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OBJECTS

The Institute of Public Affairs is a non-profit, educational organisation financed by business enterprises and people throughout Australia to study economic and industrial problems. It was launched in 1943. The basic aim of the I.P.A. is to advance the cause of free business enterprise in Australia. In pursuit of this aim it is endeavouring:—

1. To inform the Australian public of the facts of our economic system and to raise the level of economic literacy in Australia.
2. To work always for a full and friendly understanding between employers and employees and for good relations throughout industry.
3. To study the means by which private business enterprise can be made to operate better in the interests of all sections of the Australian people.

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MORE REALISM, LESS THEORY

Monetarist policies have been singularly ineffective in braking back the increase in money incomes, which now threatens to accelerate.

Most of the troubles of the economy spring from the disproportionate rise in incomes (12 to 15 percent a year) compared with productivity gains (2 to 3 percent).

Inflation, record interest rates, the housing “crisis”, unemployment, the balance of payments’ weakness, the declining competitiveness of Australian industry, all can be traced to the incomes “explosion”.

This must now be the central concern of all economic realists.

Steps needed are
* a twelve-month standstill in the salaries of politicians and senior bureaucrats;
* a revision of public sector superannuation;
* a large reduction in personal income tax;
* a return to a centralised system of wage fixation based on “capacity to pay”;
* measures to discourage employers from paying inflationary wage rises;
* Treasury estimates to demonstrate the link between incomes and prices.

* * *
The outlook for inflation is bleak: probably worse than at any time since the Fraser Government came to office.

The recently released survey of the Australian economy by the OECD forecasts a rate of 11 percent for 1982/83. Some would place the figure higher — even as much as 15 percent. Clearly, much will depend on what action is taken to avert a threatened explosion of wages, and thus of other incomes.

In recent years the Commonwealth Government has been accustomed to excuse the slow progress made in curbing inflation by pointing out that the Australian rate, at a point or two below 10 percent, was less than that in the United States and Britain and in many of the European countries. This is no longer the case. The OECD report forecasts an average rate for its member countries of 8 percent — substantially less than its prediction for Australia.

The rise of 4.2 percent in the Consumer Price Index for the December 1981 quarter was the highest for the last quarter of the year since 1974. This must be regarded as ominous because of its certain impact on wage demands. Moreover, the wage increases achieved in the closing months of last year have yet to be fully reflected in prices: and there are many more in the pipeline, and no doubt a number of additional ones being cooked up in the offices of the Trade Unions, not to mention the National Wage Case before the Commonwealth Arbitration Commission.

_The wage situation should now be the central concern of the Government and indeed of all economic realists._ There cannot now be too many economists left in the Western world who do not harbour grave doubts whether monetarist policies alone have the answer to inflation. Even those who continue to profess an unwavering faith in the monetarist cure must be getting a little uneasy. They could hardly claim that things have turned out as they expected.

Monetarism (which, to put it simply, means little more than imposing restraint on the so-called "supply of money") is an essential ingredient of a policy to contain inflation and maintain some measure of economic
stability. But to base policy on the assumption that it is the only ingredient is surely to take a strangely one-sided and over-simplified view of the economic process.

Monetarism, in theory, acts against inflation by suppressing demand. But what if price increases have their origin not in an excess of demand but in rising labour costs? Recent experience in Australia and other countries show that monetarist policies may reduce the demand for labour, even to the extent of creating unemployment and business recession, yet wages and other incomes continue to rise steeply and, with them, prices.

In the 1950s and '60s it was customary in economic circles to distinguish two kinds of inflation according to the predominant causal factor — “demand pull” and “cost push”. One seldom encounters those terms today. In the long period of full employment (usually over-full employment) after World War II the primary motivating force behind inflation was clearly “demand pull”. Since the late 1960s, inflation has been seeded, in the main, by “cost push”.

In a recent paper, the former top economic adviser to the British Government, Sir Alex Cairncross, attacks the Thatcher administration for attaching such importance to the money supply. Among a number of criticisms of monetarism, he writes:—

"We cannot assume that if the money supply ceases to grow, or if it grows more slowly, this will be reflected in the disappearance of price inflation or in a diminished rate of increase in the price-level. A reduction in money incomes may come about through lower prices and wage rates. It is just as easy to show that money wages and the price level expand simultaneously. It is therefore just as plausible to start by insisting that targets should be set for money wages as that they should be set for the money supply. But, in the monetarist view, it is the behaviour of money wages that is a mere symptom of inflationary pressure while on the other view it is the money supply which is little more than a symptom of pressure originating in the labour market (or, at times, the market for primary commodities)."
The antithesis can in fact be put more strongly. It may be natural to think that the value of money depends, like everything else, on the supply of it; but it is equally natural to think that the price of any commodity is governed by its cost and not at all obvious why changes in the money supply should have so great an influence on the level of costs that all other influences can be neglected."

Attempts to impose severe restraints on the growth of the money supply produce two effects, one working against the other, one deflationary, one inflationary. On the one hand, curbing demand by limiting the supply of money acts against inflation. On the other hand, the higher taxes, which usually accompany restraints on the money supply, provoke retaliatory action by all sections of the community to boost their pre-tax incomes, thus adding to costs and prices.

