AN INCREASING MENACE

The Australian economy is caught up in a massive wave of inflation. There has been nothing comparable to the magnitude of the present monetary expansion in the economic history of the last three decades. Indeed, in the matter of mere size, the post-1914-18 inflation and the pre-1929 depression phase of expansion, are, by comparison, of meagre dimensions.

Yet there is a curious apathy about the whole matter. Admittedly, this is not so apparent among the ordinary members of the consuming public, who increasingly resent the high prices they are called upon to pay, as among political, industrial and labour leaders. It is true that the fact of inflation is often politely mentioned, and perhaps occasionally deplored, in public statements from top levels, but there is by and large little evidence of any strong conviction of the need for bold counteracting measures and policies. In the recent election campaign, inflation did not figure largely in the political exhortations or propaganda. Yet there is no more important, and certainly no more menacing, issue facing the new Government. *Inflation is now the crucial problem of Australian economic policy. It is no exaggeration to say that if the problem of inflation can be solved, all economic problems will be solved; and, conversely, unless inflation is conquered, all problems will remain unsolved.*

COSTS OF LIVING

What are the main problems of the Australian economy? There is, first, the rising cost of living to the consumer. From the point of view of the ordinary person this is probably the most immediate and serious, and a matter, therefore, of everyday lament. It affects some sections of the community more than others; but it affects all. With some sections it may be a cause of little more than severe irritation; but with others, particularly those whose incomes in terms of money are relatively fixed—for example, those living on pensions—and, in these days, those endeavouring to establish themselves in a new home, it imposes hardship, often severe. The high cost of living in Australia today is, of course, a direct consequence of monetary inflation; of the simple fact that the "money" factor

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in the economic equation is increasing at a vastly greater rate than the "goods" factor. So long as the rate of input of money into the economic system continues to outstrip the rate of output of goods and services—the rate of production—so long will prices and living costs continue to rise.

LOW PRODUCTION

But the condition of inflation tends, of itself, to make the creation of an increased flow of goods and services infinitely more difficult. This is the second great problem of the Australian economy—low production. In the first place, inflation tends to eliminate, or at least to greatly soften, the compulsion of business competition. It makes a profit comparatively easy to come by. Because the pressure of buying is so strong, due to abundant supplies of money, the producer or trader has little difficulty in selling his goods. The incentive to speed up his production and reduce costs, to give better service, or to improve the quality of his product, is weakened. He can sleep soundly in his bed in the happy knowledge of an assured market. Many businessmen, so long as they are not too hard hit by shortages of labour and materials, which are a concomitant of inflation, might be quite content for inflation to go on indefinitely. More than most sections, they are in a position to benefit from it; and, while it creates certain difficulties in the form of government restrictions and controls, it relieves them of many harassing worries. Moreover, severe inflation, which implies a labour shortage, affects production adversely through its effect on the attitude of mind of the employee. Since he is at liberty to walk out of one job into another, he can make his own pace. He would be more than human if he didn't. The great majority of decent workers, of course, take no undue conscious advantage of this situation; but they cannot help being subconsciously affected by it. Also, there is an irresponsible fringe—an irresponsible 5 or 10 per cent.—(just as there is an irresponsible fringe of employers) who are fully and openly prepared to make hay while the sun shines. Maximum productivity and severe inflation simply do not march together.*

*This must not be taken as an attack on "full employment," which this Institute has unreservedly supported since its inception. It is a criticism of "over-full employment." "Full employment" is a situation expressed by the equation jobs = men; over-full employment by the relationship jobs > men.

