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The Australian Inflation . . . .

TOWARD the end of last year and the beginning of this, the Australian inflation appeared to be gathering a truly alarming momentum. The pace of the upward surge in prices, costs and incomes, which was dangerously fast in the middle of 1948, quickened appreciably. Public opinion, which seemed strangely apathetic and indifferent to the drift to inflation a few months previously, became genuinely concerned. Indeed, it is not too much to say that in January of this year there existed a real state of fear as to what 1949 would bring in the shape of further price rises and higher costs of living.

ECONOMIC INDICATORS

That there was some cause for alarm will be confirmed by any cursory examination of the main economic indicators.

In the two years between the end of the war and June, 1947, retail prices, as measured by the cost of living index, rose by 4%. Over the next twelve months to June, 1948, they rose by an-

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other 9%. For the six months from June, 1948, to December, 1948, a further increase of 5% was recorded.

Wholesale prices rose 4% in the two years between the end of the war and June, 1947; 13% in the next twelve months to June, 1948; 10% in the six months from July, 1948, to December, 1948.

Wages, as measured by the Commonwealth Statistician's index of weekly wage rates for adult males, increased by 9% between June, 1945, and June, 1947; 12% in the next twelve months to June, 1948.

Spending power, measured by cash and bank deposits held by the public, rose by 6% in the twelve months from June, 1947, to June, 1948; a further 6% in the six months from July, 1948, to December, 1948. Trading bank deposits show corresponding rises of 11% and 10%.

All this, of course, has to be considered in relation to the pre-war position. By the end of last year retail prices were 47% higher than in 1938/9, wholesale prices 81%, wages over 60%, export prices 325%, import prices approaching 200%. National income and spending power had both more than doubled.*

* For the convenience of the reader the above facts are drawn together in the following table:

% INCREASE IN PRICES, WAGES AND SPENDING POWER.

	1945 to 1947 %	1947 to 1948 %	June '48 to Dec. '48 %	1939 to Dec. '48 %
Retail Prices	4	9	5	47
Wholesale Prices	4	13	10	81
Wages	9	12	4*	62*
Export Prices	68	48	7	325
Spending Power	13	6	6	180

Source: Publications of Commonwealth Statistician and Commonwealth Bank.

Notes: * September Quarter.

STERNER MEASURES

The fears of runaway inflation, at least in informed quarters, may now have abated somewhat as a consequence of overseas cables in February and March reporting price falls in key commodities in the U.S.A., and with the strengthening belief that the end of the world post-war inflationary boom is approaching, if it has not already passed, its peak. There are certainly many good grounds for this belief—supply is overtaking demand in many of the major commodities that enter into world trade and the buyer appears likely, at no very distant date, to take over his rightful position as sovereign in the economic kingdom. Nevertheless, it is too early to indulge in hard-and-fast predictions of the course of economic events, and in Australia at least there is little reason to expect that the present trend of rising internal prices and costs will be reversed for another twelve months at least. It still remains true that unless we take every possible step to arrest the present inflationary movement in Australia—which, over the last two or three years, has been allowed to develop far more than was either desirable or necessary—and to stabilise internal costs and prices, an economic disaster of the first magnitude might well befall the Australian people. It is not merely the dislocations that a rapidly rising price level inflicts on the economy that give cause for concern—the economic hardships and injustices imposed on large sections of the public, the destruction of the value of savings, the chaotic effects on business contracts, the squandering of economic resources on inessential production while essential forms of production go short, the continuation of rigid and hampering controls. All these and other evils are bad enough. But the overriding danger of an unchecked, or inadequately checked, inflation such as the one we are at present experiencing, is that of a sudden collapse and a rapid slide into the trough of depression. *The first step, and one which apparently must still be learnt, in preventing depression, is to prevent the boom (which history shows has always preceded it) from getting out of hand.* This is all the more essential in a country such as Australia, whose economy is so exposed to the cold blasts of the world economic climate.