In concentrating their attention on the former effect, the "monetarists" appear to be overlooking the latter. It requires a delicate exercise in economic judgement to decide the degree of control which can be exerted over the money supply (through taxes) without dangerously increasing community pressures for higher incomes.

There have been suggestions that the underlying intention of official economic policy is to restrict consumption in order to release the capital, labour and finance needed to feed "the resources boom" (both private and public-infrastructure investment). If this is in fact so, it would strongly bias the economy toward inflation.

Such a policy would dispose the Government against reducing taxes. Its purpose, on the contrary, would be to maintain (or even increase) taxes with the object of curbing expenditure on consumption thus releasing resources for the expanding investment programme. (This kind of thinking, indeed, may have influenced the construction of the 1981/82 Budget in which tax revenues as a proportion of GDP reached their highest level in Australia's history).

In the context of the current clamour for higher wages and social service benefits, the pursuit of such a policy would certainly have serious inflationary consequences. It would give rise to a conflict within the
economy between investment on the one hand and consumption on the other. Moreover, a deliberate attempt to divert resources into investment would amount to a peculiarly non-market approach by a Government which has repeatedly proclaimed its faith in market principles as the most effective means of allocating resources.

The aim of pretty well everyone, understandably, is to improve their present standard of living. If attempts are made to frustrate them in achieving this objective by conscious policy measures, high taxes being the main one, the people are likely to react strongly. An increase in taxes merely leads to compensatory action by all sections of the community to boost their incomes, in other words to recover what they may lose by having to pay more in taxes. (There could hardly be a more convincing demonstration of this truth than the present widespread practices of tax evasion and avoidance).

If economic policy is to be effective, it must deal with human beings as they are, not as governments may like them to be. You cannot compel — at least not for long — people to act in the way you believe they should act. It is for this reason that tax increases designed to restrict spending almost invariably result not in curbing, but in inciting, inflation. Human behaviour is the most important single factor with which economics has to contend. The policy-makers ignore this at the cost of almost certain failure of their plans.

The theoretical rightness or wrongness of a policy to restrain consumption in order to release resources for investment is beside the point. It may well be that such a policy would be in the best interests of Australia — at least in the long run. The catch is that it is totally unrealistic. It could not work without massive inflation which would itself destroy the intention of the policy. Indeed, it is the obsession with the budget deficit, thus creating additional savings in the public sector (for investment) and the related need for high taxes, that is at the root of the quickening inflation we are now experiencing.

It is clear, beyond doubt, that if there is to be a serious effort to cut back inflation, there must be some kind of an incomes policy. In the absence of such a policy, inflation, steep inflation, will remain with us as a way of life. The Government, although voicing admonitions about the
need for a wage pause, seems, for the moment any way, to be taking the view that such a policy is out of the question because the Commonwealth has no constitutional powers to control prices or wages (even if that were desirable).

However, there can be an "incomes policy" without such control, provided the Government is sufficiently seized of its importance. Even if such a policy fell far short of being fully effective, it would represent a vast improvement on the total vacuum in this area which has succeeded the termination of the indexation mechanism.

Many prominent economists of world ranking, have, in the last twelve months or so, advocated the need for "incomes policies" as a necessary constituent of the medicine to cure inflation.

In a recently published article ("The Bulletin" 2.2.82) the eminent American economist John Kenneth Galbraith, argues that the monetarist approach can only succeed if it is severe enough ("murderous interest rates") to create a painful recession with widespread unemployment and business losses. But even then, says Galbraith, in the absence of an incomes policy, success would be short-lived. As the economy recovers inflation would again take over. Galbraith writes, "A prices and incomes policy is far better than unemployment and idle plant capacity and the business failures that are now being used to control inflation". Galbraith urges us to get away from theory and "retreat to common sense". While we have frequently disagreed with Galbraith's ideas, the I.P.A. is in complete accord with that sentiment.

Short of direct wage and price controls, what are the constituents of an incomes policy which could offer some hope of success?

The first step — unless this is taken, nothing else will succeed — is for Government to re-establish its own integrity and honesty of purpose in the minds of the community. We speak of "Government" not "the Government". What we say applies to all parliamentarians, Labor as well as Liberal, State as well as Federal, and to all leading servants of Government from departmental heads to judges.

Representatives of Government do not yet seem to realise the extent to
which they have damaged their credibility with the people by their acceptance of increases in their salaries and other benefits which, in many cases, exceed those obtained by the rest of the community. The most glaring abuses, of course, are in the area of superannuation which has now become a national scandal. Until Government re-establishes its own bona fides, its pleas for restraint by the rest of the community will be treated with the cynicism they rightly deserve, and will naturally fall on deaf ears.

Therefore we support two steps.

First, the Federal Government should announce a twelve-month standstill on parliamentary salaries and those of top bureaucrats, including senior officials of public statutory bodies. The second instalment of the outrageous 20 percent increase, accepted in mid-1981, is to take effect in July this year. From July 1982 to July 1983 there should be no increases.

Second, the Federal Government should set in train a comprehensive investigation of superannuation provisions at present applying to Parliament, the public service and statutory bodies. Both these actions should be followed by the States.

