HOW HIGH ARE COSTS?

THE preceding article attempted to show the fallacy of the notion that costs are of minor importance in the world of today where the prime concern of all countries is with domestic full employment. It was argued that no community could confine the effects of its economic and financial policies within its own national boundaries; and that failure by a country such as Australia to keep its costs in line with the broad world march of costs must eventually lead to the economic embarrassment of other countries and to the dislocation of international trade. A country that pursues its own domestic policies in selfish disregard of their impact on other nations must expect to attract retaliatory measures to its own serious disadvantage.

The experience of the inter-war years should have taught us that there is no future in a world where nations either consciously strive after economic self-sufficiency or are unconsciously forced into self-sufficiency because of neglect to keep their costs under control. What chance would there be of real co-operation at the political level in a world where nations were waging economic warfare on one another?

Since the war Australia has experienced the greatest cost inflation in its history. The rise in costs was attributable partly to causes outside of our own control but also to deliberate decisions of policy which might have been avoided.

But, even in face of the unprecedented increase in costs that has occurred, there is a disposition in some circles to argue that Australian prices are, in the main, still competitive with world prices. In evidence put forward on behalf of the unions in the recent Standard Hours and Wages Case, a leading authority on Australian statistics asserted that despite the deterioration in our relative position over the last few years, Australian manufacturers still possessed a 10% cost advantage over overseas suppliers compared with pre-war. This view was re-iterated at an academic forum by a prominent economist who has been close to successive Commonwealth Governments in an advisory capacity. It is perhaps no coincidence that the very people who have suddenly found that Australian costs are not so high after all are often the same people whose expansionist financial ideas contributed to the creation of a climate of opinion which was able to view with so little concern the extraordinary cost increases of the past few years.

The argument that Australian costs still compare favourably with overseas cost levels is derived from statistical averages. The movement in Australian costs, as indicated by the Commonwealth Statistician's index of nominal hourly wages and the Wholesale Price Index of raw materials, is compared with changes in the average level of import prices as measured by the Import Price Index produced by the Commonwealth Bank.

This method has glaring weaknesses, both statistical and other. For instance, the Import Price Index of the Commonwealth Bank includes the prices of imports from the hard currency areas which are not competitive with Australian products and which show a much greater rise than the prices of U.K. imports which form the chief source of competition with Australian production. Moreover the price index of U.K. imports includes essential capital equipment and semi-processed materials which are vital to Australian industry and are uncompetitive with it. These, among many other considerations, make it clear that the only meaningful and realistic basis of comparison is that of relative costs in particular industries. An analysis of these costs gives an entirely different impression to that which one might gain from a cursory survey of overall price indices.

Latest available data on the trend of wages and prices in Australia and United Kingdom is as follows:

	Australia	United Kingdom
Hourly Earnings—June, '53 (1938/9 = 100)	380	278
Wholesale Prices—Sept., '53 (1936/7—1938/9 = 100)	333	318

COMPARATIVE IMPORT PRICE INDICES AS AT JUNE, 1953. (1936/7-1938/9 = 100).
BY SOURCE OF ORIGIN OF GOODS.

United Kingdom	U.S.A. & Canada	All Countries
354*	464	380

* Note: Evidence published in the Tariff Board's 1953 Annual Report indicates that prices of British goods competitive on the Australian market have risen much less than is indicated by this over-all index which includes raw materials and capital goods which are not competitive. A direction from the British Board of Trade is quoted to the effect "that they like to see industry get as much for its exports as the traffic will bear."

Sources: Hourly Earnings: Male factory workers and including over-time, over-award payments, piece rates, etc. U.K.: Labour Gazette and relate to April. Australia: Based on a formula originally devised by the Tariff Board for transforming the Commonwealth Statistician's figure of average weekly manufacturing earnings per male unit into average hourly earnings.
Wholesale Prices: Monthly Review of Business Statistics.
Import Prices: Commonwealth Bank Statistical Bulletin.

The effect of high costs is of course not confined to the manufacturing industries. The profitability of primary production depends largely on the margin between world prices and costs of production. There are also industries whose output, although not subject to the rigours of competition, has been seriously affected by a level of costs which has become uneconomic. The key building industry is a striking case in point.

SECONDARY INDUSTRY

WE should at the outset realise that a large part of manufacturing output does not compete at all. The horror spectacle sometimes painted of the great proportion of Australian manufacturing being priced out of business because of high costs is an entirely misleading one. Possibly one-half of manufacturing production caters for an essentially local demand which could not be met from overseas sources. Typical examples are gas and electrical undertakings, brickworks, ice cream factories, repair workshops and newspapers and printing. Another section is able to anticipate immunity or partial immunity from competition because production is mainly in the hands of associates and subsidiaries of overseas concerns. And a third section is so vital to the national welfare that no government could afford to stand by and see it seriously threatened.