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A sharp and large drop in export prices would not only cause a dramatic reduction in the Australian national income, and consequently of internal expenditure, it would leave many Australian industries high and dry at a level of costs that would be seriously uncompetitive by world standards. The high business profits and economic buoyancy of today could be quickly transformed into widespread losses and economic stagnation, and a series of painful internal adjustments to the new level of world prices would have to commence. Unemployment would increase, living standards would fall, and confidence in the future would collapse. There is, of course, no certainty that this will happen; in fact there are many good reasons for thinking that it will not. But if we are to insure ourselves against the danger that it might, then, far sterner and more far-reaching measures than those so far undertaken will have to be put in train forthwith. *We cannot afford to run the risk of a sudden collapse of overseas prices, and the catastrophic effects that this would have on an over-inflated Australian economy. Now is the hour, therefore, when every effort should be made to prevent further substantial increases in costs and prices.*

POLITICAL MANOEUVRING

The public understanding of the position has not been assisted by the stream of political recrimination, of accusation and counter-accusation, in recent months in an attempt to nail the responsibility for price increases. It has been suggested by certain spokesmen for the States, that the Commonwealth's sudden withdrawal from the field of price control and the abolition of the major proportion of price subsidies are electoral manoeuvres, designed to place the responsibility for price rises during the current year on to the States. If this is the intention of the Commonwealth Government it is a vicious one. Insofar as any government must bear the responsibility for the inflationary disease with which Australia is afflicted, then that responsibility must attach to the Commonwealth. The Commonwealth Government, as the central government, has virtually complete control of banking and credit policy and over national finances. All the chief weapons for combating inflation are in its hands and not those of the States.

SUBSIDIES

The stand taken by the States, however, is by no means beyond criticism. In their efforts to see that the blame for price increases does not fall at their door, they have misled the public into believing that if the Commonwealth had been prepared to continue the payment of price subsidies, the position could be kept under control. This is a long way from the truth. No system of price control could prevent very big price increases while the Australian economy is being subjected to the inflationary pressure arising from abnormal export prices, and rising internal costs due to the 40 hour week, wage and salary increases, and other causes. The best that could be expected from subsidies in the absence of stern measures of financial policy, is that the inevitable increases in prices might be less than they otherwise would be.

There is a current tendency to exaggerate the influence of price subsidies in keeping the Australian economy in equilibrium. The effect of the reduction in subsidies of £26 million, considered in isolation, would probably be to increase the general price level by something like 3% to 5%. But prices are at present rising at the rate of roughly 10% per annum, and indeed, in the current financial year, the increase may be considerably more than this. It is worth noting that price subsidies in Australia, which amounted in 1947/8 to about £40 million, are insignificant compared with Great Britain, where they are running at about £500 million a year. In Britain subsidies constitute about 8% of total national expenditure; in Australia only 2%.

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It needs to be said with every possible emphasis that the inflationary movement in this country cannot be successfully combated through price control, based on the scale of subsidies in operation when they were discontinued. Moreover, it would be a grave mistake to attempt to do so. Subsidies have many disadvantages. In the first place they set up an artificial relationship between different prices. Since it is necessarily the essential forms of production upon which subsidies must be chiefly concentrated, the effect of control is to keep down the prices of essentials relative to inessentials. Labour and resources thus tend to be attracted away from essential industries and into "luxury" industries. This has in fact been one of the most lamentable features of the post-war economy in Australia during the currency of rigid price control. Secondly, price control itself tends in one sense to be inflationary because by holding down the prices of essentials, it leaves consumers with more money to spend on inessentials. Finally, the payment of subsidies increases the scale of government expenditure and makes it more difficult for governments to pursue an anti-inflationary policy. While subsidies were cut down with unnecessary and undue abruptness, now that they have been reduced it would, on balance, be most unwise to restore them.

INCREASED PRODUCTION

The problem of preventing inflation, or at least preventing it from degenerating into a dangerous boom, resolves itself into a relatively simple issue—that of keeping the total monetary demand for goods in equilibrium with the total physical supply of goods and services. Where there is a large addition to the spending power of the public, caused, either by a fortuitous increase in the incomes accruing to exporters, or by increases in wages and profits internally, then steps must be taken to offset those increases or a rise in prices will result.

One way, and a very necessary way, of course, is to increase production. But this cannot be achieved overnight, or at a pace nearly rapid enough to keep in step with an abnormally rapid expansion in the money incomes of the community. We would need a truly extraordinary expansion of internal production to offset the increase in incomes which took place during 1947/8—money national income increased by £300 million or by 22%—or with the increase which is expected during the current financial year.

