THE I.P.A. REVIEW

INSTITUTE OF PUBLIC AFFAIRS — VICTORIA

289 Flinders Lane, Melbourne — Victoria

Central 1249

Vol. VI MARCH-APRIL No. 2

CONTENTS

The Import Cuts

THE policy of import restriction announced by the Federal Government on March 8, is the most far-reaching economic measure (excluding wartime) taken in this country since the depression of the early thirties. The frighteningly rapid depletion of our overseas balances over the last few months had suggested that some degree of quantitative import control would be unavoidable. But the extent and severity of the restrictions surprised everyone.

The effect of the Government's decision is to reduce imports from an estimated £1,100 million for the current financial year, 1951/52, to possibly between £500 million and £600 million for the year 1952/53—a cut of about 50% in value, and, if import prices continue to rise, by more than 50% in quantity. A large range of goods considered the least essential will be cut by 80% below the value imported in 1950/51. These include motor cars, washing machines, textiles, and clothing, cigarettes and tobacco, whisky, china and glassware, cement. Other items considered somewhat more essential will be reduced by 40%. Among these are coffee, cocoa, cotton goods and timber. Some goods, such as tea and petrol and oil, may not be cut at all.

WHATEVER one may think about the import cuts—and there is no doubt that they represent a near economic tragedy for this country—in view of the position that had arisen, the Commonwealth Government was compelled to take immediate corrective action. The flow of imports was so greatly in excess of the income we are earning from our exports that funds held in London were disappearing at a truly alarming rate.

The bald facts can be briefly stated. At the end of the 1950/51 financial year, London funds stood at the record figure of £845,000,000. On the face of it we were entitled to feel that our position was reasonably

OVER

secure against any adverse movement in our trade position. But six months later, by December 1951, overseas balances had declined alarmingly to £544,000,000. And the worst was yet to come. Throughout January and February this year, the volume of imports was so great and so much in excess of export earnings that overseas balances had fallen by another £100 million. At this rate it was clear that soon Australia would have nothing in the bank at all, and the Government was forced to take decisive steps.

WHAT, then, were the causes of this extraordinary deterioration in our external position?

First and foremost was the near collapse in export income brought about by the sharp decline in wool prices. From the peak price of 202 pence per lb. in March last year wool had fallen to 71 pence per lb. by February, 1952.* In the current financial year, export receipts from wool are estimated at £300 million as compared with £636 million in the previous year. Total income from exports for the current financial year may be of the order of £650 to £700 million, compared with £979 million for 1950/51.

Second was the immense increase in the value of imports. Part of this was caused by rather over-optimistic estimates by many importers of market prospects in Australia. These estimates were based in part on the abnormally buoyant trade of the early months of 1951 which was akin to a buying panic on the part of the public. They did not make sufficient allowance for the degree of this trade that was attributable to forward buying by Australian consumers in anticipation of future price rises; nor did they make allowance for the steady development of buyer resistance throughout the Australian economy to the high level of prices. Even these miscalculations might not have had such catastrophic effects had it not been for a strangely unfortunate combination of circumstances which was almost impossible to predict. For years past Australian importers had been in the habit of ordering goods for delivery dates ahead of requirements in orde[r] to ensure seasonal deliveries on time. This wa[s] necessary owing to delays which took place i[n] manufacturing overseas, and to delays arisin[g] from shortages of shipping and slow turn-rounds The heavy ordering which followed upon th[e] abnormal buying of early 1951 happened to coincide with a recession in some trades—particularly clothing and textiles in Britain and America. As a result goods were delivered more speedily; also the shortage of shipping was resolved, as i[t] were, overnight. Australian importers wer[e] then suddenly embarrassed by the rapidity wit[h] which outstanding commitments were delivere[d] from mills and factories overseas, and also by th[e] prompt shipment of such goods. Broadly speaking, twelve months' supplies of goods arrived i[n] Australia within six months. This was the immediate cause of the import crisis.

The third, and perhaps most fundamental reason for the crisis arose from severe inflationar[y] pressure which has persisted in the Australia[n] economy in the postwar years in spite of th[e] efforts that have been made to stem the tide.

THE economics of this are simple. The externa[l] balances are to a large extent a reflection o[f] internal financial conditions. Inflation is simpl[y] the process of trying to spend more and more o[n] a static, or only slowly increasing, supply o[f] goods and services—the familiar process of "to[o] much money chasing too few goods." This spending may be made by individuals in a persona[l] capacity, or by businesses seeking additiona[l] quantities of materials or equipment or labour or by governments in their various activities When available supplies fail to keep pace wit[h] the money demand, competition for the shor[t] supplies ensues and prices rise. Where home pro duction is inadequate, the excess spending spill[s] over into overseas sources of supply and th[e] quantity of imports rises correspondingly. S[o] long as the inflation of export income matche[s] the heavy demand for imports made possible b[y] too much money, there need be no balance o[f]

* Average price, greasy basis.

payments problem. But should export incomes be suddenly deflated by a fall in export prices, then a serious deficit in overseas payments sets in.