All this however does not imply that an uncompetitive cost structure is of no great significance in the whole manufacturing complex. It is difficult to estimate the magnitude of the section of manufacturing that is highly vulnerable to overseas competition. Some authorities have suggested that it might employ up to 200,000 people. Others have placed the figure around 100,000. The vulnerable industries would consist mainly of textiles and clothing, many engineering products, paper, electrical and household goods. Moreover any serious recession in this section of manufacturing would have unfavourable repercussions on other secondary industries which may not be competitive with overseas production.

Industries already feeling the effects of overseas competition, or feeling themselves to be in an exposed position, are deluging the Tariff Board with applications for increased protection. A study of recent reports made by the Board and of evidence submitted in inquiries provide a significant commentary on the level of Australian costs.

Internal Combustion Engines—Report dated 27th October, 1952:
In 1950, hourly earnings in both United Kingdom and Australian factories were, on an average, practically equal. At the present inquiry, evidence showed that average hourly earnings in the Australian industry were approximately 27½% higher than the average hourly earnings in the United Kingdom. Hourly earnings under incentives in the United Kingdom could be expected to result in greater output per hour than hourly earnings under time work in Australia and the disparity in labour cost, when related to the unit of output, would therefore be probably greater than 27½%.

Tractors—28th October and 19th December, 1952:
Like other Australian industries the tractor industry has been severely hit by the very great increases in labour costs during the last two or three years (between 60% and 70%) and with the consequent increases in costs of raw materials. There have of course, been rises in costs overseas during the same period, but increases in Australia have been steeper. Bounty rates of 12½% were recommended in 1950. Bounty rates equivalent to an ad valorem duty of 25% are now necessary to afford adequate assistance.

Textiles—Cotton, Meat Wraps—13th May, 1953:
A comparison of the average hourly cost of direct labour revealed that the cost to the Australian manufacturers was more than 100% higher than that experienced in the United Kingdom industry.

Carpets, Carpeting and Floor Rugs—Report, 18th May, 1953:
Compared with the average cost of production of carpet made by ten United Kingdom manufacturers, Australian costs of production of similar carpet at the time of the inquiry were approximately from 20% to 35% higher. Weighted average earnings for all classes of labour were 80% higher in Australia. Holiday and sick leave payments in Australia are shown to be on a much more generous scale than in the United Kingdom.

Engineering—Chains—3rd August, 1953:
Per unit of production, labour cost in the Australian factory is over five times the average in United Kingdom factories where payment by results operates extensively.

Extracts from Evidence Presented—Reports not Finalised.

Paper—Hearing—12th November, 1952:
In June, 1947, Australia had a 30% advantage over imported wrapping paper. Local costs of paper manufacture have risen so quickly that today the landed cost of imported wrapping paper is nearly 50% below that locally produced.

Vitreous Enamels—6th October, 1953:
The local company have been producing in Australia since 1936/7 and their activities were successful, even without protective duties, right up until 1950. From then onwards the effects of Australia's high cost position reflected themselves in excessive importations from overseas to the serious detriment of the local company.

Rayon Yarn—21st October, 1953:
The request for protection is based on a level of efficiency at least equal to that of our competitors and is necessitated solely by the higher materials, labour and plant costs inseparable from the Australian economy.

Chemicals—Soda Ash—22nd October, 1953:
In 1947 Australian soda ash without duties of any kind sold for £16/15/- a ton compared with a landed cost for U.K. soda ash of £17/2/9.

Since then the Australian price has risen to £35/-/- per ton, whereas the English landed cost has only risen to £21/14/10 per ton. Unless the local product is granted a 95% duty it will be unable to compete with the overseas product once import restrictions are lifted. Costs have risen by 124% between 1947 and 1953 made up as follows: labour 66%, packages 163%, interstate freights 212%, depreciation 120% (due to excess costs of new plant installed—actual cost was £3.4m. compared with £1m. estimated in 1947). Since 1947 the cost of transporting soda ash from U.K. to Australia has risen from £5/5/- to £7/1/-, a rise of about 37%. Over the same period the cost of transporting a ton of soda ash from the Osborne works in South Australia to other Australian ports has risen from £2/-/- to £6/5/-, a rise of 212%.

THE problem of high manufacturing costs does not of course merely affect manufacturing products competing on the home market. In the early post-war years a promising export market had been built up in certain manufactured goods. Many of these markets have been lost.

Export outlets for piece goods, jams, processed vegetables and certain milk products, motor accessories, electrical and engineering products, paper pulp and a host of miscellaneous items have been lost because of high costs and General Motors-Holden have had to abandon their plans to export the Australian car for the time being.

