Editorial – The Crisis of the 6 Per Cent

Whatever the 6 per cent increase in the C.P.I. for the December quarter reveals about the so-called underlying rate of inflation, it is certainly symptomatic of an underlying situation of great gravity — grave for the Government, grave for the economy, grave for the Australian people.

In many respects, the Government, in its endeavours to clean up the unbelievable mess left by its predecessors, has performed with good sense and courage. It has attacked the ogre of Big Government with telling blows; it has already reduced taxes by much more than most people realise (by a total of some $3,000 million by 1977/78); it has restored some profitability to industry in the absence of which the economy must fail to recover and expand; it has made commendable provisions for disadvantaged members of the community.

The Government, too, has been indubitably right in setting the eradication of the cancer of inflation above all other objectives and, to this end, in its insistence on fiscal and monetary restraint. But notwithstanding its unswerving adherence to text-book orthodoxy, the harsh fact remains that it has not put the runs on the board. In 1976 the actual rate of inflation at 14.5 per cent has turned out to be marginally greater than in 1975. The Government is reluctant to face
up to this unpleasant reality; it keeps harping on the underlying rate of inflation, comparing it favourably with the rate under the Labor Government. Even from the standpoint of political point-scoring, this is to make a foolish mistake. The Australian people are not concerned with fine statistical technicalities; they are interested only in the results. All they are worrying about is the horrifying figure of 6 per cent for the last quarter — a higher figure than in any quarter since the Korean inflation of the early 1950’s. The Government should forget about politics. It should be concentrating its entire energies on the future, instead of harking back to the past. The next 12 months will be critical not merely for the economy, but for the Government itself.

The 6 per cent is frightening not only in itself but for what it portends. Some estimates suggest that for the three quarters to June this year prices could rise by some 14 per cent in the absence of any wage increases at all. This could spell desperate trouble for the Government toward the end of 1977. It would certainly spell desperate trouble for the economy: among other things, the near certainty of another devaluation, and thus a further push to inflation. We would be deep in the terrible morass of an English-type crisis.

If the Government has, on the whole, acted wisely and courageously, why has it failed to achieve results in its major policy objective, the slowing down of inflation?

Its plans have clearly been upset by the reconstruction of Medibank and will soon be further frustrated by the November devaluation. For the devaluation, the Government is not to blame. It was the inevitable end-result of the insanities of the Labor administration. But, in retrospect, the changes to Medibank must be adjudged a serious blunder. The restructuring of Health Insurance should clearly have waited until inflation was on the way to being defeated and until the economy was back on the highway of growth. The Government was over-ambitious; it should have devoted all its energies to the immediate and vital tasks. Medibank could have waited; it was not an urgent priority.
The Government may have erred, however, in a much more fundamental sense: in the notion that inflation could be defeated by a policy of gradualism, by applying the brakes gently, or in words frequently used by Ministers, "by winding back the rate bit by bit". This seemed to hold water as a theoretical conception; in practice it has not so far succeeded.

One is forced to ask whether the gradualist approach can ever succeed. In an inflation in which almost the entire impetus is coming from the cost side, not from that of demand, it may be necessary to attack the problem head-on, not, in the main, indirectly by the fiscal and monetary weapons. This means, unavoidably, a comprehensive incomes policy. Indexation is not such a policy; it is, in essence, not an attack on inflation; it is a means of adjustment to inflation. It purports to be a near painless remedy; and in this lies its weakness. As Hayek and Friedman (two Nobel Prize winners) and other economists have insisted, there is no painless cure for inflation.

The Institute of Public Affairs has consistently argued that inflation could be overcome only by the combined efforts of the Australian people, that Governments were virtually impotent unless all sections of the community were prepared to weigh in and make their contribution. Here is the nub of the problem. What we are seeing at the moment, at the political level, is an obsession with political point-scoring; and, at the community level, an unedifying scramble, each section endeavouring, in the face of rising prices, to maintain their position at the expense of other sections. The weaker sections inevitably lose out.

The worst offenders are Mr. Hawke, who has now entirely shed the mantle of a responsible union leader for that of the politician, and his fellow union officials. Their demand for full compensation for the 6 per cent price rise, plus another 2 per cent to catch up on the partial indexation in previous quarters, would be achieved at the expense of exporters, farmers, the import-competing industries, the unemployed and the already cruelly hit people who have saved for their retirement. It is a grossly callous demand. But it is worse than...
callous; it is crass, almost criminal stupidity for, if successful, it would be to the serious disadvantage of those people it is intended to benefit, the wage earners themselves. Full compensation would generate a terrifying rate of inflation through 1977 and beyond and would inevitably lead to a further devaluation of the Australian dollar. It would be tantamount to pressing the accelerator flat to the boards when the car is already careening along at a perilous speed. Wage earners would suffer along with every other section of the community.

Mr. Hawke argues that real wages must be maintained if consumer spending is to increase and thus provide the basis for an economic recovery. But the recovery, if any at all, would be short-lived. The distortions produced by such a hike in wage costs, the undermining of the profitability of the export and import-competing industries to name only one, would have near-fatal consequences for the economy. The union demands are not a recipe for recovery: they are a recipe for runaway inflation, for further unemployment and, in the end, for disaster.

Would Mr. Hawke support similar treatment for all other sections of the community — namely, full compensation for inflation? Presumably, he would not, for in that case, his members would gain no benefit. Indeed everyone would be not a mite better off. It would be a case of “as you were” except that a huge boost would have been given to inflation. Mr. Hawke might be asked to name those sections of the community that he is prepared to sacrifice so that union members will have a comfortable ride through the rough country of inflation.

The absurdity of the union position can be demonstrated in another way. Not even Mr. Hawke would, presumably, deny that a 6 per cent rise in wages would contribute to a further steep spiralling in prices in the months ahead. When that comes about, are the unions again to be fully compensated for the rise in prices resulting from their own actions? The truth is that Mr. Hawke’s prescription for recovery amounts to a policy of continuous and never-ending inflation, of inflation piled on inflation.
Mr. Hawke and his fellow union leaders are not the only offenders against common sense. There is a widespread clamour for immediate tax cuts coming from some economists and from sections of business and the press. The Federal Opposition would go further. They want tax reductions combined with an increase in government spending, a proposal which reaches the pinnacle of economic insanity. This is the Keynes' remedy for deflation and falling prices applied to precisely the reverse situation of rampant inflation and soaring prices.