PRODUCTION OF THE WRONG THINGS

Moreover, not only does total production tend to be low under inflation, but the wrong things are produced—the trumpery consumer goods, the frivolous luxuries, before those things of real worth to the economy, those things which add to the economic strength of a nation, and which are at the basis of long term development and progress. This truth, which is vividly illustrated in the Australian economy at the moment, constitutes the third great problem. The vital industries of steel, coal, rural production, constructional materials and building, urgently-needed public projects, are suffering from acute shortages of labour and physical resources. But over a wide range of production, of much less significance to the nation's economy, there has been a remarkable expansion in output and in the labour forces employed since 1939. One fact is sufficient to emphasise the point. *Despite an increase of nearly* 500,000 *in the total working population since before the war, the numbers engaged in rural production have fallen by* 60,000—*and this in what is regarded throughout the world as a great primary producing country, and in a period of exceptional world demand for foodstuffs and raw materials.*

Why does inflation distort and twist the productive structure into an unhealthy and unnatural form? There are two main reasons! Over-abundant money supplies in the hands of consumers mean a heavy demand for all types of consumer goods. Industries engaged in the production of these goods, which include many non-essentials, hold out excellent profit prospects, and are able to attract labour by the offer of good pay and working conditions. Secondly, in a time of inflation and acute labour scarcity, there will be a movement away from the less congenial to the more congenial jobs. Country labour drifts to the city. The heavy industries lose workers to the more attractive consumer goods industries. Domestic assistants are as rare as jewels—and just as costly. In a time of inflation and over-full employment there is nothing more certain than that the hard, unpleasant, but vitally necessary, work of the world will tend to be shunned.

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INDUSTRIAL COSTS

The fourth major problem of the Australian economy is the threatening level of industrial costs. There is abundant evidence to show that Australian costs are still rising rapidly, whereas costs in many countries are now comparatively steady, and in some cases, even falling. *Among the English-speaking countries, inflation is, today, almost a peculiarly Australian problem.* In the United States and Canada the natural post-war inflationary forces have been countered by a massive advance in production; these countries appear to have lost little, and to have gained much, by their early relaxation and removal of controls—a policy that was severely attacked by critics in those countries that adhered to controls. In Britain, the post-war inflationary pressures are now being contained by a policy of tight control—at some cost to production—and by the extraordinary and admirable undertaking of the trade unions to limit claims for increased wages, and, just recently, by the decision of the Trade Union Congress (which has been endorsed by its constituent unions) to accept a virtual pegging of wages until 1951. Only in Australia can it now be said that the forces of inflation are still fiercely active. To make a comparison with Canada, for instance—the country that approaches most closely to the Australian position:—During 1948-9, retail prices in Australia rose by 10%, in Canada by only 4%; export income in Australia by 35%, in Canada by 8%; the volume of spending power in Australia by 10%, in Canada by 7%.

Since the beginning of 1947, hourly wage rates (excluding overtime) in Australia have risen 39%, compared with increases in actual earnings in Britain 15%, Canada 23%, and the United States 13%. Moreover, all the portents suggest that over the next six to twelve months further substantial increases in Australian costs can be expected. Costs in Britain and the United States, on the other hand, may not increase greatly, and might even fall. *The competitive position of Australian industry has deteriorated rapidly over the last year or two, and is likely to deteriorate further during the next twelve months. Here we have a most serious threat to future stability and employment in Australia. A sudden drop in overseas price levels would render certain large sections of the Aus-*

tralian economy uncompetitive by world standards and would give rise to acute internal difficulties. The danger of the position into which we are drifting can hardly be overrated. In its 1948-9 Annual Report, the Commonwealth Bank drew attention to this danger in the following words: "While Australian costs continue to rise, overseas costs have either levelled off or are falling. In such a situation the Australian economy is particularly vulnerable to a downturn in economic activity overseas or to the effects of internal instability. In these circumstances it is important that every effort should be made to reduce costs of production and to make our industries as competitive as possible." That is, however, very much easier said than done—especially under conditions of inflation.

THE WAGE-PRICE NEXUS

Australia is probably one of the hardest countries in the world in which to arrest an inflationary movement because of the automatic link between wage incomes and prices. The movement tends to be self-perpetuating. An increase in prices leads to an increase in wages, which leads to an increase in prices, which leads to an increase in wages, which leads to an increase in prices, and so on ad infinitum.

