THE EXTERNAL TRADE PROBLEM

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THERE is no need for me to recall the statistical facts of the Australian trade problem. They are well known. The broad picture is that after some years—from the end of the war up to 1950/51—of comfortable, and sometimes more-than-comfortable, surpluses in the balance of payments, we are now striking difficulties in balancing our overseas accounts. These difficulties have not arisen—as so often in the past—from any serious decline in export income brought about by a collapse in commodity prices. They have arisen from a persistent tendency to import substantially more than our receipts from current earnings and net capital inflow will pay for.

When import restrictions were first introduced early in 1952 it was generally believed that the external difficulty was a temporary passing phase, that it had been brought about by an unusual combination of circumstances that were unlikely to recur, and that the economy would soon again be on an even keel. Certainly this was the impression given by official statements at that time. Today we are sadder, if not wiser. At the present time the accepted view is that import restrictions will be with us for some considerable time, and that there is certainly no prospect of their early removal.

There is still, however, a feeling that the trouble is not really serious and that, with reasonable good fortune, we can get by with nothing more drastic than the continuation of import restrictions of varying intensity but not-too-great severity. And, as a last resort, there is always exchange depreciation.

Now I believe this approach reveals a grave misconception of the true nature of the balance-of-payments problem, that it ascribes the difficulty to causes which, though important, are not fundamental and which, if necessary, can easily be brought under control. It assumes too, I think, that the great post-war expansion of manufacturing industries will, as time goes on, render Australia less dependent on imports; in other words, that this expansion has, in sum, a net import replacement benefit.

I cannot accept this view of the balance-of-payments problem. I propose to suggest that the reasons for the external unbalance can be traced to deep-seated changes in the structure of Australia's economy, and therefore in its economic relationships with the outside world, and that the economy, far from becoming less dependent on imports, is becoming steadily more dependent. If this conclusion is correct it follows that the trouble is unlikely to yield to simple, painless methods of treatment, even with the assistance of import quotas of moderate proportions. Import restrictions of immoderate proportions would clearly lead to grave dislocation of the internal economy. In other words, though you may safely use import restrictions in reasonable doses to relieve an adverse balance-of-payments position, it is not at all clear that you can increase the doses indefinitely without dire effects on the patient. In 1952, the import cuts then introduced were severe enough in all conscience, but you will remember that at that time we had built up an enormous surplus of stocks. It would be unwise to assume from that experience that import restrictions of a similar intensity could be applied where the stock position was more or less normal without giving rise to widespread difficulties.

Now what are the reasons most commonly advanced for the balance-of-payments deficit? There are, I think, three. These are:—

1. The increased demands arising from full or over-full employment and higher living standards.
2. An over-rapid rate of development.
3. A cost structure out of line with overseas costs.

These reasons are all partly valid. They do not however, in my view, at any rate in the form which they are usually advanced, go far enough.

It is clear that if the excess pressure on resources arising from over-full employment were removed the demand for imports would be reduced. But the reduction that would occur would not, I think, be nearly sufficient to right the external balance under normal trading conditions—that is without resort to import restrictions. I am prepared to admit, too, that if our costs were lower the balance-of-payments problem would be less acute. And I would go so far as to say that if they could be reduced to a sufficiently low level it might disappear altogether. But a "sufficiently low level" would be a long, long way below the present level, indeed so far below that such a transition would be totally beyond the bounds of reasonable economic and political possibility.

Finally, I am willing to concede that some reduction in the **rate** of development, and its accompaniment, migration, would assist the balance-of-payments position; but for reasons which I shall shortly try to make clear, so long as development is proceeding on a large scale I doubt whether a mere reduction in the rate would effect any notable, or indeed lasting, improvement.

Nevertheless, those economists who stress development as the major reason for the overseas deficiency are, I think, nearest to the truth—that is, so long as the term "development" is taken to comprise the general growth and progress of Australia and not merely major governmental projects, such as are taking place in the Snowy River area, at Eildon Weir and Yallourn. Under this conception, development would of course include much of the spectacular expansion occurring in manufacturing industries and related activities such as transport. This expansion is especially important. A nation in which the proportion of total working population that is engaged in manufacturing activities increases in two short decades from under 20% to around 30% has clearly undergone a transition, a fundamental structural change, of the utmost significance. The implications of this great change have, I think, been both seriously underrated and seriously misconstrued.