The tax cut proposals are based on a form of wishful thinking — the idea that "the deficit doesn't matter".

The deficit, unfortunately, does matter. It is a key element in the whole economic equation and cannot just be shrugged aside. It matters because a larger deficit will almost certainly lead to higher interest rates and higher interest rates will have a disastrous impact both on consumer spending and business investment: on consumer spending through their effects on the costs of housing and time payment transactions; on business investment through their effects on the costs of borrowed money and of new capital equipment.

The demands for tax cuts really amount to another attempt to seek a painless way out of the jungle. There is no such way. There is really only one way out and sooner or later we will have to take it. For a short period, and until the economy is back in balance and inflation on the way to being defeated, incomes must be virtually "frozen". The Government should act to limit income increases for the next 12 months to no more than say, 4 per cent. The limit should apply not just to wages and salaries, but to professional fees, dividends and rents.

There are two possible means of imposing an "incomes freeze".

One is for the Commonwealth Government to call a crisis Premiers' Conference to request a temporary referral of powers over incomes from the States. The stage for such a Conference would need to be set by the Prime Minister in an address to the nation to inform the people of the desperate situation Australia is now facing.
If the cynics are right in thinking that some Premiers would refuse to co-operate, the Government should consider legislation to provide that businesses which granted wage or salary increases greater than the set figure would be disallowed the excess as a deduction against profits for purposes of tax.

What is clear is that if inflation is to be defeated, the link between prices and incomes must be smashed.

We are convinced that the people want an end to inflation and will support the Government in whatever measures are necessary no matter how unpleasant the medicine. Australians are not stupid; they are sick and tired of politicians and aspiring politicians whose main concern is to score political points off one another; the majority of unionists are not deluded by union leaders who purport to be acting in their interest when they know in their hearts that further inflation must follow. Australians understand real leadership and will respond to it.

DEVALUATION IN RETROSPECT

Until November 28, the day of the 17½% devaluation, the Fraser Government had demonstrated beyond doubt the number one priority in its economic strategy of sustained economic growth — the control of inflation.

Following that decision there was widespread belief that the Government had lost its sense of purpose. Before devaluation there were few who would disclaim confidence in the Government's belief in itself. Even among those who had serious misgivings about the methods being employed to combat inflation, there was a high degree of confidence in the Prime Minister's strength of purpose, but there can be no doubt that the devaluation and unprecedented immediate revaluations disturbed the general level of confidence adversely.

In view of the fact that few people, if any, had anticipated the date or the amount, one might have expected at least some praise for a brilliantly executed operation. But the immediate reaction by the press and other observers was that the Prime Minister had panicked, that he had acted against the best available advice and that the move was to a very large degree ill-considered. Panic or otherwise, there were very good arguments for devaluing at that time. History may judge the Prime Minister less harshly than the contemporary press.
The Favourable Signs

It was clear that anti-inflationary policies were beginning to have their desired effect by the end of November. There was a slowing down in the rate of inflation and in the growth of wages and salaries.

Ignoring the earlier effects of Medibank, increases in the Consumer Price Index for each of the previous three quarters were lower than any increase for two years. The September quarter increase of 2.2 per cent was the lowest since the March quarter of 1973. Other price indicators had also shown encouraging trends. The price indices for materials used in building — both for houses and building other than houses — showed the lowest increases since November 1972.

The index for industrial production had firmed since July and in October was 9 per cent above its low point in June 1975. Investment spending on new buildings and structures in manufacturing industry was expected to increase by about 30 per cent in the half year to December. Business profitability had grown. The savings ratio had declined and the shake-out in stocks appeared to have run its course.

Not all the indicators were encouraging, but at least there were grounds for believing that some of the distortions inflicted on the economy during the previous Government's term in office were beginning to be corrected.

Two Priorities

Of all the problems confronting the Government at that time, there were two which had indisputable claims to being faced at some point if sustained economic growth was to be achieved at the same time as winning the long term battle against inflation. The first was the continuing loss of Reserves due to our over-valued currency. The second was the uncompetitive position of Australia's export and import-competing industries.

The Fraser Government inherited an exchange rate which was already subject to speculation and uncertainty. In the weeks immediately following the December 1975 election, several hundred million dollars flowed out of the country. The decline escalated in the three months to the end of November 1976 during which time Reserves fell by over $700 million — leaving aside official borrowings abroad. The Government was forced to recognise that a currency's value is greatly influenced in the final stages by international financiers and traders, and that a valuation was being placed on the Australian dollar which made devaluation at some stage inevitable.

The alternative to immediate devaluation was further overseas borrowing of around $1,000 million, and no responsible government could examine these options without considering the competitiveness of Australian industry. It has been estimated by the Industries Assistance Commission that the general competitiveness of the import-competing sector had fallen 17 per cent between 1970/71 and 1975/76. Wages in Australia's manufacturing industry had increased by 130 per cent in the last six years, compared with 53 per cent in the United States and 70 per cent in West Germany. The Prime Minister showed an acute awareness of this situation when he gave a spirited defence of devaluation a few days after the event:

"... employment in Australian manufacturing industry fell by almost 100,000 between May 1974 and the end of June 1976. There has been a growing ten-
dency for some sections of manufacturing industry to move off-shore to minimise cost disadvantages. This export of jobs had to cease.”

The option of borrowing around $1,000 million presented substantial risks. Even a borrowing of this magnitude would have been unlikely to have ended speculation against the downward movement of the dollar because investors and companies involved in international trade were looking at the underlying cost position, further aggravated by full indexation in the previous quarter, as much as the balance of payments position. With an emphasis on this argument, and following it through to its logical conclusion, the Prime Minister could have legitimately believed that going to the IMF would have threatened the strengthening economic recovery.