Increased production, therefore, is not by itself nearly sufficient. Those who place their reliance solely on increased production as a remedy for inflation are backing a losing horse. There is no one thing more important to Australia than a large-scale expansion in production, but it is a delusion to suppose that a monetary inflation of the present proportions can be remedied through production alone. There is no escape from the fact that, while taking every step to expand output, we must adopt measures to control further rises in money incomes.

This can be done in two ways—through the medium of public finance and through direct operation on the level of money incomes.

PUBLIC FINANCE

The Commonwealth Government has in its power to draw money out of the community by the technique, familiar to economists, of "budgeting for a surplus." This simply means that the government receives more in income from taxation and other sources, and from public loans, than it subsequently spends on current services and on capital projects. Because of the utterly confusing and reprehensible manner in which the public accounts are presented (to which attention is continuously drawn by the Auditor-General) it is difficult to ascertain the degree to which the Commonwealth Government has been pursuing this policy.

The reduction of the Commonwealth's short-term debt through the redemption of Treasury Bills suggests that the

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Government in effect achieved surpluses approximating £70m. in both 1946/7 and 1947/8. These surpluses are the result not of the excess of current revenue over current expenditure, but largely of receipts from long-term public loans which were not spent. The effect on the spending power of the community, however, is the same whether the surplus is achieved through current revenue or through unspent loans.

The objective of a budget surplus demands on the one side a strict economy in government spending on current services, and the postponement of all but the barest essential large-scale public projects, and on the other a programme of high taxes combined with vigorous loan campaigns. Rates of direct taxation have, however, been kept rather too high than too low. It is not the rates of taxation that matter so much here as the total revenue acquired from taxation. And, as experience since the war proves, an increase in revenue is not necessarily inconsistent with a lower scale of taxation rates. Moreover, in so far as high rates of taxation act as a drag on production, they themselves become a factor making for inflation. The important point is, that if the proceeds of high taxation are all spent by the government, as they virtually have been over the past few years, then high taxes can not assist in arresting an inflationary movement. Criticism of the Commonwealth Government's financial policy must be largely directed at its doctrinal reluctance to reduce government expenditure. Much larger surpluses might have been achieved by greater economy in government spending. In 1947/8 expenditure by the Commonwealth and States was three times the pre-war level and 5% higher than for the previous year.

It is bad finance to maintain heavy government spending at a time when private spending is reaching extraordinary heights. Nevertheless, as with increased production, it would be entirely wrong to suppose that an inflationary development of the post-war proportions could be controlled through the technique of "budgeting for a surplus," without resort to other measures. There are quite plainly severe limitations to what can be accomplished through a budget surplus at a time when the money incomes of the community are expanding at an altogether abnormal rate. In actual fact, the effect of the budget surpluses on the money supply have been almost entirely offset by the rise in the volume of bank advances which has been necessary to finance increasing costs and prices.

EXPORT INCOME

There is no escape from the fact that if the present inflationary development is to be brought under control something must be done about the level of money incomes itself. In Great Britain, Sir Stafford Cripps has followed both paths —he has been successful in realising a sizeable budget surplus and also a near-pegging of rates of wages and profits. In Australia, however, the main inflationary factor is not wages and company profits—the latter are fairly stable—but exporters' incomes, which in 1947/8 were nearly £100 million higher than the previous all-time record of £309 million in 1946/7. Receipts from exports continue to be disturbingly buoyant during the current financial year—for the seven months from July to January they were £305 million compared with £199 m. for the same period in 1947/8.

These increases in export incomes are due almost solely to record overseas prices and not to any expansion in the physical volume of exports. Thus although the value of exports in 1946/7 was 152% above 1938/9, the physical volume was the same. And in 1947/8 while the value of exports was 32% above 1946/7 the quantity was actually 10% below. Herein lies one of the root causes of the inflation from which the Australian economy is suffering.

At other times the tremendous expansion in export income, and the accumulation of overseas funds which have followed as a consequence, might have brought about an appreciation in the exchange rate. But movements in the exchange are no longer fashionable. If the Australian exchange had been allowed to return to parity with sterling, export income would have been reduced by approximately 20% and import costs would have been lowered—a substantial contribution to disinflation. However, for various reasons, perhaps most of them wise, this had not been done.