Not until these steps are taken, can Government expect its calls for incomes restraint by the rest of the community to have the slightest effect. People will only follow leaders they respect, who do not ask from the community any more than they are prepared to accept for themselves.

The second component of an “incomes policy” is a sizeable reduction in personal income tax, particularly on the lower and middle incomes. The Federal Government should endeavour to reach an understanding with the A.C.T.U. that, if this is done, the A.C.T.U. will make every effort to prevail upon its members unions to scale down their wage claims. The Commonwealth Arbitration Commission, and other wage tribunals, should need little persuasion to moderate their own awards accordingly. The scope for substantial income tax reductions should come from somewhat less emphasis on the budget deficit as the centrepiece of economic strategy, from the use of other taxes, and from intensified restraints on government spending and wastage: also from the reduced
incentives to tax avoidance and the stimulus to economic activity which would result from the tax concessions themselves.

Third, a workable centralised system of wage fixation, through the Commonwealth Arbitration Commission, should be restored as soon as possible. This should not, it is to be hoped, mean the return of "indexation" which is merely a word for built-in inflation. It should mean that employer—union agreements on wages and hours should require ratification by the Commission. "Capacity to pay", not price movements, should be the over-riding criterion in all wage determinations.

Fourth, the Commonwealth Government should take strong measures to discourage employers from entering into arrangements with unions to pay wage rises of a grossly inflationary character. Weapons which the Government can use against recalcitrant employers are the tariff, special tax advantages, and other financial incentives or benefits which employers may at present enjoy at the expense of the public purse.

Fifth, the Government should endeavour to educate the community on the link between incomes and prices. It should instruct the Treasury to furnish estimates of the increase in prices which can be expected to result from a given increase in incomes. The estimates could show the percentage addition to average incomes which is possible without any increase in prices, and the price rise which, other things being equal, could follow from various given increases in incomes — for example 5 percent, 10 percent, 15 percent.

These estimates, which could be published with the Budget, would inform the community of the inflationary consequences of various percentage additions to incomes and serve also as guidelines to the Arbitration Commission and other Tribunals in arriving at their decisions. Thus, the guidelines would help to give the Commonwealth greater authority over the incomes component of economic policy.

* * *

There is now an overwhelming view throughout the community — not least among many Federal and State Parliamentarians — that the level of personal income tax is much too high (higher than in most other Western
countries) that it is exerting a depressing influence on community morale and the economy, and, further, that it is inciting wage inflation and widespread efforts to escape paying intended taxes.

The economic strategy of the Federal Government seems to be "stuck in the groove" of monetarism. What is needed now is more flexibility, a greater willingness to take account of prevailing public attitudes, a readiness to innovate and experiment by varying the anti-inflationary medicine.

The constant repetition in official quarters of the same, now well-worn ideas is producing a kind of boredom, even irritation, in the community. This is dangerous for the Government, and it would do well to open the windows and let a little fresh air into the economic debate.
NOW IS THE HOUR
FOR TAX REDUCTIONS

The following comprises the full text of a statement to the media released by the Institute in the last week of January. The precise wording of the statement was naturally influenced by the estimates of the Commonwealth Budget for the current financial year.

Immediately following the release of the Institute's statement, the Treasurer, through the media, indicated that the actual Budget outcome for 1981/2 was likely to be much less favourable than that planned in the Budget.

In spite of the delay in implementing the sales tax increases, total tax revenues to the end of January are buoyant and appear to be running ahead of the Budget estimates. While the Budget outcome for 1981/2 remains in doubt, this has not altered the Institute's view that the most essential economic policy measure during 1982 is a substantial reduction in personal income tax.

The media response to the Institute's statement was, on the whole, highly favourable and the coverage in the main Australian dailies was considerable. The Senior Consultant of the I.P.A., Mr. C.D. Kemp, was also invited to comment on aspects of the statement on four radio programmes.

The survival of the Fraser Government may depend on whether it is prepared to make substantial personal income tax concessions in 1982.

This is the carefully considered opinion of the Institute of Public Affairs. The Government can only avert a "wage explosion" by taking the heat out of wage demands through the elementary device of increasing take-home pay by personal tax reductions. At the same time it can strike a blow for greater equity in the tax burden and lessen the scope and incentive for tax avoidance.

* * *
It is time for new initiatives in economic policy. The Fraser Government now has the opportunity to fulfill one of its major electoral commitments — to reduce taxation. The emphasis on monetarist techniques is failing adequately to contain inflation, not only in Australia, but in other Western countries that have pursued them.

The first priority objective of the Fraser Government in 1982 must be to lighten the present crushing burden of personal income tax. The reductions should be substantial, not token.

Substantial tax reductions can make a significant contribution to reducing the wage pressures building up in the economy, help to restore equity in the tax burden and improve the present sick state of industrial relations.

The "credibility gap" is the difference between promise and performance; it has destroyed many Governments. Unless it acts now the Fraser Government is in danger of facing just such a credibility gap in relation to its undertaking — repeated many times since 1975 — to introduce a new era of lower taxation and "small government". Tax revenues, as a proportion of G.D.P., are now the highest in the nation's history.

