. Further our income tax structure gives it an advantage in times of inflation in that, as a result of taxpayers moving into higher income tax brackets, it is able to snare an ever-increasing proportion of the national income in the form of tax without increasing the nominal rates thereof. These may be reasons why governments have been notoriously slow to curb inflation.

As far as life offices are concerned, they are probably in a somewhat better position than most savings organizations. Their investments are widely spread and include equities as well as fixed interest loans. These do enable them to give some protection to their policyowners per medium of their bonuses, though they naturally make no claim that this protection is adequate. The dual function of life assurance also gives the industry an advantage since inflation does not reduce the need for cover on death, but results in the amount that will be required for the dependants being increased.

Unfortunately we have been living through a period in which the community has treated inflation as being something that is inevitable. The adverse effects of extreme inflation are now becoming obvious to all. A government that wishes to embark on large developmental schemes and keep these in the hands of Australians must do everything possible to encourage the accumulation of capital in this country by means of saving and to do this must re-establish the dollar as a measure of value. Life offices feel that in encouraging saving and investing their funds in a responsible manner they have in the past played a part in controlling inflationary trends and are prepared at all times to do what they can to fight this social evil.

The position today is that the Australian policyowner has at his service a highly competitive industry that is strong and has maintained its position in this country for over a century. His life policy affords him both cover against the contingency of death and a means of saving. The former he will not derive from any other medium, while the investment expertise of life offices entitles him to expect a return as good as, if not better than, that he is likely to receive from other media on his savings. In calculating what this return is likely to be he should also take account of the income tax concessions in respect of the premiums paid by him and of the fact that both the sum assured and the bonuses are tax-free in his hands.