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Full Employment and "The New Economics"

The day is drawing closer when the modern policies of full employment will be put to the test. So far there has been no test of the validity of the new theories. Notwithstanding the claims of politicians, full employment since the war, in Australia as in other countries, has not been the outcome of the application of any economic plan or theory; it has been an automatic response to world economic conditions brought about by six years of total war. The central economic problem since the war has not been one of providing employment or avoiding depression, but one of preventing runaway inflation. Not that the two problems are not in the long run intimately related; for those countries which have been most successful in controlling their post-war inflation will enter the fight against world recession better equipped than those countries which have not been so successful.

"THE NEW ECONOMICS"

Nevertheless, "the new economics," set out in numerous government White Papers and in the writings of economists all over the world, have yet to be subjected to the ordeal of practical experience. They are still theories and no more; theories untested and unproven.

Almost in their entirety, the new proposals for maintaining employment and preventing depression are an adaptation of the theoretical structure erected by the late Lord Keynes. (This is particularly true of the Australian White Paper on Full Employment published in 1945.) In essence, they are based on the idea of maintaining and stabilising effective demand, in the event of a threatened decline, through government action to sustain spending by reduced taxation, expanded social benefits, deficit financing and public works, with government spending compensating for the contraction in private spending.

The disciples of Keynes have swallowed these ideas with an indiscriminating rashness which would certainly have shocked the master himself. Keynes, with his extraordinary flexibility and his notorious habit of changing his mind, would probably have been the last to claim that his writings constituted the final word on the business cycle. That he contributed uniquely and greatly to our understanding of the causes of depressions, and of the practical issues which have to be resolved if full employment is to be maintained, is beyond dispute. But in the application of his theories in government White Papers and in contemporary economic discussion there are evident a reckless intellectual abandon and an almost unthinking confidence in their validity.

But Keynes would have been the first to admit that he left many vital questions unanswered. The fault is not with Keynes, but with his followers. The Keynesians have read into Keynes far more than he intended, and have applied his theories in a manner that he would probably never have countenanced.

For one thing, the Keynes' theories were largely evolved on the assumption of a closed economic system, and they do not provide obvious or adequate answers to those intricate practical problems that arise in an international system where the economies of most countries are linked intimately and inevitably with those of other countries. Australia, of all nations, despite the tendency to policies of self-sufficiency by Labour Governments, is one whose economy least resembles a closed system, and one, therefore, where the Keynesian thesis needs to

be applied with the utmost caution and with all those reservations necessary in the sensible practical adaptation of any theoretical structure.

OVER-CONFIDENCE

There is thus an over-confidence in the new theories, in Australia as well as abroad, an over-confidence that has led to a deficiency of discussion and critical enquiry which could prove to be a major source of weakness in the event of a world recession. The impact of a recession on Australia might well find us armed with little more than a set of theoretical principles, but with no down-to-earth practical programme of action. For instance, there has been singularly little attempt to analyse the probable form and course which a recession would take in this country, the industries which it would most seriously affect, and how far the Keynesian remedies would prove applicable to an economy whose fortunes are inextricably bound up with those of the main industrial nations abroad. *Also, if the maintenance of full employment is to take precedence over all other objectives of economic policy (as most people believe it should), what contribution and what sacrifices of their immediate objectives need to be made by various sections of the community—particularly trade unions and employers—if the overriding aim is to be achieved? On this question, there has been a notable silence.*

The truth is that Australia has, at present, no realistic plan for maintaining employment in the event of the collapse of the world post-war boom. We have a Government White Paper (published five years ago in 1945) which is little more than a series of academic principles, and which unconvincingly skates over the obvious practical difficulties of the policy it proposes; we have a £743,000,000 programme of public works, which, while useful, no thinking person would accept as amounting to anything like a complete remedy for a serious recession in the private sector of industry,* and we have ran-

*The difficulties of timing a vast public works programme to compensate for large fluctuations in private spending are immense. Labour is notoriously immobile. Naturally enough, a man who has established a congenial life in a centre where his home, friends and interests lie, does not take kindly to the thought of moving to a remote area such as the Snowy River or Kiewa. There is also the difficulty of getting the right types of labour for public projects. People displaced from private industries might, in very many cases, not be suitable. Also large public works require huge supplies of constructional materials such as steel, cement, timber, and also adequate heavy machinery and equipment. There is no certainty that they could be organised on the scale required.

dom papers by different economists, some of practical utility, but none offering a comprehensive and water-tight programme for maintaining employment in Australia under conditions of world recession or depression.