In the face of continuous, often vicious, self-regarding sectional protests, the Government has achieved some important success with its efforts to restrain the growth of public sector expenditures, but this achievement has not yet been passed on in tax reductions to the community. It is the capacity now to make responsible tax reductions that demonstrates the real achievement of the Government to date, but until these reductions are in place, the achievement will remain largely unrecognized. The Government must avoid being trapped by a single-minded obsession with the money supply, and consequently with the Budget balance, as a means of cutting back inflation. The Budget is now running into a substantial surplus. (The full effect of the sales tax increases has yet to be felt). The Budget settings are too tight. Monetarism, as a policy to contain inflation, can only be effective if it is successful in curbing the growth of incomes. This it has clearly failed to do. In fact, by necessitating the maintenance of high levels of taxation, it is having the opposite effect.
With the termination of wage indexation the Government is now facing the possibility of an explosion of incomes in 1982 which could destroy the results of all its arduous efforts over the years since 1975 to cut inflation and which, indeed, if not averted, could plunge us back into the economic chaos of the Whitlam era.

As an integral part of a rounded policy to counter this threat, substantial reductions in personal income tax are imperative.

It is surely far more sensible to endeavour to maintain, or increase, the real value of take-home pay by tax reductions than by money increases which add to costs and prices leading again to further money increases. The large rises in wages and salaries now taking place will inevitably result in price rises which will then be used as a basis for further wage increases. Could anything be more absurd than this self-perpetuating process.

There are other, almost equally compelling, arguments for reducing personal income tax. The huge surplus now developing is an open invitation to pressure groups to seek to increase Government handouts. Taxation cuts are essential to dramatise the need for further continued restraint in government spending.

In addition, there is a compelling argument on grounds of equity. At present there are, to use Disraeli’s phrase, "two nations".

On the one side are those who are forced to pay their full measure of tax — that is, the great bulk of PAYE taxpayers. On the other there are the self-employed, the recipients of property incomes, and those qualifying for utterly exorbitant superannuation lump sums. The first two categories can virtually choose what tax they pay. For them, personal income tax is, in effect, a voluntary, not a compulsory, tax.

In addition, preposterous superannuation schemes, applying to a minority, are in effect, being used as means of tax avoidance among high-salaried personnel. In the case of many, notably members of Parliament themselves, these schemes are not, strictly speaking, retirement funds at all. They amount, in part, to huge, virtually tax-free
bonuses payable to people, far from the age of retirement, on the termination of their present employment.

In this total context, it is hardly surprising that PAYE tax payers feel a sense of injustice and are provoked to levy demands for wage and salary increases which must be grossly inflationary.

To remedy this situation, the emphasis of the tax system should be progressively adjusted so that the major burden falls on expenditure (through a broad-based consumption tax) rather than on income. This would help to correct the present gross inequity of the tax structure, catch "big spenders", and reduce the scope and incentive for tax evasion and avoidance. It would also promote efficiency and productivity and investment.

If the Government does not take advantage of the present opportunity to announce its tax-cutting plans, another Government of different political complexion may well reap the rewards of the Fraser Government's "good housekeeping".

One of the first jobs the Prime Minister should do in 1982 is to instruct the Treasurer to present to the Government its tax-cutting options.
COMPARATIVE LABOUR COSTS

This article is based on a research project which is being carried out by C.D. Kemp and J. Abrahami.

The project is being financed by the Buckland Foundation administered by the Trustees Executors and Agency Co. Ltd., and is sponsored by the Australian Administrative Staff College.

The object of the project is to compare labour costs in Australian industry with costs in countries with which we compete, and to produce an index which will measure changes in our overall competitive position. The index is to be known as "The Buckland Barometer". It is intended that the project should be on-going so as to provide up-to-date comparisons and eventually more detailed analyses.

Those interested in the technical and statistical aspects of the project may consult the authors.

The main features of previous work on this project were summarized in an article published in the I.P.A. "Review" April-June, 1980.

Summary —

Three elements determine Australia's competitiveness in international trade; labour costs, productivity and exchange rate movements.

Between 1970 and 1981 Australia's productivity increased by 18 percent. Average earnings increased by 255 percent.

The 18 percent productivity increase was the lowest of the world's major trading nations. Even the U.K. registered an increase of 23 percent, Japan had 128 percent, France 40 percent and West Germany 30 percent.

The large wage increases together with the low productivity performance caused Australia's competitiveness in international trade to deteriorate.
At various times in the past ten years (e.g. 1976-80) the Australian dollar depreciated in value, to offset, to some extent, loss of competitiveness due to high labour costs and low productivity. At other times (e.g. 1980-81), an appreciating Australian dollar has further weakened Australia's position.

Exchange rate movements have tended to dominate the state of Australia's international competitiveness, but they are erratic and unpredictable and not under the independent control of the policy-makers.

Substantial productivity gains are almost impossible to attain rapidly, and in any case the largest of productivity increases are relatively small to the size of money wage increases of recent years.

Ultimately, therefore, the rate of wage increases will determine Australia's long-term competitive strength.

