the IPA review

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THE OVERSEAS DEFICIT

AUSTRALIA has had a chronic balance-of-payments problem since early 1952, when quantity import restrictions were first imposed. But for exceptionally good prices for exports, particularly wool and wheat, in the early post-war years, and the large capital inflow stimulated by these prices, the weakness in the overseas position would probably have revealed itself even sooner.

The weakness arises from the greatly increased demands of the Australian economy for imports, without any improvement—and perhaps some decline—in its capacity to export. In 1953/4 Australia imported in physical terms about 55% more than the average of the three pre-war years 1936/7 to 1938/9. This increase is only partly accounted for by the growth in population. Australia was also importing substantially more *per head of population.* Per capita imports, in volume, were something like 20% greater in 1953/4 than before the war. Nor does this rise fully reflect the true increase in the demands of the Australian economy for imported goods for it has been held in check by restrictions and by exchange controls over goods from dollar sources.

Indeed with some easing of import restrictions in the current year 1954/5, imports have increased markedly. Preliminary estimates suggest that the volume of imports will be 80% above pre-war—or 40% per head of population.

On the other side, the increase in the volume of exports, since before the war is only around 22% (1953/4 over 1936/7 to 1938/9). Per head of population, exports have declined by 6%. *Thus, along with an increased per capita demand for imports averaging about 30% over 1953/4 and 1954/5 has gone a decline in real exports per head of 6%.* No wonder Australia has run into heavy weather with its balance of payments! Moreover the difficulties we are now experiencing in paying our way would have been intensified had not the terms of trade moved in our favour. *The prices we have been getting for our exports have risen by 400% compared with a 280% increase in the prices we have to pay for our imports—in other words we can now obtain a given quantity of imports for a smaller quantity of exports than before the war.**

The greater per capita demands for imports are a natural consequence of full employment (in the pre-war years unemployment averaged about 9%), higher average standards of consumption, and a more-than-normal rate of development in both private and public projects. But the difficulty of achieving a balance in our overseas accounts arising from these basic causes has been aggravated by the rapid inflation of money incomes and production costs, especially over the last five years. It would be fair to say that these reasons, between them, embrace the generally accepted explanations of the post-war balance-of-payments problem; although there are varying views as to the importance to be placed on the different factors.

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FURTHER light can be thrown on the problem by adopting a rather different approach. What is insufficiently stressed in the currently accepted explanations is the fundamental

*During the first half of 1954/5 import prices rose slightly while export prices fell back from 400% to 360% above pre-war.

structural change in the economy over the post-war years, and the relationship of this change to the overseas deficit. An understanding of this would help to clarify present notions of whether the problem is likely to be temporary or long-lived and of the lines along which a satisfactory solution is to be found. The adjective "satisfactory" is used advisedly. One way to solve the balance-of-payments problem would be to drastically reduce effective demand. This would mean a serious lowering of Australian living standards. Such a solution would be far from "satisfactory."

Over the last 20 years the Australian economy has changed in basic character. It has become highly, even intensively, industrialised. Before the war, in spite of substantial manufacturing development, we still thought of ourselves as predominantly a primary producing country. If this were true then, it is certainly not true now. A transformation of immense significance has occurred. There are today nearly twice as many people engaged in manufacturing as in primary production—1,080,000 as against 550,000. At the 1933 Census the figures were 550,000 manufacturing, 670,000 primary industry. Since 1938/9 real output in the rural industries has risen by just over 20%, in manufacturing by possibly 100%. *In* 1933, *of the total employed population manufacturing comprised* 20%, *primary industry* 24%; *to-day, the proportions are manufacturing* 30%, *primary industry* 15%. The degree of industrialisation in Australia is indicated by the fact that in the United States official statistics show that 26% of the employed population are engaged in manufacturing*.

This far-reaching change in the structure of the economy has given rise to a dangerous fallacy in our economic thinking. This is the view—where it is not specifically argued it is often tacitly assumed—that the expansion of manufacturing has made us less dependent upon imports and has brought Australia a long step toward "self-sufficiency". In fact this is the reverse of the truth. The increased dependence of the economy on imports is indicated by the fact—to which we have already drawn attention—that the quantity of imports per head—in spite of import restrictions—is now about 30%

*The Australian and American figures are not strictly comparable since U.S.A. excludes some service industries which are classed as manufacturing in Australian statistics.

greater than before the war. Moreover, this has been accompanied by a reduction in the real capacity to pay for imports since the quantity of exports per head has fallen by 6%.

The economic growth and progress of Australia since the end of the war have been of such a nature as to swell the demands of the economy for imports without contributing in any material degree to its overall capacity to export. *The great expansion of manufacturing has been one of the most striking features of this progress and has itself increased the import requirements of the economy (not merely in absolute quantity but per head of population).*

This should not be taken to imply any criticism of the main body of the development in secondary industry since the war. This expansion has been in part a response to deliberate government policy to foster secondary industries and national development, and in part a response to the very high level of post-war incomes and phenomenal prosperity in the primary industries. These high incomes have led directly to heavy imports of consumer goods and of motor cars, parts and petroleum. But they have also swollen the demands for the products of Australian secondary industries which, in turn, have had to purchase abroad specialised equipment and materials and component parts which either cannot be obtained locally or made here only at excessive cost.

It is clear that the extraordinary post-war growth in secondary industry can be sustained only by a continuance of high living standards or, in other words, by a high level of incomes and spending power. But these incomes, as we have seen, will swell the demand for imports both directly for consumption and, more important, by increasing the need for overseas equipment, materials and parts for local industry.