The immense increase of £150m. in the total wages and salaries bill during 1948-9 was quite largely due to the effect of the quarterly cost-of-living adjustments. One is led to question whether the system of automatic wages-cost of living revisions can be reconciled with the modern goals of economic stability and full employment. Such a remark will no doubt give rise to a storm of criticism. But the critics would do well to remember that the system of cost-of-living adjustments cuts both ways. In a time of rapidly falling prices, wage incomes fail to get the benefit of lower prices because they (wages) too fall as prices fall. Moreover, modern economic theory throws some doubts on the wisdom of a rapidly falling wage level in time of deflation and recession. This is just the time when steps need to be taken to boost demand and spending through government expenditure and borrowing. But these steps could be rendered abortive if wages were permitted to be pulled down by every drop in the internal price level. *If the severing of the wage-price nexus were to impose*

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temporary hardship on the family man, he might be given some relief in the form of a special family allowance, or through the amount paid in child endowment.

What we suggest here is intended not to reduce the real wages of the worker, but to raise and preserve them by maintaining their purchasing power, and ensuring the continuance of full employment. Nor would it preclude upward adjustments in the wage level as productivity increases. In fact, it would render such adjustments all the more condonable, since their impact on costs would be confined to the magnitude of the adjustment, and the secondary and spiralling effects, which are to be so deplored, would be eliminated.*

An alternative to this policy might be the reintroduction of subsidies on those items which enter into the cost-of-living index, in an endeavour to stabilise prices of basic consumption commodities, and thus reduce, or eliminate, the inflationary wage-price spiral. It is not necessary to detail here the manifold disadvantages of subsidies in order to emphasise the great weaknesses of this policy. And, in any case, unless subsidies were to assume vast proportions, they could, at best, be only partly successful in their immediate objective. They might reduce the magnitude of the inflationary ripples, but they could not eliminate them.

In order to minimise, or to prevent, further increases in living costs; improve industrial efficiency and swell the flow of production; restore mobility of labour and resources so that the basic forms of production can expand at a rate in keeping with the needs of the country; maintain the international competitive position of Australian industries and improve the prospects of full employment in the years immediately ahead; the removal or, at least, reduction of the inflationary pressures in the economy becomes a matter of prime moment. What, then, are the root causes of the Australian inflation?

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*This argument does not, of course, imply that the Australian wage and income structure could be maintained at anything like its present level, should we be confronted with a substantial fall in overseas costs and in the prices received from our basic exports. There is, in fact, nothing more certain than that all Australian incomes would have to be adjusted downward in consonance with the new level of world prices, and the higher these incomes are permitted to go now, the greater and the more unpleasant could be the inevitable adjustments later on.

PRE-WAR THEORIES

Pre-war theories of inflation concentrated largely on the effects of government fiscal policy and of banking action in expanding credit at too fast a rate—the conception of more and more money being pumped into the economic system when the supply of goods coming forward was inadequate to balance the expanding volume of purchasing power. That conception has little, if any, application to the present situation. The Commonwealth Government has not been borrowing from the banking system and then spending the proceeds. On the contrary, it has been paying off money lent to it during the war by reducing its short-term debt. Over the last three years the Government has been redeeming Treasury Bills at the rate of £60m. to £70m. per year. And while bank advances have been increasing, they have not been increasing at anything like a rate sufficient to account for the expansion taking place in the community's spending power. Bank advance policy has, in fact, been kept on a fairly tight and discriminating rein by collaboration between the central bank and the trading banks. The collaboration has been made effective through the system of Special Accounts (by which the trading banks are required to lodge the great proportion of their expanding cash resources with the Commonwealth Bank), and through the directions issued by the central bank to the trading banks regarding the purposes for which advances may be made. The increasing volume of bank advances over the last few years represents a response to, as much as a cause of, prevailing economic and financial conditions. As prices rise, a greater amount of money is necessary to finance the same volume of business.