Wage moderation will not only improve employment opportunities through the workings of the domestic markets but will also add to them by enhancing the competitive position of Australia's exports and import-competing industries. At the margin the contribution to employment opportunities through successful international trade can be substantial, especially for manufacturing industries.

Between the late 1960s and early 1970s there was a significant increase in real labour costs in Australian industry. In the non-farm sector real labour costs (adjusted for hours) increased by less than 8 percent over the three years 1967-69. During the following three years (1970-72) they rose by 15 percent. A further 5 percent increase in 1973 was followed by more than 8 percent in 1974.

The acceleration in wage costs was primarily due to increases in award wages for both sexes but particularly females. While labour costs accelerated, labour productivity did not depart from its trend line. The combined effect of accelerating labour costs and only constant productivity increases produced substantial increases in unit labour costs.

The rise in unit labour costs, and in particular the sharp increase in 1973/74, was followed by an increase in unemployment, particularly from the beginning of 1973/74.

The link between an increase in unit labour cost and unemployment can take place in several ways.
The increase in the cost of labour encourages the substitution of capital for labour, thereby increasing labour productivity and reducing demand for labour even in times of growth in aggregate demand.

The increase in unit labour cost can produce what has been called the "real wage overhang". That is, the percentage excess of real unit labour cost at some date over that in some base "normal period". A real wage overhang is sufficient in itself to reduce output and employment, but to make things worse it has, in the 1970s, combined with limitations on free price movements by the Prices Justification Tribunal to produce a squeeze on profits. A squeeze on profits is inevitably followed by a squeeze on employment.

An increase in money wages not matched by an increase in aggregate demand will reduce output and employment. In the 1970s increased taxation and a higher household saving ratio meant that the wage increases were not fully reflected in demand.

Higher real wages may stimulate the supply of labour at a greater rate than the demand for labour has been growing.

The relative importance of the various factors promoting unemployment in Australia is a matter of debate among economists, although just about all economists now agree that the rapid increase in real wages is the predominant cause.

The various transmission mechanisms noted above operate through all sectors of the Australian economy but in this paper we concentrate on aspects of the impact of higher wages on the output (and hence employment) of export and import-competing industries.

Most Australian exports are sold at prices that are fixed on world markets. Except for manufactured exports, the demand for Australian goods is not likely to be greatly affected by changes in Australian labour costs relative to costs in other trading nations. Import-competing industries can be expected to be more substantially affected by changes in unit labour costs.

Some evidence about the role of international trade in determining the level of employment was obtained in a study by two Industry Assistance Commission economists. They concluded that, for the manufacturing sector as a whole, the principal reason for the fall in employment between 1968-69 and 1975-76 was improved labour productivity, that is, a fall in unit labour requirement. This effect slightly outweighed the expansion in employment due to the growth in aggregate demand. For most industries the employment effects of changes in the import and export shares were small compared to the effects of other factors.

The effects from variations in import and export shares however were significant compared to net employment growth.

There is a tendency by some economists to dismiss the impact of an increase in unit labour cost in determining the
competitive strength of Australian manufacturing exports and import-competing industries. They advance two arguments.

First, they argue that Australia’s manufacturing sector is so heavily protected by tariffs that substantial wage increases can be accommodated without adverse consequences. Careful analysis shows this not to be true. Thus, in June 1975, Professor Fred Gruen concluded that “the wage explosion of the last 18 months has of course had an even more drastic effect on industry profitability than either revaluation or tariff cuts.” On the basis of input-output analysis, Professor Gruen argued that wage increases in 11 major manufacturing industries during 1973-75 had an impact on profitability many times greater than the tariff cut. For example, the effect of the 25 percent tariff cut in 1973 on the profitability of knitting mills (an industry which is often said to be over-protected) was estimated to be equivalent to wage rises between 6 and 13 percent. In the two-year period the actual increase in minimum wage rates in the industry averaged 60 percent.

The second argument used to minimize the role of wages in determining Australia’s international competitive strength is based on the exchange rate. It is argued that exchange rates fluctuated wildly and rapidly in the 1970s and much of this fluctuation offset the erosion in our competitive position due to excessive wage increases. In other words labour costs don’t really matter for international competitive strength since a devaluation of the Australian dollar will offset excessive wage increases.

The problem with this argument is that it sees labour costs and exchange rates as independent variables, with the Government having the freedom to adjust the exchange rate to accommodate labour cost movements. But we have had enough experience to realize that an increase in overseas prices will show up in domestic costs, through, for instance an increase in the cost of tradeable goods spreading throughout the economy, or an increase in the cost of imported inputs. Thus, in the long run, local prices are likely to change by the full extent of exchange rate movements. Revaluations and devaluations affect nothing but internal price movements.

We now turn to an analysis of the three elements that are crucial to price competitiveness in international commerce: labour compensation, productivity and exchange rate movements.

We begin by looking at our position in relation to the world’s major trading nations, U.S., Japan, West Germany, U.K. and France. These five countries between them account for over 50 percent of the world’s exports of manufactured goods. The weight of each country’s world trade is a better indicator of its importance than its share in Australia’s trade because this encompasses the “hidden” competitive effect of goods traded on the world market but not actually imported into Australia or exported by Australian manufacturers. In
any case the first four of the above countries are Australia’s four major trading partners.

