CURRENT FALLACIES

EACH decade seems to bring forth its own particular crop of economic fallacies. We are not referring to the cranky notions of the few inevitable crackpots; but to ideas that gain a wide credence and exert a powerful influence on thinking in high places. These ideas become a kind of prevailing mode, the dogmas of the moment. They tend to underlie discussion at learned societies and in lecture rooms. Often they play a not inconsiderable part in determining the shape of economic and financial policies.

Ten years ago the popular fallacies centred around government planning. Detailed economic planning was the master-tool which was to do away with all the ills inseparable from the pre-war laissez-faire economy. The continuation into peace of government controls introduced for war purposes; bureaucratic interference with the free choice of what should be produced; the national ownership of large-scale industries; massive government spending on social security, and the such-like, were to bring about, in short time, an economic Heaven here on earth below. Many of the fancy notions then held with such conviction have since gone by the board. They have failed to stand up to the acid test of experience, to later—and more sober—reflection, and to intellectual assaults by leaders of economic thought in many countries of the world. They no longer command a wide public acceptance, nor the support of a consensus of expert opinion.

But, in Australia, they have now been replaced with a series of other ideas just as tenaciously held and with just as wide a currency. Many of these present-day notions will, in another ten years, almost certainly have gone the same way as their predecessors. But, for the time being, we are inflicted with them; they are holding sway in important places of thought and are exerting a by-no-means negligible influence on government and business thinking and policy.

Many of the current fallacies arise from the magnificent, if foolish, refusal to recognise any limitations on *the rate* at which the Australian economy can expand. If expansion is being pushed too rapidly—which means simply that we are trying to do more than we have resources to do it with—the economic warning-signs show up in several ways. Labour becomes scarce. Materials and productive equipment become inadequate. Loans subscribed for public projects fall short of the intended amounts. Prices and costs threaten to rise further. And most important of all, the balance of payments becomes seriously adverse.

All these are symptoms of deep-seated stresses and strains in the economy. But to many people the symptoms are unpalatable. They turn their backs on them. They refuse to recognise them for what they are—the danger-signals of an over-strained economy. How can the rate of development and expansion of a country be too rapid, they say? If labour is scarce, then import labour by stepping up migration. If materials and equipment are in short supply, then import more, or, better still, where possible make more at home. If internal finances are inadequate, then borrow money overseas. If prices and costs continue to rise, then does it matter anyhow? If overseas earnings fall short of overseas commitments, then run down overseas reserves or impose restrictions on imports, particularly of consumer goods. And if the balance of payments is obstinate and refuses to right itself, and the reserves dwindle, then we can always fall back on that unfailing weapon of last resort, exchange depreciation.

Here we have quite a harvest of fallacies, expressed or implied. We will discuss five of them.

1. That migration can in all circumstances be used to cure a general labour shortage.
2. That overseas borrowing will ease the difficulties associated with an adverse balance of payments.
3. That costs don't matter.
4. That exchange devaluation will, by itself, correct a chronic deficiency in the balance of payments.
5. That drastic cuts in imports of consumer goods will solve the balance-of-payments problem.

1. *Migration and a Labour Shortage.*

If there are, say, 40,000 unfilled jobs in the community then it may at first sight seem that the obvious way to fill them is to import 40,000 workers from overseas. There are two flaws in this idea.

One arises from the fact that migrants bring not merely a pair of hands to work, but a mouth to feed, and a body to clothe and shelter. Migrants don't only produce, they also consume. They therefore set up immediate claims on the production of the community—on its supplies of food, of clothing, of housing accommodation and furniture, on its transport facilities, on its water supply, gas, electricity, sewerage, postal services and a hundred and one other things. These fresh demands create fresh jobs and the need for still more labour.

To this, the objector might be tempted to reply that the additional worker should consume no more than the equivalent of what he adds in the way of production. But this overlooks the fact that many of the demands of the migrant on the community's production run in advance of his own contribution to it. For instance, he makes an immediate demand for accommodation (and all that goes with it) which he may be able to pay off out of the product of his work only over a long period of years.

The second flaw is that migrants frequently don't come alone, but bring their wives, children and relatives. It has been estimated that only one in every two migrants is a producer. The other is purely a consumer giving rise to additional demands on the community's production.

All in all the net effect of migration is to create more jobs than it fills.

2. *Overseas Borrowing will Assist with Our Balance-of-Payments Difficulty.*

The doctrine that more overseas capital is the answer to Australia's balance-of-payments weakness has many adherents, even in high political and financial circles.

The effect—and intention—of overseas investment in Australia is to promote development in both public projects and private business and to provide the basis for increased population. The investment takes two main forms:—

(a) Government borrowing chiefly from the International Bank.