The Modus Operandi

Movements in a fixed exchange rate are invariably attended by major public concern. Official action is notoriously slow to respond to changing economic circumstances, and at least some part of the public concern is due to the unavoidable necessity for Treasurers not to inform the public of impending devaluation in order to prevent a flood of speculation. (In Australia, because of tight exchange controls, a substantial part of speculation takes the form of leads and lags in trade settlements.) The adoption of a managed float has largely relieved future Australian Treasurers of this unfortunate necessity and brings us into line with most major countries, including the United States, Germany, Japan and Canada, which have exchange arrangements that permit flexibility in the pursuit of domestic policy objectives in response to changing economic circumstances. This is clearly pointed out by the IMF in its 1976 Annual Report:

"Faced with substantial uncertainty concerning future balance of payments developments and exchange rate patterns, and aware of the persistence of marked differences among national economies, in particular with respect to rates of inflation, interest rates and levels of economic activity, as well as of structural changes, the major industrial countries have continued to permit their currencies to float. Indeed, as underlying economic conditions have continued to differ among countries whose currencies are floating, frequent exchange rate variations have been a major form of balance of payments adjustments.”

There has been little criticism of the decision to adopt a managed exchange rate, but most observers have been slow to accept the effect this had on the magnitude of the initial devaluation. It reduced the drastic consequences previously associated with an over-kill, and gave the Government the opportunity to end definitively further speculation. In arriving at the figure for the new exchange rate, the Prime Minister again showed his concern for the competitiveness of Australian industry in a speech soon after the event:

"The magnitude of the devaluation indicates the seriousness of the cost disadvantages which has been weighing with increasing heaviness on Australian manufacturing industry.”

Being wise after the event it is now clear that much of the uproar over the magnitude of the devaluation and the immediate revaluations was an emotional rather than an economically justified reaction. In any event an over-kill of that nature — if it was an over-kill — is a small price to pay for establishing a managed float and dispelling further speculation.
The decision to devalue could never be taken without a supporting policy of action to minimise the ill effects and make the most of the good effects. In this area, too, the government came in for widespread criticism, but largely on grounds of economic dogma.

The Accompanying Package

It is an unfortunate truth that economic judgments are too frequently coloured by dogmatic convictions. Either one follows traditional Keynesian doctrine in prescribing deficit budgeting, government planning and spending, and tax cuts to stimulate the economy — and is happy with the marriage of such policies to one's own convictions; or one questions whether the Keynesian approach is appropriate under the current conditions — and finds the alternatives incompatible with dogmatic beliefs. The widespread support for devaluation in 1974, even among today's most severe critics, is a sad commentary on the political impartiality of our observers.

The Federal Opposition has again been proposing that we solve our problems through yet higher government expenditure. This is a cruel deception. Every new expenditure has to be paid for either by deficit financing or by raising taxes. Nobody is recommending increased taxation, and any increase in the deficit would in itself be inflationary without any realistic compensatory strengthening effect. We are living in a post-Keynesian era where all the evidence points to the long term effects of deficit financing — stagflation.

It is true that devaluation in itself also adds to inflationary pressures, but coupled with an accompanying package which maintains the policy of monetary restraint and of cutting back the deficit there is some real hope that the good effects of devaluation will correct and stabilize the economic recovery.

Devaluation aids the competitive position of Australian industry and reduces the reasons for Australian companies to move off-shore. It has provided the environment in which investment projects have started moving again. It has provided relief in the problem areas identified by the 1975 Jackson Report where the alternatives to devaluation would have involved larger subsidies and higher tariffs.

In reviewing the decision of November 28, 1976, we can see no cause for believing that the decision was ill-considered or constituted a shattering of the government's economic strategy. No fundamental change in strategy was required as a result of the devaluation decision. What is required is an even more determined implementation of pre-devaluation policies. Despite the cries of doom and disaster from the doyens of the press, the Government is giving ample evidence that it intends to do just that.
THE TRUTH ABOUT PROFITS

Many of our current economic problems have their origins in events that took place in 1973 and 1974. In particular, the current low level of economic activity is, to a large extent, the result of a deliberate squeeze on profits engineered by the Whitlam Government in 1973 and the earlier part of 1974.

The squeeze was a scissors-like operation slashing at profits with two blades. On the one hand costs were allowed to escalate; indeed, active encouragement was given to higher wage demands by a number of Ministers of the Labor Government. At the same time compensatory price increases were prevented by the Prices Justification Tribunal. Recovery was also hampered by the over-valuation of the Australian dollar leading to additional import competition, and penal taxation brought about by the untimely withdrawal of taxation provisions in some sections of the economy.

Towards the end of 1974 the deleterious effects of the squeeze on profits were so painfully clear that even traditional opponents of the free enterprise system felt the need to speak out in support of increased company profits. Thus, on November 12, 1974, Mr. Whitlam told Parliament that he would write to the Prices Justification Tribunal "... to indicate the Government view that, in the present economic circumstances, it should now give particular attention to the problem of sustaining and stimulating an adequate level of private investment and of maintaining rates of return on capital which will induce the new investment". Other Ministers spoke in a similar fashion from November 1974 onwards.

Despite this (belated) call for increased profit there still appears to be a total lack of recognition by many people of the need for adequate profits — thus required to maintain growth and employment — by the Fraser Government to restore company profits are meeting with stiff opposition from wage and salary earners.

There are a number of reasons for this negative approach to profits, but the most important is the lack of knowledge of the facts about profits — in particular their size and distribution.

The state of knowledge about profits can best be gauged from a number of opinion surveys conducted during the past three years. The following are the pertinent points to emerge from these surveys:

1) In 1974 61 per cent of Australians believed profits were too high. Amongst some groups, such as young people and unionists, the proportion was even higher. In 1975 the figure was down to 43 per cent, no doubt in response to poor business performance in 1974 and the urging of Labor leaders as quoted above.

2) Of those willing to estimate the after-tax profits of Australian manufacturing companies, 63 per cent thought they were over 20 cents in a dollar of sales, 22 per cent thought they were 10-19 cents in the dollar and 16 per cent thought they were...
less than 10 cents. About 50 per cent of people said they did not know.

At the same time 56 per cent of people thought a profit of over 20 cents in the dollar was fair; 30 per cent nominated a figure between 10 and 19 cents; and 13 per cent thought under 10 cents in the dollar was fair profit.