Table 1 shows that Australia’s labour costs have not been the only ones to rise rapidly in the past 11 years — the Australian figure, indeed, was not far off the average for the group of major trading nations. However, after allowing for productivity increases, Australia’s performance — a 200 percent increase in unit labour cost in local currency over 11 years — is a very poor one, with only the U.K. doing worse.

The average productivity adjustment used in calculating table 1 is the growth rate in real G.N.P. per head of population. There are many distortions in such a comparison, arising from changing age structure, unemployment rates, and workforce participation rates in different countries. However, the very large difference between the performance of Australia and the other countries suggests to us that the differences are real and not entirely due to problems inherent in comparing international statistics.

The critical importance of the exchange rate is clearly illustrated in the table. For example, Germany’s unit labour cost in Deutsche marks rose by an estimated 73 percent between 1970 and 1981 — well below the rise for the other countries with the exception of Japan. But when converted into U.S. dollars a quite different picture emerges. Germany’s labour costs increased by 180 percent — reflecting the 61 percent appreciation of the Deutsche mark against the U.S. dollar.

The short term effect of the exchange rate is much more erratic than that of other components of unit labour cost. This can be seen most clearly from the two lines in chart 1.

The first index is the ratio of Australia’s unit labour cost index to a weighted average of the corresponding indices for the world’s major trading nations. The second index is the ratio of Australia’s unit labour cost index to a weighted average of the corresponding indices for the world’s major trading nations, after expressing all national indicators in terms of a common currency. The difference between the two lines represents the impact of exchange rate changes on Australia’s competitive position. A fall in either index represents an improvement in Australia’s competitive position.

Broadly speaking, chart 1 suggests that during the period of the early ’seventies Australia’s competitive position deteriorated mainly because of massive wage increases but also because of the strength of the Australian dollar. In the mid-seventies (1974-76) there was little change in Australia’s competitive strength except for a brief improvement after the devaluation of September 1974. In the next three years (1977-79) a moderation in the rate of wage increase, together with a relatively weak Australian dollar, improved our competitive position to almost the position at the beginning of the decade. More recently, substantial wage
increases and a relatively strong dollar have once again combined to weaken Australia's competitive position.

The most important conclusion that we can draw from table 1 and chart 1 is that if we want to improve our competitive position we must contain our wages growth. Productivity increases both in Australia and overseas are small relative to the other elements influencing competitive strength and exchange rate movements are determined by too many forces outside the control of the Australian economy and are too erratic and unpredictable.

A recent study by the O.E.C.D. identified what it called the group of "Newly Industrialized Countries" (NICs). This group is made up of four countries in Southern Europe (Greece, Portugal, Spain and Yugoslavia) two in Latin America (Brazil and Mexico) and four in South East Asia (Hong Kong, Korea, Singapore and Taiwan).

Between 1963 and 1977 the share of the NICs in world industrialized output increased from 5.4 percent to about 9.3 percent. The export of manufactured goods increased from 2.5 percent in 1965 to 7.1 percent in 1976.

Since these countries appear to have competed successfully in the past two decades it is worth comparing the components of Australia's unit labour costs with those of the Newly Industrialized Countries. Data limitations make it impractical to use all of the above twelve countries and we therefore compare Australia's performance with that of Brazil, Greece, Korea, Philippines, Spain and Yugoslavia.

Labour costs in these countries have generally risen much more dramatically than in Australia or any of the major trading nations. However, the productivity record and even more so the depreciating currencies of the NICs have enabled these countries to remain price competitive in manufacturing industries. Chart 2 clearly shows that without massive depreciations the NICs would have dropped in the last seven years 60 percentage points on their competitive index with respect to Australia. (The two competitive indexes on chart 2 are analogous to the two on chart 1). After years of successive devaluation by the NICs, in 1981 the competitive position of Australia was the same in relation to the developing countries as it was in relation to the developed countries, in both cases taking 1970 as the base year.

It seems as if we have no more to fear from competition in manufacturing industries from the new industrialized countries than from the developed economies. In either case the ultimate result will depend on Australia's ability to contain wage increases to within the limits of productivity.
"THE NEO-CONSERVATIVES"

Extracts from a talk given by Mr. Norman Podhoretz to an audience of businessmen, academics and journalists arranged by the Institute of Public Affairs

Norman Podhoretz is the Editor-in-Chief of the influential American journal, Commentary, a position he has held since 1960. He is the author of a number of books and has also contributed articles and reviews to most of the major periodicals in the United States, including the New York Times, the New Yorker, and the Washington Post. As a forceful, articulate spokesman for capitalism and conservative philosophies, Mr. Podhoretz has achieved wide prominence not only in the United States but in other countries in the Western world.