The post-war inflation in Australia does not stem primarily from government fiscal policy (which is, in a sense, disinflationary rather than inflationary), nor from the expansion of bank credit (which has been largely unavoidable). *The root cause is to be found in the continued rise in the money incomes of the community—in the incomes of farmers and pastoralists as a result of "Himalayan" export prices; the incomes of wage earners, and, to a less degree, of salary earners; and, to a small extent, in the incomes of industrial companies and private businesses.* The fundamental causes, however, are to be found in export and wage incomes.

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EXPORT INCOMES

The following table gives the figures of export income:

	Export Income (excl. gold)	Increase on previous Year Mentioned
1938-9	£123m.	
1945-6	£197m.	£74m.
1946-7	£309m.	£112m.
1947-8	£406m.	£97m.
1948-9	£547m.	£141m.

It will be seen that income received from exports has increased from £123m. in the last pre-war year, to £547m. in 1948-9. The significant fact is that this remarkable gain is due almost entirely to a tremendous increase in export prices, and hardly at all to any improvement in the volume of goods exported. Moreover, the increase of £141m. in 1948-9 far surpasses even the remarkable gains in the three years that preceded it. *Here is to be found the prime cause of the Australian inflation, and, in very large part, the explanation of the labour shortage, of the buoyancy of government revenues, and of the pressure of monetary demand throughout the economy on available resources.*

Of the total export income of £547m. in 1948-9, wool contributed £232m. And, of the increase of £141m. in export income during that year—which caused a great intensification of the inflationary pressure — wool accounted for £83m., wheat, which was second, for only £17m., butter £3m., sugar £10m., meat £7m., and lead £9m. Plainly, wool is a key factor in the Australian inflation.

Before the war, a prolonged continuation of heavy receipts from exports and the accumulation of overseas funds might have led to an appreciation of the Australian-sterling exchange rate, which would have softened the inflationary effect of high export prices on Australia's internal economy. This has not been done, perhaps for very good reasons; (on the contrary, the Australian £, along with sterling, has been devalued in terms of dollars, which must tend to aggravate the inflationary impact of high overseas costs and prices on Australian prices). Nevertheless, if it is unwise to use the natural weapon of the exchange rate for combatting inflation, there are stronger reasons than ever for taking vigorous steps to contain increases in internal incomes within reasonable limits. Theoretically, this could be achieved through applying income stabilisation schemes to the main export industries, through a large budget surplus, and through limiting increases in wages and salaries, which form the great bulk of personal incomes.

Stabilisation schemes would, however, achieve little unless applied to wool, and here there are great technical difficulties. So far as fiscal policy is concerned, the Commonwealth Government has already achieved fairly sizeable budget surpluses, although they might have been much larger, if taxation rates had been increased and government expenditure had been reduced. Heavier taxation rates would, however, have been largely undesirable because of their effects on production. The scope for large-scale economies in government expenditure, on the other hand, is not unlimited, although there is no doubt that government spending could be cut in some directions with beneficial effects, and that swollen staffs could be reduced, thus helping to relieve the manpower scarcity in productive industry.

WAGES AND SALARIES

This brings us to the question of wages and salaries. The total wage and salary bill expanded by £128m. in 1947-8, and by a further £151m. in 1948-9. These are extraordinary increases, for which there is probably no close parallel in our economic history. They are due, in part, to the effects of the 40 hour week on overtime earnings, in part to the interim increase in the basic wage of 7/- and increases in marginal rates, and, in part, to the quarterly automatic cost-of-living adjustments. Of the increase of £151m. in the total wage and salary bill in 1948-9, probably about £50m. to £60m. is accounted for by cost-of-living adjustments.

With the possible exception of wool, it is unlikely that the current financial year (1949-50) will see any large addition to export incomes. Export prices seem to have reached, and in some instances to have passed their peak. They will, however, in all probability, remain high, so little positive disinflationary effect may be expected from this quarter. Wages and salaries on the other hand are almost certain to rise—possibly substantially — because of the self-perpetuating momentum imposed by the quarterly revisions.