An important contributory cause—perhaps the root cause—of the Australian exchange crisis is thus internal inflation or, in other words, an increase in the level of money incomes, and consequently costs, not paralleled by increases in productivity. The more serious the extent of inflation, the more critical is the external payments problem likely to be.

A curious feature of the crisis, and one of which the general public are quite unaware, is the manner in which our overseas balances were built up from £208 million in June 1946 to £843 million five years later in June 1951. The addition to overseas reserves over this period of £635 million is almost identical with the large amount of capital invested in this country by private sources abroad. A good part of this represents permanent investment by overseas interests in Australian industries. But a sizeable proportion represents money placed in this country by overseas speculators and held in liquid form in the hope of exchange appreciation. The amount of this "hot money" is impossible to estimate, but it could possibly range from anything of the order of £100 million to £200 million. There is also a large amount of money brought here by immigrants which cannot be assessed. At the same time on the other side of the capital ledger we paid off overseas debts to the tune of £81 million.

THE volume of imports that has nourished the Australian economy over these years has thus in great part been made possible only because of an abnormal inflow of capital. It is clear that as a nation we have been living far beyond the standard justified by the scale of our own efforts and by our current earning capacity. We must now expect that the inflow of capital will diminish rapidly—there are already signs that this is occurring—and this must add to our difficulties.

It is possible that the import restrictions will be of long duration. It would be wrong to regard them merely as a temporary emergency measure to meet a temporary crisis that may soon pass. The truth is that the Australian balance of payments crisis is something deep-rooted in the instability and weakness of the Australian economy and it is likely to be with us until those instabilities and weaknesses have been eradicated.

In the meantime the immediate outlook is for reduced standards of living all round—with the greatest burden falling as always on the long-suffering unorganised middle classes—and for a greatly reduced rate of development in both government works and private business. It should be clear that it is impossible to cut the volume of imports by 50% or more without the most serious consequences on standards of comfort, on business prospects, and on national development. The immediate prospect is for further inflation, still higher costs and prices. With the reduction of competition, a stimulus will inevitably be given to high costs and inefficiency and to uneconomic forms of production. By tight control the Government may be able to offset the latter, but it has no weapon for coping with the former.

In addition, we are being forced back, despite all our efforts to break free, into a tightly controlled economy. The import restrictions will inevitably vest immense powers in a bureaucracy, most of whose members will have little experience of business processes. Fresh encouragement will be given to the black marketeer, the under-the-table transactions, and to all those parasitic elements operating on the murky fringes of the economy. *And most serious of all, the great developmental programme, on which the prospects of expanding the production of essentials and the future of Australia as a nation so largely depend, will be gravely interrupted.* And this will still be substantially true, even if we are successful in obtaining dollars from the World Bank.

Some of the more drastic features of the imports cuts might have been avoided had there

OVER

existed a closer liaison between the Government and business. For instance, the trend of imports might have been more accurately assessed had the Government been furnished with statistics of the forward commitments of importing firms.

THE balance of payments crisis is at root a crisis of low productivity and inadequate production—inadequate production of exportable commodities and low productivity in many branches of the Australian economy. The attempt to carry out, at the same time, a large developmental and immigration programme, to expand private business at an unprecedented rate and to build up standards of living, at an ir adequate level of production, must lead t inflationary instability with rising prices. Th is what has happened.

The two courses before this country—and th are inter-related—are to greatly expand produ tivity and to correct inflation. The former is ea to talk about but difficult to achieve. What certain is that we will never achieve it unle there is a drastic overhaul of the whole Austr lian attitude to this problem. The latter may y mean that some cuts in the income structure ma be forced on the Australian economy.

AUSTRALIA — EXPORTS AND IMPORTS

	1945/46	1946/47	1947/48	1948/49	1949/50	1950/51
	£A.m.	£A.m.	£A.m.	£A.m.	£A.m.	£A.m.
Exports of Merchandise	150	265	397	522	595	979
Import of Merchandise	110	208	338	415	538	743
Trade Surplus (or deficit)	+40	+57	+59	+107	+57	+236
Invisible Items (net)	+5	—105	—55	—79	—106	—152
Current Balance of Payments	+45	—48	+4	+28	—49	+84
Capital Inflow	+11	+49	+86	+147	+249	+122
Government Capital Transactions*	—49	—18	—15	+3	—14	—13
Gain/Loss London Funds	+7	—17	+75	+178	+186	+193

*Includes Repatriation of Overseas Debt J. O. Wool Transactions I.M.F. and I.B.R.D. transaction

NOTE: For the first eight months of the financial year, 1951/52, payments for imports exceed earnings from exports by £318 million. Over the same period last year, exports exceed imports by £108 million. Imports for the eight months to the end of February, 195 were 64% greater than imports for the corresponding period of the previous year, whi exports showed a decline of 21%. In the eight months since June 30 last, overseas balanc have declined by approximately £400 million, representing the total net deficit on tradin on invisibles and on capital account.