The phenomenon I'm referring to is the rise, mainly in the United States but also in some other countries, notably Britain and France, of a new group of intellectuals who have begun to make a very strong, indeed aggressive, case on behalf of the "capitalist system". Incidentally the very use of the term "capitalism" is itself a notable development, because for a very long time, capitalism was the economic system that dared not speak its name. So rough a treatment had the word itself been given in the polemics of the past century that even people who practice capitalism and those who wish to preach it were forced to find circumlocutions — euphemisms such as "free enterprise", "the free market", "the market system". The willingness, indeed the eagerness, of the group of intellectuals I'm talking about to use the word "capitalism" is itself a symptom of their refusal to continue being on the defensive in the discussion of the capitalist system and its relation to its various competitors both past, present and in the putative future. The tone of these people in the defence of capitalism is anything but defensive, and this in itself is new.

You have an anomalous situation in which people who participate in, run, profit from an economic system, are frequently unable to find a good word to say for it themselves, don't really understand in what sense it is legitimate and socially valuable, and are constantly prey to doubts and demoralisation that arises from such inner doubts, and this itself, it seems to me, helps to weaken not only the economic system but the social and institutional fabric of the societies that all of us live in. So that hope would be that a new attitude arising out of the intellectual community — a new attitude toward capitalism, toward the society generally — if it were to prevail in the
world of ideas, might in turn have as one of its consequential effects a "re-moralisation" if you like, of the community of people, practical people such as yourselves whom we rely upon to keep the system going and to make it productive of wealth, a wealth in which we all to some degree share and on which of course we all depend.

The history of this change began with a growing disillusion with the performance of socialist systems, and it was out of this growing disillusion with the major alternative to capitalism that capitalism itself began to appear in a different and rather more benevolent light to the eyes of the intellectuals I'm talking about. The consequences of the socialistic experiment, I think, are pretty well in, and they are not as advertised, and it's out of that disillusioning experience that the re-examination of capitalism began. Now this re-examination proceeding over a number of years and a lot of thought, and a lot of research, has eventually generated a series of propositions, propositions that run directly counter to the propositions making up the traditional attitude.

Let me describe that new attitude for you in terms of these three large propositions.

The first, which has to do not with economics but with politics, was the proposition that capitalism, that is a high degree of free economic enterprise — it needn't be absolute — a high degree of reliance on the market within a given society, has been historically a necessary, if not a sufficient, condition of the existence of political freedom. This is to many socialist minds, a startling, heretical and blasphemous proposition. Nevertheless, I believe, and the people whose work I am summarising here believe, and have argued very strongly, that the historical evidence supports it — supports it perfectly — in several ways. One can say that economic freedom is itself a form of freedom quite apart from any consequences it may have for political freedom, and to anyone who values freedom as such obviously this form of freedom must be valued.

The second reason that it is to be valued is that economic freedom imposes, by its very existence, a limit on State power. To the extent that the State is prevented from controlling any sector of our lives, to that extent it has less power over our lives. Therefore, if this particular sector like any other sector — religion, the arts, whatever — is free of the control of the State, then the degree of individual freedom is increased.

What's more important in a time when all over the world everyone is worried about the growing centralisation of State power, and the quickening growth of State power even in the freest of our societies, this, in itself, seems to be more important to more and more people. Anything that limits the encroaching State begins to seem very valuable, and not to be lightly dismissed. There was a time
when central State power seemed too weak and a lot of people wanted to strengthen it. Very few people anywhere in the world today would say that the governments they live under are too weak. I don't care what their political persuasions might be and I don't care where they live, almost everyone believes that everywhere in the world there's too much State power. So any institution that sets a limit to that State power is valuable so far as the preservation of individual freedom is concerned.

In addition to those theoretical propositions, which I think are very forceful and very difficult to refute, we have a record of performance now to examine, and what we find on the whole is that no society that we know of in which the State controls economic activity to any considerable degree also offers room for political liberty. In other words, political liberty itself is incompatible with complete, or almost complete, State control over economic activity. There are societies in which economic activity is free and in which political liberty does not exist, or does not exist except in a very small degree. We all know such societies — South Korea, Taiwan, to a much lesser extent I would say Singapore — but we know of no societies in which the converse is true. In other words, there are no societies in which there is no economic liberty and in which there is political liberty.

To those of you who are wondering how I fit the social democratic countries of Western Europe into this scheme, it is very simple. Those that are, in fact, blessed with political liberty, have left the market, on the whole, pretty free to produce the wealth which the socialist governments then wish to distribute. Some of them are now beginning to worry about the effects of such State mechanisms of distribution on the capacity of the society to produce the wealth that is needed in order to distribute it. Sweden is the classic case. You have there, in effect, the free market to produce the wealth and then government takes a lot of it and distributes it. But Sweden has relied basically on free enterprise — on capitalism I should say, in line with the new fashion — to produce the wealth.

The second point, to which I have already alluded, is that capitalism is a necessary and a sufficient condition of the production of wealth. That is to say, the argument between socialism and capitalism that used to rage twenty or thirty years ago, among economists and among ideologues as to which of the two systems was better for producing wealth, is now over. There's scarcely an economist left on the face of the earth, outside the Soviet Union, who would now argue that strictly from the point of view of producing wealth — forgetting what happens to it when it's produced — State control of the economy is a superior instrument to the free market. There are still arguments everywhere as to what you
do with the wealth after it's produced and whether those who produced it are entitled to as large a share of it as they may think, or whether the State ought to confiscate some of it and give it to the poor. But that's a separate issue. On the issue of production, capitalism is now almost universally agreed, and certainly by the new defenders of capitalism, to be a necessary and a sufficient condition of wealth.

