If Export Income Fell Steeply !! – A Symposium

NOTE: (This is not a forecast. At the moment, fortunately, there is no reason to anticipate a grave decline in export proceeds. But in economics it is wise to be prepared for any contingency, however remote. Nobody expects a modern passenger liner to sink; but it still carries life-belts, life-boats and has life-saving drill for the passengers.)

IN May, 1945, the famous White Paper on "Full Employment" issued by the Commonwealth Government declared that never again would deflation and unemployment be used to correct an adverse balance of payments. In the event of a prolonged and severe fall in export income, quantitative restrictions on imports were to be imposed and, if the decline proved to be permanent, the exchange rate would be depreciated. But in no circumstances were imports to be reduced by curtailing the level of internal spending. Internal spending was to be maintained by increased Government expenditure, particularly on public works, and by banking policy and other measures to encourage private expenditure.

The I.P.A. does not believe that this set of academic principles provides a satisfactory solution to an acute balance of payments problem which could conceivably face Australia should export incomes fall steeply, and we have thought for some time that adequate expert discussion of this problem is a matter of some urgency. Accordingly, we invited three prominent economists to answer the following question:—

"What would be the correct policy for Australia to pursue in the event of a substantial and sustained falling-off in export proceeds—say, of the order of 20% to 30%—due either to a serious weakening in wool values and other export markets abroad or to adverse seasonal conditions at home (or both)?"

Three contributions appear in the pages which follow:—

PROFESSOR R. I. Downing, Ritchie Professor of Economics at Melbourne University, proposes a series of measures which are broadly in line with the White Paper policy of 1945. He suggests that the level of internal spending must be maintained and he looks in the main to a substantial increase in public works expenditure to compensate for a serious decline in export earnings. Professor Downing would also pursue a policy of tight import control but would presumably (and probably rightly) keep exchange depreciation as a weapon of last resort. Since he also advocates tax reductions to stimulate consumer spending and since the loan market would almost certainly be tighter under the conditions we have postulated, this increase in Government spending would no doubt have to be financed by the issue of Treasury Bills.

PROFESSOR P. H. Karmel, Professor of Economics at the University of Adelaide, takes two positions. If the fall in export proceeds is believed to be temporary, he would follow broadly the same policy as Professor Downing. He does, however, recognise some of the difficulties with which this course is beset—particularly the danger that it may be impossible to finance essential imports at a level sufficient to maintain full production and employment; also the time lag involved in expanding public works to take up the slack in private investment. But this policy, he says, would not be adequate (in fact, it would have to be put into reverse) should the decline in export receipts be long continued. Such a situation, he suggests, would have to be met by **fundamental** economic adjustments such as exchange depreciation, an increase in tariffs and a reduction of money incomes, or a combination of the three.

MR R. F. Holder, Economist of the Bank of New South Wales, does not share the faith of his fellow contributors in the merits of credit expansion for in his opinion it would do little to promote business confidence or to assist private business to meet world competition. He sees a reduction of export income as a loss of real resources whose effect on the nation's standard of living cannot be escaped. "In practical affairs," he writes, "it is most unlikely that the slick formulas of the mathematicians for maintaining full employment and the volume of production will work at all accurately." This is broadly the view of the I.P.A.

Those who regard internal credit expansion (to increase Government outlays on subsidies and public works) and reduced taxes (to encourage consumer spending and private investment) as the fundamental remedy for a fall in export receipts—and this view is very widely held today—seem to side-step the manifest difficulties to which such a policy would give rise. The level of internal costs would be maintained, and possibly even increased, at a time when the restoration of the export market, the reduction of imports and the adverse balance of payments would all seemingly call for an adjustment of costs at a lower level.

The fundamental problem in our view would centre on the level of private investment. The physical difficulties involved in the large-scale expansion of public works, such as the limited mobility and suitability of labour, tend in our view to be greatly under-estimated. The financial problems to which internal credit expansion would give rise would also be considerable. As Mr. Holder points out, it would aggravate a balance of payments problem, already acute, and boost internal costs at a time when the economy was crying out for a reduction of costs. One important point seems to be overlooked by the credit expansionist school—that is, the effect of their policies on overseas opinion. If Australia ran into serious economic difficulties it would more than ever need a sympathetic and lenient response from its friends abroad. It is hardly likely that the United Kingdom or the United States or international borrowing agencies would look favourably upon a policy of credit expansion combined with savage import restrictions.

What, then, is the real answer? One should avoid dogmatism on a matter so complex but a few observations may not be out of place.

