PRICE SUBSIDIES

The following comprises the full text of a statement on price subsidies issued to the Australian press on the 2nd February, 1950, *by the Editorial Committee of the Institute.*

1. The re-introduction of price subsidies as one of the main weapons of attack on inflation would be wasteful, ineffective and unwise. It could not, of itself, prevent increases in prices and living costs, while the basic conditions for effective price stabilisation (i.e. the pegging of wages and other incomes) are lacking. Admittedly, subsidies under present circumstances might help to slow up the *rate* of increase in costs and prices; *but any advantage in this direction would be far outweighed by their manifold disadvantages.*

2. Subsidies were first introduced at a critical stage of the war in July 1943 as part of a plan to impose a virtual price ceiling at the level of prices ruling on the 12th April, 1943. They covered potatoes, tea, milk, coal, fire-wood and certain imports (mainly textiles). Subsidies were later extended to include rubber, tobacco, raw wool and coastal shipping freights. Basic wage increases due to quarterly cost-of-living adjustments were also absorbed by the government by refunding employers.

3. This policy was on the whole successful, as over the four years from the introduction of subsidies until late 1946 increases in the retail price index were practically negligible. But in 1947 the retail price index began to rise as basic wage subsidies were cancelled and price increases were permitted to meet rising import costs. *It is clear from this that price stabilisation through subsidies is only practicable where virtually all domestic costs, especially wages, are pegged.* To achieve price stabilisation where those costs are free to move, and when import costs are rising rapidly, would require a prohibitive level of subsidy payments. Over the two years 1946/7 and 1947/8 retail prices rose by 12%, and wholesale prices by 17%, in spite of payment of subsidies amounting in all to nearly £60m. Following the prices referendum in May, 1948, price subsidies were progressively withdrawn and, with the exception of the tea subsidy, were all terminated by 31st October, 1948.

4. Two main arguments which are advanced in favour of subsidies are:

(a) To protect the lower incomes from the impact of rising living costs by the payment of subsidies on essential consumer commodities.

(b) To offset the cumulative, spiralling, inflationary effects which arise in the Australian economy because of the nexus between wages and prices under the quarterly cost-of-living revisions. This is easily the most potent argument.

5. The arguments against the use of price subsidies to prevent inflation are, however, overwhelming.

(a) In the absence of other measures, subsidies can only ameliorate the wage-price movement; they cannot prevent it. They do not tackle the problem of inflation at the source; in effect, they accept the existence of inflation and endeavour to offset its impact on the price structure. They, therefore, tend to divert attention away from the real basic remedial measures which must be taken if inflation is to be overcome. They are no substitute for strong measures to deal with the root causes of inflation. *They tackle the symptoms of the disease, not the disease itself.*

(b) They are a negation of the free price market, and therefore mean the abandonment of the advantages which the free price market has to offer in the way of securing the most economic distribution of resources, of encouraging the production of commodities in scarce supply, and of providing maximum incentives to efficiency.

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(c) The amount of subsidy tends to be based on the costs of the least efficient producer and there is thus little incentive for the more efficient producers to raise their efficiency and lower their costs. Since producers know that rises in costs will be covered by subsidy, the incentive to reduce costs and thus prices is weakened. *It is almost elementary in economic theory that subsides inevitably tend to result in high costs of production in subsidised industries.*

(d) They require a complicated and extensive administrative machine if they are to be effectively administered—otherwise the scope for serious abuse would be considerable. Since the virtual abandonment of subsidy payments and the relaxation of price control, it is doubtful whether this machine any longer exists. Moreover, since authority for subsidies rests with the Federal Government, and authority for price control with six different State Governments, the basic requirement for an effective administration, namely a single controlling authority, is lacking.

(e) Since any claim for an increased subsidy requires rigorous scrutiny of the costs and profits of the producer or industry making the claim, the whole process of price adjustments, and therefore of business and trading, becomes slow and cumbersome. When subsidies were in operation, delays in obtaining price approvals frequently amounted to more than three, and sometimes as much as six, weeks. This meant that merchandise, which would otherwise have been immediately available to the public, had to be withheld from sale pending decisions by the prices authorities.

(f) *Because subsidies are, of necessity, concentrated on essential commodities the prices of those commodities are held down by comparison with the prices of non-essentials, and manpower and materials are diverted to the latter fields instead of to where they are needed most.* This result also follows from the fact that because the prices of the necessities of life are kept down, people have more to spend on the non-essentials or on the luxuries. The effect of the gigantic food subsidies in Great Britain in releasing money for football pools, gambling, and trumpery types of spending is notorious. The present mal-distribution of labour and resources between industries is retarding Australian development and is one of the most serious aspects of the Australian economy.

(g) *Subsidies are a wasteful form of assisting the lower income groups because they also assist the higher income groups which are not so much in need of assistance.* It would be far more sensible to provide assistance for the lower income groups by special family allowances or by increasing pensions and in other ways.

(h) *Subsidies add greatly to the costs of government expenditure and, therefore, increase taxation.* Subsidies, thus, have certain inflationary tendencies; firstly because they reduce incentives at a time when greater production is urgently needed; and, second, because they make the attainment of a disinflationary budget surplus more difficult.

6. Price subsidies are no solution to the problem of the Australian inflation and of rising prices and living costs. A policy of a much more fundamental character is required.

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