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The prospects of an early alleviation of inflation are therefore anything but bright. We have given reasons for thinking that the possibility of cutting temporarily the link between prices and wages should, under present conditions, be given serious consideration.* But this step, which is admittedly a drastic one, would certainly be bitterly (and rightly) contested by the trade union movement, unless it represented part of a concerted plan of attack on inflation, in which all sections were required to make comparable "sacrifices."

It would be necessary, for instance, for employers on their side, to give a clear undertaking that they would exercise the greatest restraint in fixing selling prices and that, as a general rule, dividend rates would not be increased above the average levels of the past few years. Such an undertaking could best be given through their main representative bodies who would have to call on their members to faithfully observe the need for limiting their dividends in the interests of national economic stability.

Inflation is as much a problem for the people as for the Government. Unless the various sections of the community, and particularly employers, trade unions, and primary producers, are prepared to bring a high sense of duty and responsibility to national problems, and to do whatever the economic situation demands, the Commonwealth Government's position on this, as well as on other major matters of economic policy, would be rendered well-nigh impossible. Equal sharing of responsibility and of sacrifices is the key to the solution of inflation, as, indeed, it is to so many other national problems.

Table I.

TEMPO OF INFLATION IN AUSTRALIA 1939-49

	1939-41 First 2 years of war	1941-43 First 2 years of Pacific war	1943-45 Last 2 years of war	1945-47 2 Post war years	1947-49 2 Export Boom years
			TOTAL INCREASE		
Volume of Money £m.	9	75	686	142	396
Wage Rates, Pence per Hour	2¾	3¾	—¼	4½	12
Retail Prices, Points	11	14	—1	7	27
Wholesale Prices, Points	20	21	2	8	41
Export Prices, Points	18	10	19	108	68

Note: The quarters begin and terminate July-September of years stated and the prices indices are based 1936/7-38/9 = 100.

Source: "Monthly Bulletins of Statistics"; "Statistical Bulletins," Commonwealth Bank.

*It is interesting to note that the Trade Union Congress in Britain has proposed a temporary suspension of sliding scale wage arrangements linking wages to prices.

Table II.

INFLATIONARY DEVELOPMENTS IN AUSTRALIA COMPARED WITH TRENDS OVERSEAS.

	Wholesale Prices Sept. 48-Sept. 49	Vol. of Money June 48-June 49	Hourly Wages Sept. 48-Sept. 49	Export Income 1947/8-48/9
		Percentage Variation		
Australia	+8	+10	+9	+35
New Zealand	—2	+2(1)	N.A.	+5
United Kingdom	+4	+1	+5(2)	+26
Canada	—2	+7	+6	+8
United States	—9	—1	+1	—9

(1) March 48-March 49.

(2) April 48-April 49.

Source: Commonwealth Bank "Statistical Bulletin"; U.N. Monthly Bulletin of Statistics; Government Statistician, New Zealand.

Notes.

The accelerating tempo of inflation in Australia in the last two years is graphically illustrated in Table I above. Soaring bank deposits, as a result of abnormal export returns and great increases in money wages and salaries, are swelling the money supply at a rate only comparable with that which was required to finance the astronomical needs of war.

The policy of price and wage stabilisation, which helped to keep the inflationary trend within reasonable bounds for the first two post-war years, was relaxed just when an immense new inflationary factor, in the shape of soaring export prices, was making itself felt. Over the last two years internal prices and wages have been increasing three or four times as fast as during the earlier post-war years.

Table II clearly indicates that all inflationary factors—prices and wages, the volume of money, etc.—are at present increasing at much greater rate in Australia than in the other English-speaking countries. Costs in the United States are falling, exchange appreciation has contributed to a decline in prices in New Zealand, while reasonable stability of prices, incomes and the money supply has been achieved in Great Britain as a result of firm counter measures to inflation. The effect of the devaluation of sterling on British prices and finances is not yet clear.

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