Under the conditions we have postulated, the all-important problem would be to prevent any general collapse of business confidence. This would be disastrous. A complex series of measures would certainly be necessary. Exchange depreciation would possibly be one.* By one means or another costs would have to be drastically reduced, for instance, by a greater all-round effort, a more exacting economy. Some cut-back in real incomes would be unavoidable. The burden should be equitably spread. A judicious measure of credit and budgetary expansion could, in these circumstances, be undertaken.

But the problem would be anything but easy. In these things prevention is better than cure and prevention implies the maintenance at all times of a strong, healthy, disease-resistant economy. Is the existing state of the Australian economy as healthy as we might wish; or are there present disturbing symptoms of weakness?

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Professor R. I. Downing.

A HEAVY fall in export receipts is purely hypothetical. No firm set of remedies can be prescribed. It would depend completely on the circumstances in which a fall occurred. The fall which occurred in 1931, for instance, brought economic disaster. The fall which occurred in 1951, on the other hand, had some beneficial effects.

The problem needs to be considered from several different aspects.

1. Export Incomes.

The first impact of a cut in export receipts will be on incomes of exporters. A heavy fall now would be less easily borne than in 1951-52. Many wool-growers could still afford the loss but some wool-growers and most producers of other types of export products would not be able to. Before advising any early depreciation of the exchange rate I should prefer to explore first the possibilities of securing shifts of marginal export producers into other more economic industries and of protecting those who remain in export production by direct and indirect subsidies. It would be time enough to consider the need for exchange depreciation when it had become clearer how long the cut in export receipts was likely to continue.

2. Liquidity.

The other inevitable consequence of a fall in export receipts is that the drain on our overseas reserves

*Exchange devaluation is no remedy for the present balance of payments difficulties. It would add fuel to the flames of our domestic inflation (which may rage again in the coming months without the stimulus of depreciation). It is never a measure to be undertaken lightly. A depreciated currency means a loss of prestige abroad. It is taken by the others to be indicative of a weak economy. Overseas interests looking for outlets for the investment of capital tend to be frightened off. Moreover, depreciation is a step never to be taken *in isolation.* To be effective, it must be accompanied by other measures to offset its inflationary impact on internal prices and costs.

is reflected here in a fall of both cash and deposits in the banking system, so that liquidity—the ratio of cash to deposits—is reduced.

If such a situation arose now, when liquidity is already rather low and falling, it would certainly be necessary for the Commonwealth Bank to ensure that purchases of Government securities and its releases from Special Accounts were adequate to supply the liquid resources necessary to finance production at full employment levels.

3. Imports.

Unless overseas reserves are well above the level regarded as safe, a heavy fall in export receipts must be balanced by a cut in imports.

The weapon of import licensing is clearly too precious ever to be discarded. It enables international solvency to be maintained without causing internal depression and enables cuts in imports to be made where they will do least harm. It also enables us to ration the supplies of scarce currencies without having to ration other currencies which may be less scarce. Its very attractiveness makes it the more important that we should seek to confine its use to meeting short-term fluctuations in our balance of payments and to dealing with particular scarce currencies. Long-term equilibrium should be maintained so far as possible through such instruments as the exchange rate and the tariff, which interfere less directly with the freedom of individuals to spend their money as they like and to buy in the cheapest market.

4. Spending by Other Sectors.

(a) Investors.

The fall in export receipts may administer a shock to the confidence of investors and so lead to a reduction in their spending. The situation with private investment now might be more difficult than in 1952 when export receipts were still high, wool having but fallen from an abnormal peak; many long-term development projects promising profit were available; overseas competition was held off by import licensing.

Private investment has been running at high levels for so long that there must be ample room for heavy reductions. On the other hand, current complaints about overseas competition suggest that some encouragement might be drawn from more severe import licensing. **A continued substantial flow of immigration would be stimulating. There appears also to be a considerable backlog of commercial and industrial construction awaiting execution. The situation envisaged would clearly present the most favourable opportunity for introducing special depreciation allowances, whose short-run "announcement" effects would probably be greated than their long-run effects.** In all, however, I should be inclined to allow for the possibility of a significant fall in private investment as a consequence of any substantial cut in export receipts.

(b) Governments.

The important question is not so much whether Governments would now be prepared to spend their way out of depression, but rather in what directions they should either expand their own expenditure or encourage an expansion of the expenditure of others.