The third point which bears on the issue of distribution: these new defenders of capitalism have said that even on the issue of distribution, even on the question of equality, if you want to put it in abstract philosophical terms, the capitalist system has done better than the socialist systems because there has proved to be a better chance under capitalism than under any known alternative for a widespread sharing of the wealth that the system has produced. So that the case is that even as concerns the political value of equality — which is not the prime value of the liberal capitalist tradition — liberal capitalist tradition exalts liberty as its prime value; equality is the prime value of the socialist tradition — even in realising that value, the capitalist systems have a better record. But the people I'm talking about — the new defenders of capitalism — when they say that capitalism has a better record in the establishment of equality are not talking about the abolition of inequality. They are not talking about a world in which as far as humanly possible, discrepancies of wealth would be eliminated. This is not their vision of a good society. What they are talking about is the improvement of life at the bottom in such societies, the raising of the bottom, the progressive raising of the bottom through the establishment not of equality of result, but of equality of opportunity.

Equality of opportunity is an essential element of any healthy capitalist system. Obviously individuals differ in capability, talent, energy, luck, but as far as possible you try to make the rules of the competition fair at the outset, because this draws on initiative and energy within the society which would otherwise be lost. But, at the same time, if you have a race based on equality of opportunity, it will be a race, there will be competition, and someone will win and someone will lose. Someone will do better than someone else. This is not only not to be regarded as unjust, or inequitable, or immoral, but, on the contrary, as perfectly consistent with the rules of justice and fairness within the terms of such a system. As a matter of fact, not only is it morally defensible — that is inequality of result — it also is structurally, as you might say, necessary, because without the incentive of winning you also deprive the system of energy and initiative. You need the energy and initiative that you get from giving everyone a chance to compete. But you equally need the energy and initiative you get from giving everyone a chance to win. It doesn't mean that the losers have to be
penalised. It doesn’t mean that you can’t have what Ronald Reagan has come to call a safety net in which the penalties for failure are softened and in which even those at the bottom are able to live at some minimum decent level.

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The one qualification that the new defenders of capitalism — or some of them anyway — have made, because their enthusiasm for capitalism, while very great, in the terms that I have just outlined, is qualified by one large reservation and that has to do with the spiritual dimension of the question. Irving Kristol wrote a book very well known in the United States called “Two Cheers for Capitalism”, obviously meaning to withhold the third. It’s a title that was modelled after an essay by E.M. Forster called “Two Cheers for Democracy”. “Two Cheers for Capitalism”! Well, why not three? Why indeed not three? The reason, Kristol says, is that the one essential element missing from the capitalist system and the capitalist societies is that they fail to provide what you might call a “transcendental” dimension to life. People looking for something more than bettering one’s condition — one’s material circumstances — are invariably disappointed by the way of life proposed through the capitalist system. When they are young or even when they get to be a certain age, some people begin to feel that there must be more to life than this. I wouldn’t be surprised if one or two people in this room might have had a twinge or two of that experience, and there’s no question that this is true. Now I, myself, regard this not as a deficiency but as a virtue, because I think any social system — any economic system — that pretends to offer the answer to the ultimate questions, what you might call the religious questions, becomes very dangerous. The fact that we are not required to worship capitalism is itself, I think, a protection against the possibility of tyranny in society.

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Let me quickly give you — I’ve given you the good news — the bad news. This is that the new defenders of capitalism remain a minority within the intellectual community and their attitudes are by no means sweeping the world of ideas. On the other hand it is a very dynamic minority. It has elan, it has energy, it has dynamism, it has a sense of freshness in its writings which are conspicuously lacking in the writings of some of its rivals and opponents, some of whom I think literally fall asleep at their own typewriters as they are typing the same idea for the ten-thousandth time. There’s something new being experienced in the work of the new defenders of capitalism, and, in the articulation of that new experience. There’s a good deal of excitement which, as much as anything else, accounts for the disproportionate influence they have been exerting despite the relatively small numbers they represent. But this is the kind of battle that is not won by numbers. Numbers are
not the decisive element in wars of ideas. The decisive element is persuasiveness, plausibility, fidelity to experience and the facts, determination to speak the truth as one sees it in the light of the world around one.

By those criteria, I think the new defenders of capitalism stand a very good chance of prevailing ultimately within the world of ideas, and since I believe that the survival of capitalism is intimately connected with the survival of the entire liberal democratic order of which it is a constituent, it seems to me that the success of the new defenders and their ideas can only serve as a contribution to the larger struggle that we all face to maintain and preserve the socio-political values. This is a system that is under assault from without, menaced by the missiles of Soviet power. It is also a system that is under threat from within, menaced by a sense of demoralisation and flagging energy. We in this generation are charged with the responsibility, as no generation before us has been, to make certain that the heritage of free societies, including free economic activity, is preserved and passed on to our children and grandchildren, and their children and grandchildren, to future generations. In my judgment, if we fail in that responsibility, we will be cursed by our posterity and we will deserve their curses.
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