Australia is looking to overseas markets to take its surplus production of pig iron and steel. But whereas before the war Australian pig iron f.o.b. commanded an 80% advantage over British pig iron, today this advantage has been whittled down to 15%. Apart from the greater increase in wage rates, the price of coal—the main cost ingredient in manufacturing pig iron—has since 1938 increased by 420% in Australia compared with 250% in United Kingdom.

PRIMARY INDUSTRY

BECAUSE of a remarkable succession of bountiful seasons and record prices it is easy to lose sight of the fact that the main export industries—wool and wheat—are now in a much weaker position to cope with any decline in prices.

Because of their inability to pass on costs, farmers' real incomes have slumped since 1947/8 despite higher wool prices and a wonderful season in 1952/3. After allowing for the reduction in the value of money, real farm incomes in 1952/3 were £312m. as compared with £359m. in 1947/8.

It is admittedly difficult to calculate with any precision the average costs of growing a pound of wool or a bushel of wheat. However surveys carried out by the Bureau of Agricultural Economics, the Rural Bank of N.S.W. and other authorities in recent years throw valuable light on this subject and give a significant indication of cost trends in relation to selling prices.

WOOL COSTS

IN 1938 a Queensland Royal Commission on the Wool Industry estimated the cost of producing wool at about 11d. per lb. compared with average selling prices of 12.5d. in 1937/8 and 10.4d. in 1938/9. These conditions seem like a nightmare compared with average selling prices of 81d. per lb. in 1952/3 and an average of 82d. over the last five years. However, recent surveys suggest that costs of producing wool have soared almost as precipitously as selling prices.

After warning against placing too much reliance on average cost of production figures, the Rural Bank of N.S.W. has published data for typical N.S.W. properties grouped under various categories, showing costs per lb. of wool in 1952/3 ranging from 41.65 pence to 62.11 pence (see Appendix—Table 1).

It should be borne in mind that this data was collected during the most favourable growing season on record with top quality fleeces. Granting that any significant and sustained change in wool prices would probably be accompanied by compensating changes in certain costs, particularly an appropriate return on lower capital values, a sharp decline in wool prices could still lead to serious difficulties in the industry. Cost of production now appears to be at or above the average level of wool prices ruling in 1948/9. In the following table the data collected by the Rural Bank survey is combined with an analysis of costs for an earlier period conducted by the Bureau of Agricultural Economics:—

AVERAGE COST OF PRODUCTION OF WOOL	Pence per lb.	SELLING PRICES Australian Average Pence per lb.
B.A.E. 1947/8	34	40
B.A.E. 1948/9	38	48
B.A.E. 1950/1	n.a.	144
Rural Bank 1952/3	58	81

WHEAT COSTS

At the outbreak of World War II wheat prices had fallen to 2/1 per bushel compared with 3/1 in August, 1938, and 5/1 in August, 1937. The lowest monthly quotation during the depression was 2/2 in August, 1931. Farmers had to be assisted by government bounties and other relief during most of the 30's, because wheat was being sold at less than cost of production. No one wishes to see the financial despair of those days (when practically every wheat-grower was hopelessly in debt and dependent on the charity of the State) return again.

Since the war-time marketing arrangements were instituted all Australian wheat has been marketed by the Australian Wheat Board. From June, 1942 to December, 1947, the price of wheat for gristing into flour for home consumption averaged 3/11½ per bushel. All proceeds, including export sales at various prices, were paid into "Wheat Pools" from which advances were periodically made to growers. With the expiration of the war-time controls, the States and the Commonwealth agreed in July, 1948 to continue a wheat stabilization plan until June, 1953. The Commonwealth Government guaranteed a return to growers based on costs of production. This increased from 6/3 per bushel in 1948 to 11/11 in December, 1952. The home consumption price (kept down by subsidy) was also closely related to it.

Export prices ranged as follows:

1946/7—12/6.
1947/8—19/5.
1948/9—15/8.

	Wheat Sold Under International Wheat Agreement	Wheat Sold in Excess of I.W.A. Quota
1949/50	15/5	18/6
1950/51	16/1	18/8
1951/52	16/4	20/9
1952/53	16/6	21/6

For the ensuing season, the home consumption price (without government subsidy) will be 14/- per bushel for wheat for flour-making and the I.W.A. price should continue around 16/- per bushel. However, the "free" market price for wheat has dropped back to about 17/- per bushel, so that wheat in excess of the I.W.A. quota will no longer command a substantial premium. As about half Australia's wheat must be exported any weakening of overseas prices must be viewed with concern. Production costs are now estimated at 12/8 per bushel, over double tthe base year 1947/8.

According to the Bureau of Agricultural Economics, the profit per bushel in wheat growing has more than halved between 1947/8 and 1952/3. Here are the figures:—

	1947/8 Per bushel	1952/3 Per bushel
Total "pool" returns	14/4	15/5
Cost of production	6/3	11/11
Profit per bushel	8/1	3/6*

* 1/10 in 1947/8 values.