I am not optimistic as to the possibility, usefulness or desirability of Government action directly to stimulate private investment, apart from the possibility, mentioned above, of special depreciation allowances. **It seems to me better for the Government to increase its own expenditure and that of consumers, leaving private investment to come in as investors and regain confidence in continued expansion and prosperity.**

There is no shortage of useful objects of Government expenditure at present. The developmental works programmes of the State Governments could easily be expanded. In particular, plans for slum-clearance and town planning should be revived.

The possible need for a big increase in public works expenditure makes us the more acutely aware of the disappointing record of the National Works Council. This body was established in 1943 primarily to ensure that we had always a reserve shelf of projects, planned ready for immediate execution whenever the opportunity presented itself in the form of a slump in other sectors of the economy. This sort of planning is essential to ensure that the right types of projects can be put into execution in the right places, according to the type of resources that become available.

(c) **Consumers.**

Consumers are commonly supposed to spend more or less according to their incomes. In the 30's, their incomes fell as spending by exporters, investors and Government fell. Their own spending was then reduced and led to further reductions of income and spending in a downward spiral of deflation.

If the original effects of a fall in export receipts can be minimised and more or less completely offset by increased expenditure in other sectors, these secondary effects will not occur and depression will never develop. It is much more difficult to pull an economy out of a deep depression than it is to prevent it ever getting into one.

Some of any slackening that may develop in the economy can be taken up by necessary and desirable increases in public expenditure. **For the rest, there should be deliberate public action to increase private spending power. Part of this should take the form of direct and indirect subsidies to housing, to match any public programme for providing better housing. For the rest, it is a matter of cutting taxes and expanding disbursements to private persons.**

I should prefer such action to take the form of cuts in indirect taxes, increases in exemption limits and reductions in the lower ranges of income tax. This would have several advantages—it would bring a desirable increase in the progressiveness of our tax system, it would concentrate the tax cuts where they were most likely to lead to higher consumption, it would provide stronger incentives to increased effort which would be of first importance in a situation where our real income had been substantially reduced by a fall in export receipts. Moreover, tax cuts of this type could, if necessary, be reversed later without placing apparently heavy burdens on particular sections such as recipients of social service benefits.

From the foregoing discussion, we can draw several conclusions. In the first place, better understanding of economic problems by economists and by the public, better economic staffs at the Treasury and the Commonwealth Bank, the availability of vital policy instruments such as import licensing, and the existence of a solidly-established system of social services, make us infinitely better equipped to face our economic future than we were in the early 'thirties.

Secondly, the more effectively we can offset the primary effects of any fall in export receipts, the less serious and widespread will be the secondary effects which are much more difficult to cope with. **We need effective economic forecasting to warn us to get ready.** Thirdly, economic remedies cannot be applied automatically. Each situation has to be analysed carefully to discover whether it is the 1931 or the 1951 or some other type, so that the appropriate remedy can be chosen.

Finally, in a situation which requires to be treated by expanding expenditure, while any type of expenditure will be better than none, economic welfare will be the more benefited, the more successful we are in selecting those types of expenditure most urgently needed at the time concerned. Political pressures and administrative convenience and ease are tempting but poor guides to policy.

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Professor P. H. Karmel.

To many Australians remembering the depression of the 1930's the possibility of a substantial decline in export proceeds is an ever-present fear. During the past few years, export prices have been high and seasons good but signs of weakening in export proceeds over the past twelve months have served to remind us that periods of relatively low export proceeds may return. However, our knowledge of the working of the economy has greatly improved over the past 20 years, as has our willingness to use the weapons of economic policy which this greater knowledge has given us. **Consequently we can be reasonably optimistic about our power to deal satisfactorily with a substantial decline in export proceeds should it come in the near future.**

A substantial decline in export proceeds has two main effects on the economy. First, the reduced spending resulting from lower export incomes exerts a contractionary influence on the level of economic activity. The maintenance of full employment requires that this reduced spending be offset by increased spending in some other sector or sectors of the economy. Secondly, the decline in export proceeds has an immediate unfavourable effect on the balance of payments. Unless London Funds are high, imports must fall in order to protect our international solvency.