(b) Investment by financial interests abroad in Australian enterprises.

Loans from the International Bank are ear-marked for the purchase of specific dollar goods which would not otherwise be obtainable. The immediate impact on the balance of payments is neutral since the importation of the capital equipment is exactly counter-balanced by equivalent dollar grants.

But the more rapid development, made possible by the loan, increases imports of consumer goods (because of the additional employment provided) and also of materials, parts and equipment of Australian industries which expand as a consequence of the development. The effect on the balance of payments is, therefore, unfavourable. The only circumstances in which this would not be true would be where the development is of such a type as to increase the capacity to export faster than it raises the demand for imports.

Investment by private interests abroad, mainly in the manufacturing field, has the same train of consequences. It promotes development, increases employment and thus the demand for imported consumer goods, and materials and component and replacement parts for the new industries.

Overseas borrowing and investment make possible a higher rate of development without immediate detriment to the balance of payments, possibly even a short-run saving if it is devoted to "import-replacement". But the higher rate of development before long must raise the over-all demand of the economy for imports, and thus place increased pressure on the external balance. Some economies in a stage of rapid development, notably Canada, have been able to avoid the dilemma in which Australia now finds herself. The Canadians have kept internal economic activity at a lower level than in this country, and thereby, avoided a spilling-over of excess demand into imports. In addition, most of the overseas capital has been invested in export production, for example, wood pulp, oil, and minerals, rather than in import-generating local industries.

Overseas borrowing is necessary for the rapid development of Australia; but let us not delude ourselves that it provides the way out of the balance-of-payments impasse. As Australia's population grows its appetite for imports will increase.

3. *Costs Don't Matter.*

There are a number of variations of this theme. One is that costs have little or nothing to do with the adverse trade balance, which is due to quite other causes. Another is that our costs, by and large, are not high anyway; that they are still generally competitive.

The idea that costs don't matter represents a complete rejection of the doctrines of the old classical economists to whom costs were all-important. It is Keynesianism run wild. It is inconceivable that Keynes himself would ever have countenanced such absurd notions.

It is, of course, impossible to tell to what extent the external position has been adversely affected by the rapid rise in Australian costs over the last five years. Certainly it has not been assisted. Some of the fringe exports—certain dairy products, dried fruits, some canned foods, for example—are rapidly losing ground in overseas markets. Markets for manufactured goods, established after the war, have been lost through inability to compete. To what extent imports have been encouraged because of high costs of home production cannot be known. It would probably be considerable.

The most extraordinary perversion of this general idea is that costs are not high anyway. Some economists and statisticians have been prepared to resort to the use of remarkable data to prove that this is so. What is more surprising is that their arguments seem to have been accepted in some official quarters. However, one has the feeling that the contention that costs are not high is argued without conviction by its own advocates. Why it is argued at all is difficult to understand.

In a self-sufficient economy, it is true that *the general level of costs* would not matter very much. Costs are no more than incomes in reverse. If costs and prices are high, incomes are correspondingly high. But Australia is not self-sufficient. It is one of a large number of nations competing with one another for world markets. Under these conditions the level of costs becomes vital, because it influences how much we can sell abroad and how much of our home market we can retain for ourselves.

The people who most strongly incline to the view that costs are not very important seem to imagine that the Australian economy can, when necessary, protect itself against the consequences of a high-cost structure by a variety of devices—restrictions on imports, tariffs, subsidies, and exchange-rate adjustments. Unfortunately such a barricadoed economy is possible only within narrow limits—or perhaps in the lecture-room. For all these devices which are designed to procure trading advantages for Australia tend to be to the disadvantage of other countries. They are led to protest. International institutions register disapproval. These countries and institutions become less inclined to friendly co-operation. Overseas financial assistance becomes harder to obtain. Other nations are provoked into retaliation. The whole climate of international economics would rapidly become less favourable to Australia.

These things are so obvious that they should hardly need to be stated. But they are overlooked by some of the modern thinkers, who appear to believe that Australia has an unqualified right to manage its own affairs in its own way without regard to the effects of its policies on other countries.

4. *Exchange Depreciation Will Correct a Chronic Deficiency in the Balance of Payments.*

This is one of the most common, and, incidentally, one of the most dangerous, fallacies abroad at the present time. If one asks the rather unpopular question: "What will Australia do if the deficit on overseas transactions persists to the point where it threatens to exhaust our overseas reserves"? the answer almost invariably is: "Oh, in that case we would depreciate the exchange". It seems to be assumed that the simple act of depreciation would restore balance and maintain continued health in the Australian economy without the need for any other action on our part. If it were as simple as that we would certainly have nothing to worry about. Unfortunately it is not so simple.