(3) An English survey revealed that business managers do not know all that much more about the size of profits than other employees. Average estimate of profit made per £100 sales was £20.

(4) Twenty-seven per cent of people thought company directors were the main beneficiaries of profits.

(5) Twenty-one per cent linked inflation to excessive profits.

(6) Eighty-two per cent thought they did not get any benefit from company profits. Although 86 per cent believed profitability safeguarded jobs.

Two general conclusions emerge from these surveys:—

(1) There is a feeling that profits are not distributed fairly. Many people believe that directors and to a lesser extent shareholders receive too large a slice of profits. At the same time wage and salary earners believe that they do not benefit greatly from profits except to the extent that a company needs to be profitable to stay in business.

(2) There is a highly exaggerated estimate of the amount of profit in a dollar of sales. Consequently profits are given an exaggerated role as a cause of inflation.

These are the impressions. What are the facts?

The Distribution of Profits

There are three components of profit:—

(1) Over 40 per cent of all company profits go to the government in company tax and are used for social services, education, health and other purposes. For example, in 1975/76 tax on company profits netted the Federal Government $2,500 million. This was enough to cover the Federal Government expenditure on education and housing. (This does not include taxes other than income tax which are paid by companies — that is, payroll tax, council rates, land tax and sales tax). The more successful the company the more money governments get.

(2) About 25 per cent of all company profit is used to modernize plant, expand productive capacity and thus provide additional employment. Retained profits are a major source of investment funds. In 1973/74 approximately half of business capital requirements in Australia came from internal company sources. Approximate calculations reveal that to create a new job in manufacturing requires an average investment of over $25,000 in plant, equipment.

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1 North Broken Hill Limited is a case in point. The Federal Government takes 421 per cent of profits in tax — after royalties have been paid to the N.S.W. Government. The average royalty rate on gross mining profit was 20 per cent in 1975/76, but the sliding royalty scale goes up to 50 per cent. This means that for every additional dollar of gross mining profit earned by North Broken Hill Limited, 71.25 per cent goes in taxes to the Federal and State Governments. Other significant taxes, principally payroll tax and local government rates, have been deducted before arriving at the figure for gross mining profit.
and working capital. In iron and steel production the figure is over $40,000 and in petroleum and refining over $80,000. In mining it can be as high as $350,000 per new employee.

Quite clearly, without reasonable profits, investment funds of this magnitude will not be available from within industry, nor will they be forthcoming from outside investors.

(3) About 30 per cent of company profit is used to pay dividends. This is of course the part of profit providing the incentive for people to risk their money by investing it in business. Dividends paid to shareholders are taxed again — in some cases by as much as 50 cents or more in the dollar — and the proceeds once again applied for the benefit of the community.¹

Some people believe this third component of profit which makes up 30 per cent of total profits and about two cents in a dollar of sales goes to a few rich people. But this is far from so.

For the most part the large shareholders in modern industry are life insurance companies and pension funds. Everyone with a life insurance policy or an interest in a pension fund benefits from company profit. Over 3 million individuals have life insurance policies and 1½ million people are members of employee pension funds. In this way the direct benefits of company profits are spread throughout the community.

In addition, most large companies have tens of thousands of shareholders — people in all walks of life and of all levels of income. In total there are hundreds of thousands of individual shareholders in Australia. In fact, most large companies have many more shareholders than employees. For example, B.H.P. has 61,000 employees and 184,000 shareholders.

Professor Peter Drucker has made an extensive study of the distribution of profits. Although this covers the U.S., it is, subject to some qualifications, largely applicable to Australia.

Drucker points out that, through their pension funds, employees and self-employed in both the private and public sectors own more than one-third of the equity capital of American business. Within 10 years, he predicts, the pension funds will increase their holdings and will, by 1985 at the latest, own at least 50 per cent of the equity capital of American business. (These figures do not include the relatively small, but not negligible, personal ownership of stock by individual American workers).

The large employee pension funds in the U.S. (about 1,200 of them) own a controlling interest in practically every one of the 1,000 largest industrial corporations and the 50 largest companies in the 6 non-industrial groups (banking, insurance, transport, etc.).

Thus Drucker concludes that, “Indeed a larger sector of the American economy (outside farming) today is owned by the American worker — through his investment agent, the pension fund — than Allende in Chile proposed to bring under government ownership to make Chile a ‘socialist country’, than Castro’s Cuba has actually nationalized or than is nationalized in Yugoslavia or even Poland.”

The Australian position, though similar, is probably less advanced for two reasons. In the United States about 60

¹All following references to “profits” relate to profits after company tax as defined above except where otherwise specified.
per cent of the workforce is covered by superannuation while in Australia the figure is close to 40 per cent. Also, the investment portfolios of Australian superannuation funds probably contain proportionately fewer company shares and more of other assets than do the American funds.

Some people have seized on these observations to argue that there lies the solution to all our industrial relations problems. All that needs to be done, they argue, is point out to wage earners that in fact they are ultimately the recipient of profit and hence they only harm themselves when they jeopardize profits. In fact, this is not likely to convince wage and salary earners — for reasons that follow from an examination of the second conclusion (concerning the size of profits) to emerge from the surveys.

The Size of Profits

Profits account for only a small proportion of income (that is wages, salaries and profit) generated by companies. Even in the most profitable companies profits rarely make up more than 10 per cent of total after-tax income. Thus, where there might appear to be a conflict of interest between wages and profits it is only reasonable to expect employees' main interest to lie with their major source of income — wages.

Unfortunately surveys generally ask for opinion on the profit in each dollar of sale, while little attention is paid to people's understanding of the equally important concept of profit as a return on investment. Thus there is little awareness of profit as percentage of shareholders' funds — compared with return available from alternative forms of investment such as government bonds and building society deposits.

Last year the Melbourne Age presented the results of a survey of 470 companies and pointed out that they made $730 million profit, a 21 per cent increase over the previous year compared with a 12.5 per cent rate of inflation during the same period. This at first appears to be a very impressive performance, and it has been used by a number of commentators to erroneously claim that large profits are being made by Australian companies.

It fails, however, to answer three questions—

- What was the return on investment?
- Was the 21 per cent increase in profits from a previous high or low?
- When comparing the profit with inflation, was an allowance made for stock valuation and depreciation allowance?