In discussions of the trade problem there is a tendency to think of the Australian economy as it was before the war—that is, when despite a considerable development of manufacturing, primary industry still contributed the major proportion of physical production, and when the exportable surpluses of the primary industries were generally sufficient to pay for the import requirements of an economy that was notably smaller and much less intensively industrialised than the Australian economy today. I think, too, that it is not unfair to say that the extraordinary growth of the manufacturing industries in recent years has given rise to the notion that, as we were now making many things in Australia that we did not make before, the Australian economy was becoming more self-contained and less dependent on imports. This notion has probably, sub-consciously as much as consciously, caused us to push ahead with our manufacturing development even more rapidly than might otherwise have been the case. It has also led us to undervalue the importance of exports to the economy and thus, perhaps, to fail to encourage export production to the extent that we might otherwise have done.

I think it could be said that this great expansion in manufacturing has been held to be good not merely because it is the source of a justifiable national pride, not merely because it proved to ourselves that we can do what the older industrial nations can do; but also because it was believed that through it we were bringing our economic destinies more within our own control and were rendering the economy less subject to the wide traditional swings in export income to which we had hitherto been exposed. This was particularly welcomed by many Australian economists who have perhaps been rather too greatly influenced by what is frequently called "the new economics". For if we were becoming more independent of external trade then we were getting closer to realising a basic assumption of Keynesian doctrine—I refer to the assumption of "the closed economy"—and therefore nearer to a state where Keynesian ideas could be applied without fear of retribution.

Unfortunately the facts have shown this general notion of an increasing economic self-sufficiency to be sadly astray. In spite of, indeed partly because of, the remarkable growth of manufacturing, the import requirements of the economy have risen substantially since before the war. In 1954/5 Australia imported, in volume, over 80% more than before the war, or about 40% more per head of population, notwithstanding the checks imposed by quantity import restrictions, dollar exchange controls and higher tariffs. On the other hand, the capacity to pay for imports has declined. The quantity of exports in 1954/5 was only about 25% more than pre-war; per head of population, exports were around 5% less. Had not the prices we receive for our exports risen substantially more than the prices we pay for our imports since before the war the balance - of - payments difficulties would clearly have been intensified.

How then did this extraordinary misconception of a reduced dependence on imports arise? It arose, I believe, partly from wishful thinking. It is amazing how easy it is to overlook simple, and even obvious, economic truths when emotion enters into the evaluation of practical policies, when subjective instead of objective values hold sway, when there is an obsession with theory, or when one particular economic purpose—desirable though it may be in itself—is pursued to the virtual neglect of all others. I venture to say that all these things have exerted a big influence on economic thinking in Australia in recent years.

The misconception arose also, I suggest, from confusing the conditions prevailing in the post-war economy with those of the pre-war. Before the war it is possible that many developments in manufacturing tended to make the economy less dependent on imports. In a comparatively stationary economy, that is one which is growing at no more than a normal rate, and which has a substantial surplus of labour, it could be true that a movement toward greater industrialisation could also be a movement toward greater self-sufficiency. But in a rapidly growing and fully extended economy, undertaking an impatient programme of development, an economy in which population is increasing apace due to large-scale immigration, and total production is rising at least proportionately, and in which there is no surplus of labour, the position would appear to be far otherwise. In such a situation the total demand for imports, and even the per capita demands, are much more likely to increase than diminish, and, unless the economy's capacity to export is increasing in step with its general growth, it is almost certain to strike trouble with its balance of payments.

The import requirements of an expanding, fully employed economy of this kind will set up additional demands for imports.

Firstly, the mere growth in population will swell the demands for imports of essential consumer goods that cannot be duplicated out of home production—tea, coffee, Scotch whisky, luxury clothing lines such as furs are obvious examples.

Second, the new and expanding industries will add to the economy's requirements of imported materials, component parts and productive equipment.

Third, the increase in incomes resulting from full employment will swell expenditure on imports. Where there is a condition of more-than-full employment—such as we have in Australia at the moment, the demand for imports of course becomes greater still. Nevertheless I am prepared to assert that, while the existence of full or over-full employment has clearly added to the demand for imports, by comparison with pre-war, the basic cause of the increased demand is to be traced to the mere fact of growth, to the simple fact that the economy is rapidly becoming bigger and its appetite for imports correspondingly larger.

Now it will no doubt be contended that this argument, and also what I have said on the failure of manufacturing to make the economy more self-sufficient, entirely overlooks the import-replacement aspect of much of the development that has occurred. It may be said, for instance, that while it is true that many of the new manufacturing developments increase the need for imported materials, parts and equipment the value of these imports is necessarily less than the value of the finished goods which they produce and therefore of the imports they replace.

Is this so?