As far as the maintenance of full employment is concerned, most economists now agree that this should not prove an insuperable difficulty. By means of its budgetary policy the Commonwealth Government can offset the reduced spending from the lower export incomes. **It can do this either by reducing taxation and hence raising spending by private individuals or by increasing its own expenditure on, say, public works.** At the same time it is necessary to prevent the deterioration in export proceeds from causing a shock to confidence and to prevent the reduced liquidity of the banking system, which will result from any fall in London Funds, from bringing about a restrictive bank advance policy. Either of these two consequences would, if allowed to materialise, adversely affect private investment plans and make the maintenance of full employment more difficult. However, in an economy expanding as rapidly as Australia is at present, business confidence should be buoyant and the Commonwealth Bank can by its special account procedures assist in the maintenance of trading bank liquidity in the face of a fall in London Funds, and possibly can encourage private spending in certain fields, such as housing.

Appropriate budgetary and monetary policy should be able to maintain reasonably high levels of employment in the face of a substantial decline in export income. This is, however, subject to one important qualification. **The technological conditions of production require a certain minimum level of essential imports without which the economy cannot function at full employment.** If the balance of payments position is such that this minimum level cannot be financed, full employment cannot be maintained. However, this minimum level is almost certainly smaller relatively to the size of the economy now than it was in the 1930's, and the collapse in export proceeds would have to be very great for this limiting factor to come into operation.

It must be recognised that, however successful is economic policy in maintaining full employment in the face of a decline in export proceeds, **such a decline implies an unavoidable loss of real income.** Full employment may be maintained but it will be at a lower level of real income. This loss of real income will in the first instance fall on export producers and the extent to which it should and can be spread over the whole community is a question of considerable complexity and importance. **It must also be recognised that a substantial fall in export proceeds will inevitably cause some dislocation in the economy.** Lags in the operation of government policy are unavoidable and in any case the changes in the composition of aggregate spending, which will be necessary, will require adjustments in the structure of the output of the economy.

Parallel with action to maintain full employment, measures must be taken to control the adverse balance of payments. Indeed it is essential that spending should not be stimulated beyond the full employment level for this would produce a state of inflation with demand spilling over on to imported goods. Even with the maintenance of economic activity at full employment without inflation the demand for imported goods will remain approximately steady whereas export proceeds will have fallen. This will result in a continuing deficit in the balance of payments on current account. Such a deficit can be financed out of London Funds or from borrowing overseas. The latter is, however, at all times a doubtful quantity and particularly at a time when exports have fallen. If London Funds are high they can be run down for at least a period. But if they are not adequate or if the decline in export proceeds is at all prolonged some action to cut imports will be necessary. This can, of course, be done simply and directly by straight-out import restrictions. In the situation envisaged here this may well be necessary. However, import restrictions of the kind we have experienced over the past few years have unfortunate long-run consequences. They tend to freeze trade in existing channels and they give an undeserved bonus to the importer who happens to have a quota in the base year. In addition, since import quotas always tend to favour essential as against non-essential imports there is a tendency for domestic industry to be directed towards the production of non-essentials in short supply. Furthermore, they introduce an element of speculation into the demand for imports, leading to an excessive demand for imports whenever restrictions are relaxed for fear that they will be re-imposed later. Consequently, import restrictions should be used only as a short-term weapon. That is, in the circumstances discussed here, a case for them can be made out only if the fall in export proceeds is expected to be temporary. However, if it is expected to be permanent, as would be the case if the world demand for wool was falling due to the development of synthetic substitutes, a more fundamental adjustment in the economy would be necessary. Such an adjustment would require a raising of the Australian prices of imported goods relative to internal costs (or a lowering of internal costs relative to the Australian prices of imported goods) so that the demand for imports at the full employment level of economic activity would be reduced. **This could be achieved, for example, by a depreciation of the rate of exchange, an increase in the tariff or a lowering of money wages or by a combination of these actions.** Any action to reduce imports will exert an expansionary influence on the level of activity in so far as domestic production to replace imports will be encouraged; consequently any measures which had been taken to maintain full employment, at the time when export proceeds fell, will, to that extent, have to be reversed.

Australian economic policy must be viewed against a back-ground of fluctuating export proceeds. Export proceeds will be sometimes high and sometimes low. **It should be the object of economic policy so to determine the relation between internal costs and external prices that the demand for imports at the full employment level of activity will be matched by export proceeds over a period taking good years with bad.** Such a policy would imply that imports should be kept relatively stable from year to year, while London Funds should be accumulated when export proceeds are high and run down when export proceeds are low. This would avoid dislocation in the economy due to marked changes in the level of imports. Restraint in importing during years of high export proceeds is of the first importance. But whichever policy is advocated for smoothing out the effects of short-run fluctuations in export proceeds, we will always have to face up to the difficulty of deciding whether any particular change in the level of export proceeds is merely a short-run fluctuation or a long-term change in the demand for our exports requiring a fundamental adjustment in the economy.