These questions can be answered by looking at some aggregate figures covering a large number of Australian companies.

Figures published by the Reserve Bank covering hundreds of companies in Australia showed that profits as percentage of shareholders' funds averaged a little less than 9 per cent. Profits actually distributed as dividend averaged only 4.6 per cent of shareholders' funds.

The figures are equally applicable to small and large companies. Despite popular belief to the contrary, large companies on average are no more profitable than small companies. If there is any difference between the large and small companies with respect to profits, it is that the performance of large companies is more variable from year to year than that of small companies. On average, however, they are no more profitable. This is supported by an examina-
tion of “Fortune’s” survey of the 500 largest corporations outside the United States. Last year 80 of these corporations made a loss. On average, net profit was only 4 per cent of sales and 4.3 per cent of assets employed.

B.H.P., Australia’s largest company, illustrates this point very well. In 1975 B.H.P. received considerable publicity after reporting a record $120 million profit. Yet little attention was paid to the fact that this represented only a 7.4 per cent return on shareholders’ funds—considerably less than could be obtained from riskless government bonds. Last year B.H.P.’s profit was down to $65 million, giving a return of only 3.8 per cent on shareholders’ funds. If this year B.H.P.’s profit should climb back to its 1975 level, the media will no doubt report a dramatic doubling of profits, with little attention to the fact that this is merely a return to the modest rate of return on shareholders’ funds achieved two years ago.

The discussion so far has been based on the conventional accounting concept of profit. But during prolonged periods of high inflation rates, such as we have been experiencing since the early 70’s, this concept of profit results in a misleading picture. Current cost accounting techniques, by allowing for the replacement cost of stocks and equipment at prevailing market prices, highlights features of the economy which are obscured by historical cost accounting techniques.

In 1975/76 reported pre-tax income of Australian trading companies based on historical costs was $5,903 million. After paying $2,690 million in company tax, companies were left with a net profit of $3,213 million. However, if an allowance is made for stock appreciation and depreciation at replacement cost, real pre-tax income was only $2,304 million (instead of $5,903 million). With a tax bill of $2,690 million based on unadjusted profit the apparent net income of $3,213 million becomes a loss of $386 million. The company tax was therefore 117 per cent of real incomes.

In other words, companies are living on capital and paying taxes and dividends out of capital. This kind of dis-saving means “a substantial erosion of the capacity of industry to produce goods and services”. This point is highlighted in a recent study which suggested that if current cost accounting prevailed last year only 21 of Australia’s 50 largest companies would have recorded a profit sufficient to cover their relatively low dividend distributions. Most of these 21 companies would have had little left for capital spending on new plant, buildings, etc.

In the light of these considerations the level of company profit does not appear to be accurately reflected in the figures highlighted by “The Age”.

Profit and Prices

The other more popular measure of the size of profits is profit as a percentage of dollar sales. Most people, the surveys revealed, had a highly exaggerated impression of the size of profits measured in this way. Only a minority believed they were less than 10 cents in a dollar, while the majority thought the figure was over 20 cents in the dollar.

What are the facts?

According to studies by the Industries Assistance Commission, pre-tax profits in manufacturing companies represent on average 8 cents in a dollar of sales. After company tax — which in recent years varied between 42.5% and 47.5%
of profit — has been paid, profits represent little more than 4 cents in each dollar of sales. In retailing, profit can be lower than 2 cents in the dollar.

The following figures, based on the annual report of the Industries Assistance Commission, show margins of profit for selected industries before and after tax.

**PROFIT IN THE DOLLAR OF SALES**

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<th>Industry</th>
<th>Before Payment of Company Tax</th>
<th>After Payment of Company Tax</th>
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<td>Chemicals and Fertilizers</td>
<td>11.0</td>
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<td>Food and Drink</td>
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<td>Oil and Fuel</td>
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<td>Motor Vehicles</td>
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<td>Machinery</td>
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<td>Textiles</td>
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<td><strong>Average for all Industries</strong></td>
<td><strong>8.0</strong></td>
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The fact that profit on sales in some industries is greater than in others does not necessarily mean that shareholders are doing better. It generally reflects different amounts of investment in plant and equipment and the fact that different industries carry different degrees of risk.

Although profits are only a small part of the prices paid for goods and services, they are vital. If profits are whittled down it may make little difference to prices, but it could make a great difference to the progress of the economy, to our standard of living, and ultimately result in unemployment and shortages of goods and services.

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A clear picture of the meagre knowledge about the size and distribution of profits emerges from the preceding analysis. The implications of this for the success of government policies for economic recovery are far reaching. These implications arise from the oft-forgotten fact that the success of government policies depends on the cooperation of all sections of the community. Yet no cooperation will be forthcoming unless the facts about profits are known and understood. Had these facts about profits been appreciated by the previous Government we might have never sunk to our current low level of economic activity.
The Uranium Debate: Some Economic Aspects

by Prof. H. W. ARNDT

H. W. Arndt has been Professor of Economics in the Australian National University since 1951. In 1963 he became head of the Department of Economics in the Research School of Pacific Studies and of its Indonesian Project. He has written widely on problems of economic development in Australia and Indonesia. After more than twenty years as a member of the Australian Labor Party he resigned in 1971 in protest against the foreign policies of Mr. Whitlam and the economic-nationalist policies of Dr. Cairns and Mr. Connor.

CONSCIENCE RADICALISM

Conscience radicalism is an honoured tradition in Western, and especially the English-speaking, democracies. To take up the cudgels against the Establishment of church or state, to protest in the name of conscience and humanity against some course of action that is recommended by experts and accepted by majority opinion is the right of every citizen. At worst, it adds an element of crusading excitement and virtue to otherwise humdrum lives. At best, it stops or prevents an avoidable wrong. British history is full of such protests, from great and successful movements such as that for the abolition of the slave trade to vain battles such as those for unilateral nuclear disarmament or against smallpox vaccination, vivisection and fluoridation. The unsuccessful ones failed not because the campaigners were proved conclusively wrong but partly because the facts spoke increasingly against them and partly because the majority of adherents became doubtful or bored and fell away. But a small band of enthusiasts remained, and remains, unconvinced.