Let us assume that a new manufacturing industry is established and that this industry employs say 10,000 additional workers. It is immaterial for the argument whether these workers are supplied from migration or from the natural increase in population. At first sight the value of the imports saved might seem to be represented by the equation:—

> Net value of imports saved = value of finished goods otherwise imported — (the value of imported materials and parts + an annual valuation of imported capital equipment).

This is the sort of argument, reduced to mathematical terms, advanced by the numerous people who claim that new or expanded manufacturing industries must necessarily have a net import replacement benefit and therefore a favourable net effect on the balance of payments. Unfortunately the argument is invalid.

The demands for imports which result from the establishment of the new industry do not stop at the materials, parts and equipment required by the industry itself. The industry sets in train a whole series of additional demands for imports. In the first place, there is the increased population represented by the 10,000 people employed in the industry. These people drink tea and coffee. They smoke cigarettes. They may prefer certain items of imported clothing to the home-produced products. And it does not stop there. On present statistics the 10,000 employees will buy 4,200 motor cars and 3,000 washing machines. Admittedly, these may be made in Australia, but the additional motor cars and washing machines produced may require certain imported materials and parts and perhaps additional imported machinery. They will also increase the demands on Australian steel and the increased output of the steel industry will in turn add to the import requirements of that industry. They will increase the demands for power and for oil and for rubber and this will necessitate additional imports. Moreover this is not all. The 10,000 people employed in the new industry must be fed and clothed. Their requirements of food and clothing will reduce the surpluses of primary products otherwise available for export and will thus affect the balance of payments unfavourably.

In these many ways an expansion of new manufacturing industries, **which is part of a general programme of rapid development and increased population,** will swell the demand for imports, and may at the same time reduce the economy's capacity to pay for those imports.

In a country whose economy is expanding and whose population is increasing rapidly, it is clearly not true that the development of new manufacturing industries will, on balance, have a net import replacement benefit. Many new developments, pursued in the vain hope that they will reduce imports and ease the balance-of-payments position, may turn out to have the reverse effect. In a country such as Australia, as development continues and the economy grows, there seems no escape from the fact that the demand for imports will also grow. The mere fact of growth and expansion increases the requirements of imports. It is this fact of growth and expansion that constitutes the basic cause of the balance-of-payments problem. As we grow bigger, our appetite for imports will increase.

If this is true, it follows that it will not be sufficient, in order to solve the balance-of-payments problem, to slow down the rate of development. It does not matter whether the rate of development is **slow** or fast. A slower rate of industrialisation will only mean that import requirements will not increase so rapidly as with a faster rate. But they will still increase.

Nor, so long as the economy continued to grow rapidly, would a mild deflationary policy give more than temporary relief. Let us assume that such a policy were applied to produce a more or less permanent excess of workers over jobs of, say 125,000, or unemployment of around 3 or 4 per cent.—undesirable as this could be from the social and human standpoint. At the present rate of increase of population, it would need little more than a year to restore the economy to its previous position so far as the total numbers employed were concerned.

Nor is the way out to be found in additional overseas borrowing, even if ample funds were readily available —which they are not. Far from relieving the balance-of-payments position this would, in the long if not the short run, only serve to aggravate it. The purpose of overseas borrowing is to permit a faster rate of development and population increase than would be possible from our own resources. The increased population and the secondary effects of the accelerated development would result in additional demands for imports in the same way as the establishment of new manufacturing industries. Only if the development were of such a nature as to expand the economy's capacity to export faster than it increased the pressure on imports would this general thesis not be true. The same may apply to investment in Australia by overseas business interests.

It is ~~highly~~ doubtful, ~~too~~, whether, in the long run, import restrictions and higher tariffs assist the balance of payments, unless they are so severe as to cut deeply into standards of living or to cause substantial unemployment. If import restrictions simply give rise to compensatory attempts to expand local production to replace imports, the policy would in the end be self-defeating. The new industries set up in Australia would inevitably lead to the need for greater imports of a different type to those excluded. Moreover a policy of severe import restriction would have an unfavourable effect on exports, both because of the retaliation it would invite from other countries and because of the increased cost burden it would throw on the export industries.

In particular, the idea of savagely restricting imports of consumer goods—even if that were feasible—to permit the continued importation of so-called "essentials" is so much nonsense. It would react disastrously on the balance-of-payments. The importation of capital goods to promote industrial expansion and give employment would, unlike the import of consumer goods, generate secondary demands for imports in the ways I have already described. It would promote development at the expense of a deteriorating balance of payments.