The capacity of the wheat industry to cope with a drought cycle or the unloading of surpluses building up in other wheat-growing countries has already been greatly weakened since 1947/8.

OTHER PRIMARY INDUSTRIES

DAIRYING in Australia has always been recognised as a high-cost industry and the home consumer has been expected to subsidise the export price in order to enable producers to compete on world markets. The present home consumption price is causing consumer resistance and a reduction in the per-head consumption of butter. Cost of production has risen from 2/- per lb. in 1947/8 to 4/1 in 1951/2 and Governments are naturally reluctant to further subsidise the industry or permit any additional rises in costs to be passed on to the consumer.

The Bureau of Agricultural Economics estimates that costs of producing meat rose by over 50% between 1948/49 and 1951/52 and costs of egg production by 90%. Dried fruit costs in 1952/53 were estimated at 87% above 1948/49 levels although the average price received by growers at the packing shed had only increased by 63%.

SERVICE INDUSTRIES

THE unhappy consequences of a high cost structure are not confined to industries competitive with imports or those dependent upon export markets. Some industries completely sheltered from overseas competition find that the rising level of costs builds up a price resistance which in some instances has dangerous national implications. The building industry is perhaps the best example of this.

Building costs have become so steep that very few people are willing to go ahead with new city buildings or extensions to premises not absolutely necessary. Building for investment purposes is a thing of the past. The lack of city building in Melbourne and other capital cities is partly traceable to the fact that rentals at the present level of building costs would become prohibitive to prospective tenants. There is also the fear on the part of prospective investors of serious losses of capital should costs decline.

With statutory additions, such as sick leave, holiday and wet weather pay, average award rates of building workers have jumped from 2/6 per hour in 1939 to over 10/- today —an increase of 300%. Prices of building materials which were 335% above pre-war levels at the peak in July, 1952, have dropped somewhat, but are still 265% higher. Tradesmen engaged on jobs carried out by builders of new buildings in Victoria have dropped from 34,000 in March, 1952, to 27,000 today.

Despite the pressing need for new city buildings for office and shop purposes, for hotel accommodation and civic development, the high level of costs has produced an almost complete standstill.

* * * *

IN face of the evidence given in this article—all of which is taken either from official or well-informed sources—it is difficult to understand the complacency of those who find comfort in the beguiling simplicity of statistical averages. There seems little doubt that quite a significant section of the economy could no longer compete on the basis of present costs. While export prices, especially of wool, remain firm, serious trouble should be avoided. But a steep fall in these prices could render the basic export industries unprofitable and would spread something that might be little less than chaos through the Australian economy.

APPENDIX

TABLE 1.
WOOL GROWING COSTS

	Pence per lb. of Wool Lowest Group	Pence per lb. of Wool Highest Group
Direct costs—packs, shearing, cartage, freight, etc.	8.22	7.83
Maintenance and replacement plant and stock	8.14	28.31
Wages of employees	4.91	1.54
All other operating costs	5.25	4.10
Rates and insurance	2.45	2.19
	28.97	43.97
Owner's wage allowance	5.04	12.15
	34.01	56.12
Less "sideline" income	17.33	14.12
	16.68	42.00
Interest on owner's capital	24.97	20.11
	41.65	62.11
Type of property	4,000 mixed sheep (Breeding own replacements)	1,500 wethers (Purchasing replacements)

Source: Surveys carried out by 15 valuers of the Rural Bank scattered over New South Wales' sheep growing districts.

TABLE II.
COSTS OF WHEAT GROWING

	Pence Per Bushel 1947/48	Pence Per Bushel 1952/53
Maintenance and depreciation of machinery and structures	15.62	28.14
Fuel	12.48	21.88
Fertilizer and seed	9.48	20.30
Hired labour	9.24	20.17
Cartage and corn sacks	3.30	7.22
Rates and taxes, interest, insurance, rent and sundries	12.96	15.02
Total cash costs	63.08	112.73
Interest on farmer's equity	13.08	19.18
Allowance for farmer's labour	22.80	48.37
Total farm costs	98.96	180.28
Less 1/3 for "sideline" income	33.96	61.89
Net cost of production at siding	65.00	118.39
Rail freight and handling	10.00	24.36
Total costs, bulk basis f.o.r. ports	75.00	142.75

Source: Bureau of Agricultural Economics.
Notes: These calculations are based on the following assumptions:—
1. A fair average long term yield of 12 bushels per acre.
2. An average holding of 300 acres.
3. A wage allowance of £6/10/- per week to owner operators in 1947/8 adjusted upwards for 1952/3 in line with basic wage increases.
4. Interest on farmer's equity—in 1952/3 at 3¾% on a most conservative valuation of properties and other assets.