The long campaign against fluoridation of the water supply is a good example. Scores of enquiries had been held, hundreds of reports written, expert testimony carefully sifted. The overwhelming evidence was that fluoridation greatly improved dental health without
any adverse side effects. It all made no difference to the opponents. If they could find one dentist to take the opposite view, they dismissed all other professional opinion on the ground that "the experts disagree". In the 1950s an exasperated city engineer in a mid-Western city in the USA announced that the city's water supply would be fluoridated as from the first of March. All through March the letters of protest poured in: people's hair was falling out, pregnant women lost their babies, virgins became pregnant, fractures would not heal, bones became brittle, etc., etc. At the end of March the engineer announced that the water had never been fluoridated. In May fluoridation was carried out with overwhelming public support in that city. But anti-fluoridation fanatics elsewhere continued the good fight, unmoved, and do so still.

The anti-fluoridation campaign is rather an extreme case, though an obsession, almost paranoid, streak has characterised many such protest movements. But it illustrates two features which are common to most of them. One is that the questions at issue are seen as matters of conscience, involving value judgments which cannot be proved right or wrong. The other is that they often turn, in part, on highly technical matters which laymen find it hard to understand let alone assess, while the experts, as in all matters of applied science, can never be absolutely certain but have to base their opinions on the weight of evidence.

The present anti-nuclear campaign, which, in Australia, concentrates on opposition to mining and export of uranium, is clearly in this tradition of conscience radicalism, and the issues are without question uncommonly far-reaching and grave. As a layman in matters of science and technology I must, like the Fox Commission, try to inform myself as best I can on the current state of expert opinion on the scientific aspects and as a citizen I must try to make up my mind on the value judgments. But as an economist, I may be of some use in trying to clarify those aspects of the problem which fall into my province. I have chosen to do so today because it seems to me that on some of these there is still a good deal of misunderstanding, even, if I may say so with respect, in the first report of the Fox Commission.1

NUCLEAR ENERGY: COSTS AND BENEFITS

Most of the current debate, in this country as in others, revolves around the economic benefits and non-economic costs of nuclear energy developments, to individual countries and to mankind. The debate is wide-ranging and acrimonious because many of the relevant facts, both with respect to future trends in world energy requirements and sources of supply, and with respect to the risks involved are subject to great uncertainty. I propose to summarise the issues on this central question rather briefly because it is really no longer open. There does not seem to be any room for doubt that the use of nuclear energy for electricity generation will go ahead at an accelerating rate throughout much of the world over the next 25 years. The question for Australia, to which I mainly want to address myself, is what we can do to reduce the risks and increase the benefits, to the world as a whole and to ourselves.

It is agreed on all sides that the use of nuclear power for electricity generation involves two kinds of risk which are unique to this source of energy. One is the risk of accidents in the form of leakage of radiation from reactors or from nuclear waste. The other is the risk of non-peaceful use of nuclear materials.
All the available evidence and the preponderance of expert opinion seem to suggest that the risks from uranium mining and from generation of electricity in the present type of thermal reactor are very small, almost certainly smaller than from coal as a source of energy. Because extreme care has been taken from the beginning, the safety record of the nuclear power industry, with not a single fatality in 25 years of operation, is probably unequalled by any other industry. It is true that, as the number of reactors throughout the world grows from the present 150-200 towards several thousand, many in countries with less well established standards in such matters, the likelihood of accidents through human error will increase. But even if such accidents were to happen, the seriousness of any one of them should not be exaggerated. Much anti-nuclear argument and public anxiety arise from confusion between nuclear explosions, the horrors of Hiroshima and Nagasaki, and nuclear power generation. Thermal reactors cannot explode; and while leakage of radiation could, in some cases, expose a number of people in and around the scene of the accident to serious danger, it is absurd to speak in this context of a risk of "a major disaster for mankind" or of a "catastrophe of unimaginable dimensions".

The risk would be greater for fast breeder reactors which are still in the experimental stage but which would become commercially more attractive if the price of uranium rose substantially since they could use the abundant uranium-238. The higher risk would arise mainly from the use of sodium as coolant.

Disposal of high-level radioactive waste generated by nuclear power stations, at present negligible in quantity compared with that resulting from manufacture of nuclear weapons, will become an important problem as nuclear generating capacity increases. No absolutely safe method of storage is as yet available, but there seems good reason for confidence that vitrification and underground burial in steel containers in geologically stable terrain will prove a satisfactory solution.

By far the most serious risk is that expanding peaceful use of nuclear energy will make it more difficult to control its use for non-peaceful purposes. I confess I remain quite unimpressed by the so-called terrorist threat. Determined terrorist groups, prepared to inflict horror or blackmail on others at risk to themselves, already have a range of easier means at their disposal. Manufacture of a nuclear bomb by such a group seems out of the question unless it operates under the patronage of a national government in which case the problem merges into that of nuclear proliferation.

The key question here is whether the risk of nuclear proliferation, that is to say the spread of the capacity to make nuclear bombs to countries that do not already have it, can be reduced by halting nuclear power development. This question is clearly not relevant to the countries that already have both the capacity to make bombs and their own supplies of uranium, pre-eminently the United States and the Soviet Union; nor probably to countries like France, Britain, China and India which have the capacity but not the uranium, unless it were thought possible to devise a system of superpower or international control to withhold all supplies of uranium from them; nor to countries such as Sweden or Denmark or the Netherlands which no one suspects of harbouring plans for
nuclear war. The question then comes to this: Are all these countries to forgo the use of nuclear energy in order to reduce the risk of other countries acquiring the capacity to make nuclear bombs? The question need merely be put in this form for the answer to be obvious.

This is not to deny the extreme importance of the nuclear proliferation problem. Everything possible should be done to move toward nuclear disarmament among the nuclear powers and to limit the use of technical know-how for transforming nuclear materials from peaceful to military uses, especially enrichment and reprocessing techniques. But it is neither sensible nor realistic to try to throw out the baby with the bathwater. The "major challenge facing the nations of the world", as President Ford put it last year, is to "develop the vast benefits of nuclear energy while at the same time preventing a spread of nuclear weapons."