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Mr. R. F. Holder.

The consequences of the fall of 18% in export income since last year have been a policy of credit restraint, and stiffer import licensing to curtail the drain on oversea balances caused by strong import demand. Yet employment has continued to grow to peak figures and consumer demand has expanded, supported in both cases by heavy capital expenditure by business, particularly in building and construction, and by rapid extension of hire purchase facilities. How would these conditions be changed if the fall in export income continued to about 30% below the previous year? How strict would credit policy become; would capital programmes be able to stimulate demand and sustain employment; how should the balance of payments be dealt with; if employment wavers what action should the Government take?

It is important to recognise that a fall of 30% in export income is not merely a financial adjustment but a reduction in real income which must be sustained by some groups or diffused throughout the community. To some extent the fall in export earnings would set in motion its own adjustments. Lower rural incomes would mean a lower demand for imports and would also tend to reduce the sales and incomes of other sectors of the economy dependent upon rural demand. If the fall in export earnings were believed to be only temporary, as, for instance, during a drought, the cut-backs would probably not be severe and the bulk of the effects of lower export income could be met by drawings on individual savings and increased bank support and by allowing a temporary run-down in oversea reserves. In these circumstances economic activity and employment should not be unduly prejudiced, but there would undoubtedly be considerable pressure on the banking system's liquidity. To some extent realization of private holdings of securities would lessen this difficulty, but the central bank would be obliged to support the bond market, make substantial releases from special account, and perhaps take other steps to support bank liquidity.

If the fall in export earnings appeared to be less temporary, arising, say, from a decisive fall in prices or loss of markets, more positive measures would have to be applied. The probable immediate political solution would be to strengthen import licensing so that the balance of payments would not run into serious deficit, and step up government works to absorb any unemployment resulting from falling rural and related demand. **Yet any or all of these measures will only create additional problems, leading to more stringent import restrictions and economic controls to deal with the inevitable pressure towards inflation and drain on overseas reserves which they would promote.** To the very extent that they were successful in preventing an import surplus and in maintaining employment and incomes, these measures would encourage inflation, unless by some strange miracle in the resulting transfers of labour they could ensure an increase in local output of goods and services to match the necessary fall in imports. **In practical affairs it is most unlikely that the slick formulas of the mathematicians for maintaining full employment and the volume of production will work at all accurately.**

In the past year private investment has probably been the chief influence in sustaining prosperity despite the reduction in export earnings that has in fact taken place. But on the given assumption, it is unlikely that it could be expanded even with special encouragement by tax concessions or other means. In the event of a reduced volume of private investment a compensating increase in government works would be planned with all its problems and delays in transferring men and resources to new sites and to different uses. The probable concomitant, credit expansion, would do little to promote a renewal of business confidence or to assist private business in facing up to world competition.

To avoid the progressive deterioration in economic activity which would inevitably follow this approach, adjustments are called for which recognize the real effects of a fall in export earnings and lay the way for a measure of recovery and expansion. It would be realistic, if politically disturbing, to consider depreciation of the currency to the extent indicated by the fall in export earnings. This course would help to maintain the incomes in local currency of export producers and hence of the level of employment supported by their demand and it would also check the drain on oversea reserves by raising the price of imports. An important feature would be the advantage and stimulus given to Australian exports which formerly could not compete on world markets.

A decisive devaluation would be far preferable in the conduct of international trade to the indefinite prolongation of import licensing with all its uncertainty. In the circumstances devaluation would probably command the blessing of the International Monetary Fund as an adjustment to a "fundamental disequilibrium".

Yet the benefits of devaluation would be only temporary if internal policies encourage or permit a continued rise in the cost structure. Ultimately the question boils down to whether we are trying to live beyond our means. **If so, no amount of protectionism or subsidization of the standard of living can prevent a fall in our real welfare if export income drops seriously.**

A decrease in export income inevitably involves many stresses in the economy, and it is impossible to escape the consequences, though they may be cushioned or more equitably spread. A full recovery for a country as dependent on exports as Australia can only lie in the efficiency of industry to take advantage of an improvement in world conditions and in the flexibility of the economic system to switch resources to meet other demands.

The industrial advances of the post-war years have broadened the Australian economy, but they have not appreciably lessened its dependence on a large volume of exports. Policies designed to overcome a fall in export earnings will eventually be assisted by growing industrial maturity, but they must safeguard the cost level so that living standards are not permanently burdened by high costs consequent on economic controls and restrictions.