All this implies that in the absence of artificial restraints on imports—and assuming no change in the terms of trade—the balance-of-payments position in the years ahead will tend to become steadily less favourable. Admittedly this would not occur if the capacity of the economy to export were keeping step with its general growth—in other words, if its capacity to pay for imports were expanding in correspondence with its increasing requirements of imports. But this of course is not happening in Australia. The secular picture in Australia since the war has been a rising level of real import needs accompanied by a fall in the real capacity to export. This picture has been obscured by the terms of trade which have become markedly more favourable to Australia and to some extent I suppose by the inflow of capital which this movement has encouraged.

There is no solution to this problem through more and more industrialisation, as many people seem to imagine. On the contrary, as the economy grows, as its secondary industries and development projects expand and its population increases, requirements of imports will continue to outstrip—and by a widening margin—our ability to pay for them. A policy of import replacement would be like a dog chasing its own tail, with the difference that the more strenuous the efforts to catch it, the further away it would get.

The drive for self-sufficiency has thus proved to be futile. It has had the opposite effects to those which were visualised. Australia will shortly have to realise again, what for the time being it has forgotten, that the capacity to export is all-important. This implies not only the need for a different pattern of development, with much more attention to the importance of costs than we have been disposed to pay in recent years, but also a new view of our trading relationships with other countries. Policies designed to protect the internal economy, which adversely affect trade with other countries, which encourage retaliation in the many forms it can take, may provide short-term relief but will in the end get us deeper into the mire.

I have no doubt that many people will interpret this paper as an attack on our great post-war manufacturing development; that it, in effect, says that manufacturing is the "villain in the piece" in the balance-of-payments drama. I want to forestall any such criticism. **What I have done is to attribute the balance-of-payments difficulty to the whole process of growth in the economy, not just the growth of manufacturing. What I have tried to point out—and it is a conclusion that on the score of the facts cannot be avoided—is that the post-war development in manufacturing has not, as so many people assumed it would, made the economy more self-contained and decreased the need for imports.**

The great part of our manufacturing progress has been a necessary development for Australia — and necessary not merely on strict economic grounds. I am as proud of it as anyone else. At the same time there are good reasons for thinking that if this development had been more concentrated on those things which Australia can produce most efficiently and at the least economic cost, and had not been spread so indiscriminately over such a wide field, regardless of strict economics, the economy today would have been in a sounder position, and the problem of the balance of payments less acute. The classical law of comparative advantage or comparative costs seldom appears in modern economic thinking, but it is not yet ready for the rubbish tip. It is still good economics for a nation to devote its energies to those things it can do best and in which the resources used bear the most economic ratio to the value of the product produced. The fantastic idea that all expenditure is good, so long as it gives employment, regardless of whether the expenditure is directed into the most economic channels, will rapidly become discredited. In the end it may destroy more opportunities for employment than it creates.

I was recently reading a book comprising a series of lectures on international trade given to the University of Brazil in 1952 by one of the greatest of American economists, Jacob Viner of Princeton University. In it is this pregnant statement:—

"The opportunities open to an undeveloped country in the foreign trade field are certain to be a vital factor in determining the rate at which it can make economic progress. No country except the United States has attained a high level of per capita income which has not maintained a high rate of imports to total national product, and no country, except possibly Russia, can in this respect make the United States its model without courting perpetual poverty."

The words "perpetual poverty" may be rather too strong to apply to the happy land of Australia. But "poverty" is after all becoming more and more a relative term and if Australia wishes to continue its development without seriously sacrificing its present standards, then we could with advantage pay heed to Viner's words.

In the post-war years we have indulged in a great deal of self-delusion. It is late, but I hope not too late, for us to realise that no country in a stage of rapid growth and great development — and particularly a country such as Australia, where many essential industrial resources are lacking and where much technical and scientific "know-how" must be imported—can avoid, or should by deliberate purpose attempt to avoid, an increased economic dependence on the rest of the world. Australia, because it is small, because it is young, because it must grow up economically as fast as possible, is peculiarly unsuited to doctrines of self-sufficiency. It can achieve its destiny only through the steady expansion of its external trade and with the maximum of economic, financial, scientific and technical assistance from its more highly-developed friends.

There is no easy path to the goal of national economic greatness, of greatly improved standards of life for all and a population approaching 25 million by the end of the century. It cannot be attained out of the products of the work of other countries, or by "soft" internal policies too often dictated by narrow political motives. It needs great enterprise, immense labour, a "tough" economy closer to the American model, and a restraint and discretion in the management of our internal economic affairs which we have not exhibited since the war. Our supreme delusion has been to suppose that such a goal could ever have been easy of attainment, or could be achieved by the self-regarding doctrines of economic self-sufficiency with which we have been infested since the war. Unless we can dramatically and greatly increase the capacity to export, the vision of Australia as another United States —in the economic sense—will almost certainly remain an idle dream.