With an appreciation of the exchange ruled out, then the best practicable alternative would seem to be to place some of the excess receipts from exports to stabilisation funds, to be paid out when export prices and revenue fall away. Already the wheat industry has agreed to a stabilisation plan which will have this effect. But the main fly in the ointment is wool which in 1947/8 accounted for 36% of export income from all sources. The Wool Board, in its latest report, stresses that the present high prices for wool cannot be expected to last indefinitely. There are, therefore, some arguments in favour of a similar scheme to that adopted for wheat being applied to wool—that is, if such a scheme is technically feasible. The wool grower would lose nothing. Over a period of years he would get his full earnings. The principle of stabilisation merely means that the exporter would receive less in the fat years of high prices and more in the lean years of low prices. Under an appreciation of the exchange what he would lose immediately would be lost for good and all. Moreover, woolgrowers are at present paying exorbitant rates of taxation and might benefit materially from the deferment of some part of their present abnormally high incomes.

WAGES AND PROFITS

But if exporters' incomes are to be stabilised, what of other forms of income—for example, the profits of those producing for the home market and of importers, and also wages which comprise over 50% of total incomes and which have been increasing over the last two financial years at a rate greater than £100 m. a year?

In Great Britain, Sir Stafford Cripps has been able to slow the inflationary advance, largely because he has been successful in getting the trade unions to limit claims for increased wages and employers to peg dividend rates. It is not suggested that such drastic action is necessary in Australia—at any rate not yet. Nevertheless, the time is long since past when the Commonwealth Government should have made the strongest representations to trade unions to postpone claims for wage increases, and to employers to keep prices and profits to the absolute minimum consistent with a reasonable return for effort.

It cannot be too emphatically stated that the prevention of boom and slump, and thus the maintenance of stable employment, depends on the sense of responsibility and restraint displayed by key sections of the community, and the degree to which they are prepared to place national welfare before their own imagined interests. The trade union claim for an increase in the basic wage to £10 is, at the present juncture, the very antithesis of what the national interest, and indeed the interests of wage-earners themselves, demand. Indeed, an increase in wages of anything remotely approaching these proportions would throw a crippling burden on the cost and price structure and would render abortive any attempt to halt the inflationary advance. The new state of full employment has enormously increased the bargaining power of labour, and it is for the trade unions to show they can use these powers in a sane and responsible manner. They have accused the pre-war order of lacking that stability which can provide economic security for the workers; they should now beware that they do not by their own actions make a fatal and irrevocable contribution to economic instability.

The responsibility for halting inflation is largely that of the Commonwealth Government. If inflation is not under

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control by the end of this year no amount of argument or political manoeuvre will serve to exonerate the government from the blame which will justly be theirs.

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It might be argued that any strong disinflationary action at the moment is unnecessary, and indeed unwise, in view of the possibility of a sharp falling away of overseas price levels within the coming twelve months or two years. If this should occur the drop in export income would automatically correct the present boom tendencies and would serve to bring about a degree of disinflation without the necessity of strong internal measures. Indeed, should the fall in overseas prices be of substantial proportions, the whole economic outlook of Australia would undergo a dramatic change, and we might well be faced with the problem not of countering an inflationary boom, but of preventing an economic recession from degenerating into depression with a collapse of spending and the growth of unemployment. In this case what would be required would be an expansionary monetary and fiscal policy, not a restrictive one.

The recent sag in the prices of certain key products in the United States and the laying-off of workers in some industries might seem to give some weight to these contentions. At the time of writing there are few authorities so bold as to predict the course which economic events will take in the United States. Few are prepared to say definitely whether the present softening of prices is a natural adjustment to normal trading conditions, or whether it presages the beginning of an economic downturn.

But whatever happens in the U.S.A., it seems probable that in Australia inflationary forces will continue in the ascendancy for some little time yet, and that there will be no early reversal of the present rising trend of prices and costs.

Moreover, any really substantial and permanent fall in overseas prices of food, metals and wool is at present highly problematical. And even if it were to come, Australia would be in a better position to face it, if in the meantime we take every possible step to hang on to our own internal cost and price level.

If there should be a radical change in world economic conditions, then it would not be difficult to put into reverse many of the measures advocated in this article. Government budgetary and public works policies could swiftly be changed to cope with new conditions, banking policy could be made less stringent, and money accumulated in stabilisation funds could be released to primary producers.

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