WHAT IS AHEAD?

THE last issue of "Review" for 1952 is an appropriate one in which to assess briefly the economic and financial prospect for the next twelve months or so. Such an assessment cannot pretend to any high degree of definity. Economic prediction is in any case a perilous pastime. When it is reduced to terms of mathematical certainty it enters the realm of intellectual bravado.

Today we are inclined to judge business conditions by the boom years of 1950 and 1951 and to entertain the rather pious hope that these conditions may return. But to get our ideas in the right perspective we should recognise these years for what they were—that is, years of altogether abnormal prosperity brought about by unimaginably high prices for wool and an unprecedented inrush of capital from abroad. The combination of circumstances which gave rise to the "enchanted evening" of 1951 is not likely to be repeated for many years.

Experience since the war shows that business conditions in Australia are still largely governed by the size of the export cheque. Indeed one might go even further and say that business prosperity in Australia varies with the price the world is prepared to pay for one product, wool. Certainly the businessman, anxious to assess the probable state of business conditions and confused by intricate economic analysis, could do much worse than keep both eyes glued on the wool market. Seasonal variations in the average price of wool can add tens of millions of pounds to spending power within Australia.

So far in this financial period, wool prices are holding up encouragingly and the average price for the whole year may be somewhat above that of 1951/2. With the possibility of lower returns for metals—because of reduced prices—and for wheat—because of a smaller acreage—export income may be around the same level as last year, say £650 to £700 million.

WHY does the size of the export cheque exert such a decisive influence on business in Australia?

There are three reasons:

1. It decides in large part the level of spending. The exporter receives a greater income; he spends more; the people from whom he makes his

purchases thus increase their sales; in turn they have more money to spend, and so on in a kind of chain reaction. The material and psychological inducement to business expansion is strengthened. The economist has summed up this sequence of events in the technical term "multiplier." It simply means that a given increase in export income tends to multiply spending in the economy by several times the amount of the increase iteslf. The total economic influence of a given addition to export income is thus considerably greater than the size of the increase itself.

2. The export cheque affects the liquidity of the banking system and consequently the amount of credit which the banks are able to extend without financial embarrassment. An increase in export income means an increase in deposits and a reduction of overdrafts and therefore an improvement in the lending capacity of the banking system.
3. A higher export income means that Australia is able to purchase more imports without running down essential overseas financial reserves. The larger proportion of imported products, contrary to popular opinion, consists not of consumer goods, but of materials and equipment necessary for the healthy expansion of industry within Australia.

As we have indicated, Australia should be able to anticipate a fairly high level of export income for the current financial year, although well below that of the boom year of 1950/51. On this ground, then, the business outlook is reasonably promising.

But the prospect darkens when we come to examine the purely domestic economic factors. Here the main immediate influence is the volume of investment made both by private businesses and public authorities. Investment in new plant and additional stocks generates income and spending power in a similar way to export income. An increase in investment provides the people engaged in constructing the plant or supplying the stocks with additional income which they will in turn use to purchase the products of businesses supplying consumer goods. A falling away in investment has the reverse effect.

UNFORTUNATELY the underlying economic conditions which would be conducive to a large volume of private investment—namely, a buoyant business psychology, stock shortages, ample supplies of cheap money, low costs—are at present conspicuously absent. Moreover, the scope for offsetting lagging private capital expenditure through expanding public investment is limited by the chronic scarcity of savings. Indeed programmes of public investment for the current financial year will have to be financed to a substantial degree through the provision of central bank credit. But Treasury Bill finance is an economic drug which can be used effectively and safely only so long as the doses are of moderate proportions. It may soothe or stimulate the patient but it does not touch the underlying causes of his trouble.

The extreme shortage of investment capital is thus a critical point of weakness in the Australian economy at the moment. Interest rates are rising, but are unlikely to attract additional savings on any scale, primarily because the savings are just not there to attract.

There is no easy solution to this problem. Basically the shortage of investible funds can be traced to the heavy demands of taxation on the earnings both of individuals and of companies. The combined effect of high taxes and high costs on these incomes leaves little scope for the accumulation of savings. If Governments, through heavy taxes, slice the fat off the people's earnings, they can hardly expect an overwhelming response to their appeals for loan funds.

Is there any way in which this shortage of savings can be made good? One way is through higher productivity at lower costs which would enable present standards of consumption to be maintained or improved and at the same time lead to increased savings. Productivity in some fields is at present showing an encouraging improvement, but there is little likelihood of raising productivity over the whole economy, in the next twelve months sufficiently to have any marked effect on the general outlook. When a nation becomes geared and accustomed to a certain tempo of work, it is not easy, and it takes time, to raise the tempo.

ANOTHER way to overcome the savings famine would be by obtaining increased capital from abroad. Certainly if Australia were successful in doing this, the whole domestic business outlook would improve immeasurably. But what are the prospects? Overseas capital today means American capital. But it is unlikely that private American investors or lending institutions dominated by the American Government will be induced to put money into Australia in a big way when the return on their investment is likely to prove much less than that obtainable elsewhere, and while Australia continues to suffer chronic difficulties with her balance of payments. One hope—it is probably a faint one—is that as a result of the Commonwealth financial discussions to be held in London in November, the United States may be persuaded to provide developmental capital to the British Commonwealth for primary industry and basic public projects on a substantial long-term basis.

At the core of all the economic difficulties of Australia lies the inordinately high cost structure, and this casts a cloud over the immediate business prospect. *The high level of costs hampers the expansion of vital export production; it acts as a psychological and material deterrent to both private spending and industrial and public investment; it discourages savings; it compels import restrictions; it makes Australia a less favourable place for investment in the eyes of overseas financial interests.* Indeed, in the cost structure is to be found the key to the Australian economic outlook perhaps for the next two or three years. If costs should fall, the economic prospect would greatly brighten.

SOONER or later Australia will have to bring its costs closer to overseas levels. Until that is done, economic policy will proceed by a series of expedients which may—or may not—give strictly temporary relief, but at the expense of greater troubles in the future.

In the immediate future, while the drugs retain their effectiveness and provided export prices hold, there seems little reason to expect a dangerous slump. Nevertheless, it has to be frankly recognised that the happy, but enervating, South Sea Island economic climate of the post-war years has gone. Business, and indeed the whole community, are now confronted with a much more rigorous and challenging environment. Every improvement in industrial efficiency will strengthen the Australian economy and enhance its capacity to cope successfully with the new conditions. This is what business, to play its part, must continue to strive for.