The benefits of nuclear energy are, of course, being disputed by environmentalists on various grounds. There is, some say, not going to be an energy crisis after all, even if economic growth is maintained; and if there is, resort to nuclear energy would put off the crisis only temporarily because uranium supplies are limited. In any case, solar energy and other new sources will make resort to nuclear energy unnecessary. Above all, further economic growth in the rich countries is neither necessary nor desirable; and the poor countries which are admitted to need further economic growth are too poor to be able to afford nuclear energy.

The answer to the first two points is that all projections of world supply and demand for minerals and energy have proved extremely precarious. What has come to be called the "Club-of-Rome fallacy" of confronting exponential growth of demand at current rates with "finite" reserves, without regard either to growth of technology or to the dependence of supply and demand on price, was partly responsible for the excessively alarmist predictions of an early energy crisis which, in turn, by encouraging the OPEC countries to quadruple the price of oil, played a major part in accelerating investment in substitutes for fossil fuels, including nuclear energy. The same fallacy underlies predictions of exhaustion of uranium reserves by the end of the century. The only certain facts are that most oil-importing countries are anxious to develop nuclear energy as a means of reducing their vulnerability to OPEC-type pressure and that supplies of uranium which is a fairly common element on the earth's surface will almost certainly respond readily to a rise in its price.

The assertion that resort to nuclear energy will be rendered unnecessary by a new solar energy technology raises technical rather than economic questions. A major research effort on solar energy is obviously very desirable, but the evidence so far appears to cast doubt on the technical or economic feasibility of solar energy as a general substitute for fossil fuels.

That still leaves the opponents of nuclear energy with the anti-growth case for rich countries and the high-cost objection for poor countries. To the former I shall return at the end of this paper. The latter involves another economic fallacy. If the supply of energy from nuclear power in the rich countries adds to total world supplies and thus keeps down the prices of oil and coal, this will benefit energy-deficient poor countries whether or not they themselves use nuclear energy.
It is time to sum up this part of the argument. Since there is no objective basis for trading off the non-economic risks and the economic benefits to mankind of nuclear power development, a survey of the issues still leaves the question wide open. One cannot, for example, refute the Fox Commission's view... that all reasonably practical steps should be taken to limit reliance on nuclear energy" and, since the words "reasonably", "practical" and "limits" are all capable of elastic interpretations, it is difficult even to dissent from it. All one can say is that there has been a tendency among environmentalists to exaggerate the risks and to understate the benefits — it is my personal view that the Fox Commission's first report is, in some degree, open to the same criticism — and that, judging by their ambitious plans for nuclear energy development, most national governments, in capitalist and socialist countries alike, regard the risks as worth taking. Where public opinion has been consulted, as in the recent referenda in seven American states, large majorities have supported this judgment.

**URANIUM EXPORTS: COSTS AND BENEFITS**

I have heard academic colleagues argue that if Australia by exporting uranium, were liable to contribute in however small a degree to nuclear proliferation or to risks however small or remote of a major nuclear accident, they would regard uranium export as morally indefensible, however great the economic benefits, to Australians or to mankind. With such superlative refinement of moral scruple it is impossible to argue. Ordinary people, and their governments, cannot avoid a more pragmatic attitude. They must weigh the risks against the benefits — somehow. This is what I shall try to do in this part of the paper.

The risks chiefly emphasised by the opponents of uranium mining and export in Australia are the non-economic risks of nuclear accidents and nuclear weapons which we have already discussed, rather than any health risks to uranium miners which no one regards as serious in Australian conditions of properly supervised open-cut mining. The pragmatic question for Australia then is whether abandonment, or deferment, of uranium exports could significantly reduce the risks entailed in overseas nuclear energy development.

The likelihood that Australia could halt or slow down overseas nuclear energy development simply by keeping its uranium in the ground is virtually zero. Australia's reserves of uranium ore constitute a sizable proportion, perhaps 20 per cent or more, of the world's proved low-cost reserves, but this does not imply any significant dependence of the major importing countries on Australian supplies.

As the Fox Commission has pointed out, if Australia were to stop uranium mining and exports, "further low-cost supplies would become available from higher grade ores in other countries to meet any deficiency created by Australia not exporting uranium... Withholding Australian supplies would not appreciably affect U.S. uranium prices, at least until 1990... The principal effect of not making Australian supplies available would be to make it necessary for other countries to put more effort into developing and mining known uranium resources."99

Those opponents of uranium export who admit this then fall back on the moral suasion argument: "If Australia were to decline to mine and sell uranium... and were to announce its policy to..."
the world, this would be likely to have an important effect in restricting further nuclear development, if not actually causing a cut-back."¹⁰ A victory of the anti-uranium lobby in Australia would undoubtedly encourage similar groups in other countries and might, at least for a while, shake business and official confidence in the prospects for the nuclear power industry. But such a decision (which, as the Fox Commission points out, would incidentally involve a breach by Australia of its legal obligations under the Non-Proliferation Treaty) would at best affect only democratic countries whose governments are sensitive to public opinion; it would thus discriminate against these countries, in favour of countries with authoritarian regimes, an effect which some but surely not all the opponents of uranium mining would welcome. In any case, it seems most unlikely that Australian environmentalists could more than momentarily play King Canute.

Indeed, the most likely effect of an Australian decision to withhold further supplies of uranium would be to give an immediate impetus to the development of fast breeder reactors which, by largely dispensing with the need for supplies of uranium-235, would make the importing countries relatively immune to OPEC-type blackmail from the major uranium producers such as Australia but would, as we have seen, considerably increase the risk of serious accidents. It would be ironic if the environmentalists, in their earnest anxiety to minimise such risks, were once again to prove that the path to hell is paved with good intentions.

A decision to stop uranium mining and export would also of course have adverse economic effects for Australia. It would warn our trade partners, and especially Japan, that Australia cannot be relied upon as a dependable supplier of essential raw materials. Inevitably, they would ask themselves, after beach sands and uranium, what next? But this aspect is best considered together with the economic benefits to Australia from uranium mining and export which the environmentalists ask us to forgo.