It is true of course that we can now produce many things in Australia that were not produced here before the war. Motor vehicles are an outstanding example. But the production of motor vehicles, and of many other products, has set up new and heavy demands for imported materials, parts and productive equipment.

It is now becoming more widely known that the main bulk of Australian imports consist not of consumer goods but of materials, parts and industrial and transport equipment for use in local industry. Consumer goods over the last few years have comprised only around 15% of all imports. Since before the war all these categories show substantial increases. Here are some comparisons (in 1936/37-38/39 £'s per head of population):—

IMPORTS	1936/7-38/9 £'s per head	1951/52 £'s per head	1953/54 £'s per head	1954/55 £'s per head (Estimated)
Producers' Materials — Manufacturing	6.6	8.1	7.1	8.5
Producers' Equipment	1.8	3.9	3.5	3.5
Motor Vehicles and Parts	1.7	4.3	2.1	2.5
Fuel and Oil	1.3	2.8	2.6	2.25
Consumer Goods	3.1	4.1	3.0	4
All Imports (including miscellaneous)	16.6	29.2	19.8	23

Source: Import figures in Monthly Review of Business Statistics, deflated by the Commonwealth Bank's Index of Import Prices—Commodity Groups as published in "The Australian Balance of Payments."

Imports of producers' materials for use in manufacturing have risen, per head of population, since before the war. Also some part of the increase in producers' equipment, together with a proportion of the increase in motor vehicles and parts, oil and other items, must be attributed to the expansion of local manufacturing industries.

Perhaps the notion that the post-war development in manufacturing has led to greater national self-containment has resulted from confusing the structure of Australian manufacturing with that of the United States, whose economy is largely self-sufficient. It is true that Australia now employs somewhere about the same proportion of its population in manufacturing as America. But in spite of a growing dependence on imports of certain strategic materials, the manufacturing structure of the latter is largely self-supporting. The United States imports only a comparatively minor proportion of its raw or processed materials and practically no parts or capital equipment. Australian manufacturing is fundamentally different. It is compelled to import a substantial proportion of its materials, a large volume of component parts and a good deal of important productive equipment.

Many new developments in manufacturing in Australia thus set up additional demands for imports and throw an increased strain on the balance of payments. Moreover this situation is unlikely to alter greatly in the forseeable future. Australian manufacturing is supported at present by heavy imports. Without these imports it could not operate at its present scale and level of efficiency. Unlike the manufacturing structure of the United States, it is far from being self-contained. In its reliance on imports it bears a much greater similarity to the United Kingdom, which is dependent on the large-scale importation of raw materials without which its industries cannot function. To obtain these essential requirements the United Kingdom must be able to export a high proportion of the finished products of its factories. Australia, fortunately, is not in this position. It can still pay for the *major* part of its import needs by exporting its surpluses of wool, wheat, meat and other primary products. But the continuance of import restrictions for over three years, in spite of good export returns, strongly suggests that the traditional export of primary products is no longer, by itself, sufficient to pay for Australia's requirements of imports, at its *present standard of living and level of employment.*

This can only mean that if Australia is eventually to dispense with import restrictions and achieve a more or less permanent equilibrium in its overseas trading it must supplement its traditional exports of primary products with increased exports of the manufactured goods now being produced by its enlarged industrial structure. At present Australia is exporting manufactured goods to the value only of about £40m. to £50m. a year, or about 2% of its total manufacturing output. If we are to pay our way in overseas trade, without the aid of import cuts, this figure would have to be raised to something of the order of £200m. a year—probably more rather than less. It is not suggested that this objective can be achieved in the near future. We are concerned only to establish the point that unless and until it, or something like it, is achieved, Australia will in all likelihood be compelled to suffer the continuing inconvenience, indignities and economic drawbacks of large-scale import restrictions.

This conclusion rests on two important assumptions which should not be overlooked:—First, that income from the export of primary products will continue somewhere around present levels, i.e., about £700m. a year. If anything this assumption may err on the optimistic side. If export income from primary products fails to maintain this level, that would increase the need for exports of manufactured goods. Second, the continuance of Australian standards of living not greatly below the present standard and the maintenance of high employment levels. A reduction in Australian living standards or in employment would of course lower the demand for imports. It would also, of course, reduce the demand for the products of local manufacturing industries.

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IT seems clear that Australia can no longer look to its traditional exports of primary products to pay for the imports required to support accepted standards of living and employment and rapid large-scale development. Until we have developed a sizeable export market for manufactured goods, the balance-of-payments problem is almost certain to continue. Australia is today a highly industrialised nation, with the production of secondary industry contributing more to national income than that of primary industry. Under these conditions, it is hardly realistic to expect to achieve a balance in overseas trade unless a reasonable proportion of this production contributes to export income. Looked at from this perspective, it seems rather obvious that a country such as Australia, in which a rapidly declining proportion of its total work force is engaged in the traditional export field and a rapidly increasing percentage in manufacturing, whose exports are insignificant, would run into trouble with its overseas trading.

If these conclusions are correct, it follows that the level of costs will in the long run be the decisive factor affecting the balance of payments. For the development of a large export market for Australian manufactures depends almost entirely on producing at costs competitive with the rest of the world. It looks as if the despised classical economists were after all not so far wrong as some post-war economists have rashly assumed.