It is, therefore, highly necessary that the over-confidence at present manifest in the absence of discussion on full employment and in the arrogant assumptions of the Keynesians, should give way to that intellectual humility which is the precursor of serious questioning and scientific analysis. *It is not enough that this inquiry should be confined to economic theoreticians; for the practical man, in both business and trade unions, has much to contribute to this subject, and, one might add, much to learn about his responsibilities if world recession is to be successfully surmounted in Australia.*

RECESSION AND INFLATION

What are some of the questions to be answered?

The Keynesian thesis, briefly stated, is that a decline or threatened decline in private spending, or in the private sector of the economy, should be offset by government measures to subsidise consumers through adjustments of taxation and social benefits, by the maintenance of wage rates, and by compensatory spending by governments on capital works and public projects. *But would these measures prove effective if the decline in private spending were brought about through a severe reduction in export income following upon a collapse of overseas prices?* This would almost certainly be the pattern of the recession in Australia. Previously, situations of this kind have been met, and eventually corrected, usually after prolonged unemployment, largely by internal deflation.† The effect of deflation was to restore the overseas position by reducing domestic prices and costs, thus discouraging imports and encouraging exports. The internal economy also responded as a consequence of the effect of a reduction in costs on the profit expectations of businessmen. This policy clearly imposed great sacrifices of a temporary character, particularly on the wage-earning sections of the community.

†In the Great Depression (1929-1933), the corrective measures included inter alia a 10% cut in wages, a 22½% reduction in interest rates, lower salaries, and rentals, and a heavy reduction in government expenditure.

"The new economics" proposes a course almost exactly the reverse of this. In other words, a threatened collapse in private spending, resulting from falling export prices and an unfavourable overseas balance of payments, is to be countered by a policy of internal inflation and the maintenance of wage rates. *How this policy can be carried out without aggravating the overseas balance is by no means clear.* And if that should prove to be the case, how would we maintain the volume of imports of essential raw materials and equipment necessary to keep our industries in full production, and for public projects? *And how would the export industries continue to operate on an economic basis to provide employment where their returns were being squeezed between falling prices overseas and rising or stable costs at home? How, too, would those manufacturing industries in competition with overseas suppliers continue to compete successfully under conditions of rigid internal costs, when overseas costs were declining?*

It is no answer to these questions to say that it is the responsibility of the main overseas nations to maintain their economies in a state of high activity and full employment and thus prevent any catastrophic fall in world prices. What if those nations prove, for one reason or another, incapable of fulfilling their responsibilities?—and that is the assumption on which we must work.

THE WAGE LEVEL AND EMPLOYMENT

Many of the disciples of Keynes have also deplored any idea of a fall in wage rates in order to counter recession and maintain employment. A fall in wage rates, they point out, reduces demand and spending, as well as costs, and therefore aggravates the condition it would correct. As a theoretical proposition this contains some elements of truth. But if effective demand could be expanded and unemployment prevented simply by increasing wages then full employment would be absurdly easy to achieve. The proposal does not resolve the practical issue of how a large section of Australian industry could be maintained in profitable operation if Australian wage rates were rigidly fixed in face of declining costs abroad. Is it not conceivable that under these conditions a rigid wage structure would delay recovery and intensify depression?

These are practical doubts which arise and which the Keynesians have by no means convincingly answered. Indeed, so far as wages are concerned, they have almost been inclined to argue, and they have certainly been instrumental in spreading the notion, that the level of wages has little relationship to the level of employment, except that a declining wage rate is, under any conditions, bad for employment. Has the level of wages in an international system no effect on the level of employment? It would certainly be remarkable if it had not, since wages constitute the great bulk of costs, and it is on the level of costs and on expectations of profit that businessmen base their plans for production and investment. It seems highly probable, on the contrary, that the average level of wages is the most important single determinant of the volume of employment.* The trade unions as well as all other sections of the community should give this question the most serious thought.

Do the trade unions seriously think that wage rates can be pushed almost to any height without adversely affecting employment? That is certainly a relevant question under today's conditions, just as in the past, one might have been justified in asking employers if they thought wages could be recklessly slashed without reducing the demand for their products—and thus their profits.

The Keynesian remedies would appear to have more validity, if, when a recession hit us, our prices and costs were not too far out of line with prices and costs abroad. But what if our wage and cost structure were greatly above overseas levels when the world boom broke? Would the cure for internal inflation at home and external deflation abroad be still more inflation at home? Or would we be faced with the painful neces-

*Whether, at any given time, a rise or a fall in wages would tend to increase or reduce the volume of employment, depends on the relationship of costs to prices, and on the general economic situation when the change is contemplated. Under certain conditions to raise wages might reduce employment, whereas under other conditions it might increase employment. The same applies to a lowering of wages. It is economic nonsense to assume that any increase in wages is, at any time and under any conditions, good for employment, just as it is economic nonsense to argue that, at any time and under any conditions, a reduction of wages is bad for employment.

sity of adjusting our wage-cost structure to the lower level of overseas wages and costs?