Those who view the situation so complacently usually have somewhere at the back of their minds Australia's experience during the depression of the 'thirties when the Australian pound was devalued from parity with sterling to £130(A) = £100(E). At that time we had an ominous balance-of-payments deficiency; but there, any similarity with the present position, or the position which might conceivably face us sometime in the near future, begins and ends. In the Great Depression, the difficulty with the balance of payments arose from a steep fall in the prices for Australia's main exports caused by a world-wide economic collapse. Our present external troubles are not caused by any major recession in prices for our exports, which, on the contrary, have been remarkably well maintained. They are caused by an excess demand for imports which is the result of the internal policies being pursued. This is the essential difference. In the depression we had a collapse of internal demand with acute under-employment; now we have over-employment. In the depression we had falling prices and costs; now we have rising prices and costs. In the depression we had serious deflation; now we have threatening inflation.

In the conditions of the early 'thirties the depreciation of the exchange was undoubtedly the correct remedy. It gave a stimulus to spending by increasing the incomes of export producers in Australia. By raising export prices in Australian money it helped to restore profitability to the vital export industries. Even so, it did not achieve its results in isolation. Its efficacy depended partly upon a number of other measures—of which the deliberate reduction of costs was one—pursued in conjunction with it. Now depreciation is claimed to be, by itself, and without the need for other, accompanying—and possibly uncomfortable—measures, the unfailing cure-all for an entirely different situation, one of serious inflation as against catastrophic deflation.

The present balance-of-payments weakness partly arises from an over-stimulated economy. The advocates of exchange depreciation propose to solve this by giving the economy an additional stimulus, or at least by maintaining the present strength of the stimulus. They propose to correct the consequences of inflation by still further inflation. Exchange depreciation is essentially an inflationary measure. It increases spending by augmenting the incomes of export producers and thus of other producers. By increasing the cost of imports and by providing a blanket protection for high-cost local production, it eventually increases internal prices and costs in general. It generates the dreaded spiral with all sections of the community striving to achieve compensatory increases in their incomes. How this process would benefit the already overblown Australian economy is hard to understand. Australian prices and costs would be further increased relatively to overseas prices and costs. When this happened, as it probably would, there would soon be an army of people urging a further depreciation. Who can say where it would stop?

Moreover, there are two other important aspects of depreciation which tend to be overlooked. By common consent Australia is a country which badly needs overseas capital for its programme of rapid development and migration. Would exchange depreciation be likely to help us in this need? It would almost certainly have precisely the opposite effect. Devaluation is taken by overseas financial interests to be a sign of a weak internal economy—as indeed it is. Private investors abroad, if they were not frightened off altogether, would become increasingly wary of placing money in Australia—and with good reason. The earnings on their investments, when converted into their own currency, would be badly depleted by devaluation. Official lending institutions would almost certainly turn the cold shoulder instead of the warm, helping hand they have hitherto been disposed to extend. We might even find that we were confronting a net annual outflow of capital instead of the inflow we have had since the war. That would be disastrous for the long-run development of Australia.

The second aspect is that other countries, for obvious reasons, would not look kindly on devaluation. International institutions were devised and established at incredible labour toward the end of the war to prevent this very kind of thing. Devaluation makes the products of the devaluing country more competitive in the markets of other countries, and the products of other countries less competitive in its own. Are they likely to stand idly by and watch this happen? Or will it provoke them to retaliation in one form or another? And if that occurs, may not many of the calculated benefits of depreciation to the balance-of-payments position go by the board?

All in all, exchange depreciation is one thing into which Australia should not enter lightly in the years ahead.

5. *Drastic Cuts in Consumer Goods Imports are the Answer to the Adverse Balance of Payments.*

The idea behind this suggestion is that the import of consumer goods should be severely curtailed to permit the maintenance, or even increase, of imports of so-called "essential" capital goods.

Actually, a much greater proportion of consumer goods are "essential" than is generally thought—tea, coffee, tobacco are good examples. However, we will leave that on one side.

The purpose of this suggestion is to expand production in local industry by imports of capital equipment, provide increased employment, and, where possible, replace goods previously imported. Its eventual effect on the balance of payments would be disastrous. The import of consumer goods has no secondary effects on the balance of payments. £20 million spent on tea is spent on tea and that is the end of it. £20 million spent on imports of capital equipment sets up secondary demands for imports of materials, parts and equipment and consumer goods in consequence of the increased employment provided. Moreover, savage restrictions on imports of consumer goods would be highly unpopular in other countries, and would invite retaliation to the detriment of our export income.

Money spent on imports of consumer goods helps to raise, or maintain, immediate standards of living. Money spent on capital goods promotes development and growth, and development and growth increase the demands for imports.

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