The Fox Commission, in its first report, attempted to estimate these benefits and came to the conclusion that the contribution of the uranium industry "to net national income and employment opportunities would be small."¹¹ Professor Johns and others have given reasons for thinking that the Commission has underestimated the benefits, in particular by making insufficient allowance for the stimulus to investment and employment in other industries which would result from uranium development, by assuming no further increase in the volume of uranium exports after 1991 on the unrealistic assumption that annual production at the assumed 1991 rate of 30,000 tonnes would exhaust Australia's reserves by 1997-8, and by neglecting the contribution uranium development might make to attracting overseas capital.¹²

But the details of such estimates which are in any case subject to very considerable margins of error do not matter very much. There appears to be fairly general agreement that the uranium industry can be expected for some decades to make a contribution to Australian exports, income, and economic growth roughly comparable in magnitude to that of the sugar or the bauxite-alumina industry. What does matter is that, to the environmentalist opponents of uranium mining and export, such economic benefits count for nothing and that the first report of the Fox Commission is strongly coloured by this same outlook.
It has to be recognised that the anti-uranium campaign, for all its apparent preoccupation with the Hiroshima syndrome, is in large part a by-product of the anti-growth attitudes which have been one of the luxury products of affluence in western countries. As an article in *Chain Reaction*, the magazine of the Friends of the Earth put it quite openly: “Underlying the nuclear debate as a whole, there is the more fundamental question concerning the desirability or otherwise of continued economic growth.”

When anti-uranium campaigners describe their opponents as arguing “for nuclear electricity just to maintain the luxuries of the rich” and plead that, since “a more equitable distribution of material wealth” must come anyhow “uranium to keep up energy-extravagant life styles in the rich countries is only postponing the day of reckoning”; when they present the issue by airily referring to money as “a very temporary commodity compared with the continuing environmental health of the planet”; when one of Australia’s most distinguished poets, in her capacity as Patron of the Campaign Against Nuclear Power, denounces the three members of the Fox Commission as “the final betrayers of our [our young people’s] hopes” and their report as signifying that “Australia has made its choice under the dollar sign”; one wonders whether some of them do not positively welcome the uranium issue as another stick with which to belabour the economic values which they, mostly middle-class intellectuals, bored and guilt-ridden by affluence, affect to hate and despise. It is not surprising that they are joined on their bandwagon by others who see a chance to promote older, more familiar causes. The Convener of the Movement Against Uranium Mining in Victoria is one of those who believes that “the main beneficiaries [from uranium mining] would not be Australian working people but a handful of overseas shareholders”.

I do not think that these views are shared by the majority of the Australian people. It therefore seems to me regrettable that the first report of the Fox Commission gave quite so much prominence to the anti-growth ideology, repeatedly referring to the view that “people in the developed countries should simplify their life-styles appreciably, so as to decrease the demand on non-renewable energy resources” and suggesting in this context that “certain standards and values accepted in the past . . . may not be held now by a substantial minority or even a majority of Australians”.

Since the Fox Commission’s first report was published the opponents of uranium mining have discovered another argument to buttress their case, the so-called “Gregory thesis”. The great expansion of Australian mineral exports in the past decade, so the argument goes, has raised the equilibrium exchange rate of the Australian dollar and has thus made other traded-goods industries, especially farming and manufacturing, less competitive. The Australian economy faces a problem of structural adjustment, shifting resources out of some of the high-cost rural and manufacturing industries into others in which Australia retains a comparative advantage, and into the service industries which will in any case absorb most future increase in Australia’s work force. Such structural adjustment is obviously particularly difficult in a period when overseas recession and domestic inflation have brought about abnormally high rates of unemployment. All this is quite true, but to draw from it the inference that Australia
should put a brake on mineral development makes no more sense than it would have done to put a brake on railway development to protect the farmers who raised horses and hay. The whole issue is particularly irrelevant to the question of uranium mining since, by the time this adds substantially to Australian export earnings in the mid-1980s, the short-term problems of structural adjustment within the traded-goods sector of the Australian economy will have sorted themselves out.

**IMPLICATIONS FOR POLICY**

It will be apparent from what I have said that I agree with the Fox Commission's main recommendation: "The hazards involved in the ordinary operations of nuclear power reactors, if those operations are properly regulated and controlled, are not such as to justify a decision not to mine and sell Australian uranium". But I would go further.

A decision to withhold Australia's uranium would seem to me deplorable partly because, far from reducing any risks from nuclear power development overseas, it would very probably add to them by hastening efforts towards independence from uranium-235 supplies through fast breeder reactors; partly because only as a supplier of uranium can Australia, like Canada, hope to exert significant leverage in support of international constraints on nuclear weapons proliferation; but above all because for 14 million Australians, 0.04 per cent of the world's population, to claim the right to withhold from the rest of the world 20-25 per cent of all high-grade uranium reserves is in the long run an untenable position. People in other countries will not necessarily share the simplistic view that "selling uranium to make money is selfish, whereas leaving it in the ground is not". Allow me to repeat something I said last year about Australian resources policy generally, because it is particularly applicable to the case of uranium: "Australia's security of tenure as the owner of a not inconsiderable proportion of the world's reserves of non-renewable resources depends on a kind if implicit trusteeship: a belief abroad, and especially among the major consuming countries, that the resources will be safer — in the sense of more efficient management and freer access at reasonable prices — in Australia's hands than in those of any other country and that this is, for them, an asset worth defending."22

I would also, in all seriousness, support a suggestion made a few months ago by Dr T. M. Sabine, of the N.S.W. Institute of Technology.23 Once a satisfactory vitrification and storage process has been developed, Australia should offer an area, somewhere 1,000-1,500 miles or so west of Alice Springs, as a nuclear waste depository. If, as seems certain, nuclear energy development will proceed in much of the world for the next 50-100 years, Australia, as one of the few countries in the world with a sufficiently large uninhabited geologically stable and almost water-free area suitable for the purpose, has, it seems to me, a moral obligation to make such an offer, and environmentalists who are so ready to preach morality should be the first to agree. Others, more worldly, might be persuaded that Australia might find here another "invisible export" industry, charging other countries heftily for its service, and using the proceeds for environmental protection and other worthy purposes.
10. Ibid., p. 174.
11. Ibid., p. 83.
18. Fox Commission, op. cit., p. 175 (italics supplied).

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