The policy with which Australia met the last depression—the famous economists' or premiers' plan—has been very severely criticised since for its deflationary elements, particularly the "10% wages cut," by the proponents of the new economics. But it did prove highly successful at the time in stimulating recovery and lifting Australia out of the depression more rapidly than was the case in most other countries. And it was praised in the highest terms by Lord Keynes himself.† Perhaps, faced with the same circumstances again, we would find that we could not do anything greatly different. Certainly the remedies would be applied earlier, but they might not prove to be basically dissimilar.

PREVENTION NOT CURE

What, if any, conclusions emerge from this? One of overriding significance—that the best remedy for a depression is never to get into one. Preventive measures are infinitely more important than the curative. The cure, if we are forced back upon it, is almost certain to be unpleasant, almost certain to require great "sacrifices" on the part of the patient. The seeds of depression are sown in prosperity, and if we do the wrong things when we are prosperous, we will find it exceedingly difficult to avoid depression, and to escape retribution for our misdeeds.

The invariable lesson of economic history is that the greater the boom the deeper and more disastrous the subsequent depression. It is one we would do well to heed in Australia just now. We have already let the post-war boom in Australia develop beyond the bounds of all reason and commonsense. We should endeavour to retrace our steps while there is yet time, and time is rapidly running out. What does this imply? It implies a strong policy of disinflation, in which all sections of the community must join, in an effort to stem further rises in prices and costs and to achieve a measure of stabilisation.

In a report on full employment prepared by a panel of five economists of world reputation for the Economic and

†In 1933, Keynes wrote: "I am sure the Premiers' Plan last year saved the economic structure of Australia."

Social Council of the United Nations*, it is suggested that "if labour unions, farmers, groups, trade associations, cartels or business monopolies press for increased earnings in such a way as to produce a continued upward pressure on prices," the success of the policy of full employment will be endangered.

THE CO-OPERATION OF ALL

There seems to be a bland assumption in some quarters that full employment is a matter that can be delegated to the government, and that so long as governments do the right and intelligent thing, the rest of us can be left to pursue our own courses and profit with a happy mind and a clear conscience. Nothing (as the United Nations Report, just quoted, implies) could be further from the truth; and nothing is more dangerous. *The truth is that no government, and no government policy, can be successful in preventing depression without the full understanding and co-operation of the different sections of the community.* This is another fact which the Keynesians tend to overlook. What is economically wise is, unfortunately, not always politically practicable. As we have said before in this journal, economic stability is impossible in an unstable and irresponsible community.

In an economy rigidly planned and tightly controlled from top to bottom, it might be true—although it is by no means certain—that a government could do all that was necessary to assure full employment. But in a free economy (and most Australians show by their actions, if not by their political professions, that they believe in a free economy) all sections of the community must make their contributions toward the objective, or the objective will most certainly not be achieved. The supreme test of the workability of a free society lies in the willingness and ability of its members to act responsibly

*This important report has just been published and bulk supplies, at the time of writing, have not yet reached Australia. The panel of economists consisted of Prof. John Maurice Clark, of Columbia University; Prof. Arthur Smithies, of Harvard; Nicholas Kaldor, Fellow of King's College, Cambridge; Pierre Uri, economic and financial adviser to the Commissariat General du Plan in Paris; and E. Ronald Walker, economic adviser to the Australian Department of External Affairs.

and intelligently. Without a decent measure of responsibility we will fall again into depression and unemployment, and in that eventuality it is conceivable that we would vote ourselves into the economic tyranny of the totally planned state.

A TIME FOR GREATNESS

It is for this reason that the supporters of free enterprise have probably far more at stake in the continuance of full employment than any other section of the community. In another depression the losses of business would be much more than mere financial losses; they would be much more than those involved in falling profits, in intense cut-throat competition (with every man for himself), in a mounting roll of business casualties, with the weaker and the more unfortunate going to the wall. They would be losses of personal liberty and business initiative and freedom of enterprise.

What must be clear to all men who think is that another depression of any proportions, by which is meant one in which unemployment rose to 15% or over, would be well-nigh fatal to the political and economic interests of private enterprise. The people would rise in their wrath to denounce a system that could not apparently provide regular work for its members and a new and irresistible impetus would be given to doctrines of socialistic planning. For this reason, if not for the narrowly financial reason, it is imperative for the business community to do everything within its power to aid, encourage, finance and indeed demand further inquiry into the problem of full employment. This is of all times, a time for business interests to display that vision, selflessness, and sense of urgency, and to provide that leadership, without which, apart from an undeserved stroke of miraculous good fortune, the system of free enterprise will not survive. It is, indeed, a time for greatness.

