the IPA review

THE INSTITUTE OF PUBLIC AFFAIRS — MELBOURNE, VICTORIA

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OCTOBER-DECEMBER, 1955 Vol. 9 — No. 4

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CONSUMPTION OR DEVELOPMENT?

WHEN the Prime Minister addressed the House of Representatives on the 27th September on the economic situation he was contending with one of the most baffling, although, in the immediate sense, not one of the most critical, problems in Australian economic history.

The position has been compared favourably with the balance-of-payments crisis of 1952. In fact the situation is much more intractable and deep-rooted than in 1952. The crisis of 1952 arose, at least partly, from temporary causes—the collapse in wool prices from the abnormal levels brought about by the Korean outbreak, and the unexpectedly rapid fulfilment of an excessive volume of import orders, tacitly if not actively encouraged by the Government itself. At that time there were hopes, reasonably founded, that export prices would shortly show some recovery and that imports would, of themselves, stabilise at a lower level. In the present situation such hopes could not be confidently entertained. There seems little prospect of any marked upward movement in export income; nor does there seem much likelihood that the flow of imports, if left to itself, would show any substantial decline.

The policies which should be adopted to arrest the fall in overseas reserves will naturally depend on a right diagnosis of its causes. On this it is possible to take two fundamentally different standpoints.

One standpoint is that the excess of imports is attributable, in the main, to a more or less sudden splurge of spending on consumption goods. This is the view which has been taken by the Government. The other is that the balance-of-payments deficit is to be traced to something much more fundamental than a temporary boom in consumption spending; that it is due rather to deep-seated forces which have been at work in the Australian economy for some years. In this view, the difficulty arises from structural changes in the size of the economy and in the pattern of employment of its resources. It attributes the balance-of-payments problem largely to the unprecedented growth and development of the economy in recent years. This development has greatly added to import requirements but it has not resulted in any material increase in the capacity to pay for imports—that is, the capacity to export. The effects of these changes on the balance-of-payments have been masked by highly favourable terms of trade, but they are now becoming clear as export and import prices settle down to a more normal relationship. This might be called the "development" diagnosis as opposed to the "consumption" diagnosis advanced by the Prime Minister.

The core of the Prime Minister's analysis is to be found in the following sentences: "Our prosperity, for the most part, is well founded insofar as it springs from high levels of employment, active industry and improving standards of production. But it is ill-founded to the extent that it is eating into, largely for consumption purposes, our vital international reserves." — "This makes it perfectly clear that the present condition is much more accurately described as a consumption boom than as a developmental boom."

To substantiate this diagnosis of the problem the Prime Minister quoted various statistics, all of which suggested a large, and some a staggering, rise in consumption expenditure in recent years. The critical figures were:—

1. An increase, since 1952/3, in personal consumption spending (excluding cars and houses) of 22%.

2. An increase in private expenditure on cars and houses of 41%.

3. An increase in imports of consumer goods of 172%.

Unfortunately it is impossible to accept these figures as giving an accurate reflection of the true increase in consumer spending. The Government's statistical advisers have erred in three important respects, and these errors combine to give a highly magnified picture of the rise in expenditure on consumption goods.

The first error lies in the selection of 1952/3 as the base year. It is an elementary principle of statistical method that the base year or period from which economic trends are assessed should reflect a more or less average or normal position in which the magnitudes are not distorted by factors of an exceptional or temporary character. In 1952/3, imports of consumer goods were abnormally low because of the stringent import restrictions which came into effect in March, 1952, and which fell with particular force on consumption items. Moreover, 1952/3 was a year of comparatively depressed business activity with slight unemployment and, in fact, total spending on personal consumption was, in physical volume, less than the preceding two years, despite a substantial growth in population.

In the second place, in order to give a true picture of increases in consumer spending, it is necessary to make allowance for price increases. These have been disregarded in the Prime Minister's statement.

Third, since 1952/3, population has increased by nearly 400,000. Under these circumstances an increase in total spending on consumption goods is naturally to be expected. But it is clearly wrong to take the increases on this account as being in any way indicative of a consumer spending "spree."*

If spending on consumption goods in 1954/5 is related to an acceptable base (we have selected the yearly average of the period 1950/1 to 1952/3) and if adjustments are made for price changes and population increase, the picture becomes strikingly different from that painted in the Prime Minister's statement. The increase in imports of consumer goods becomes 23%, not 172%, and in personal consumption spending

* The Prime Minister's statement pointed out that there are now 200,000 more people in employment than in 1952/3.

(excluding houses and motor cars) 7%, not 22%. The increase in expenditure on motor cars becomes 32% as opposed to the Government figure of 64%. On houses there is no change, not a 25% increase (the increase denoted by the Government figure of £40m.).

For convenience the comparison is set out in the table below:—

Increased Spending on Consumer Goods.

	Government's Figures	Our Figures
1. Imports	172%	23%
2. Total Consumer Spending (Excluding cars and houses)	22%	7%
3. Motor Cars	64%	32%
4. Houses	25%	No Increase

NOTE:—In addition to adjusting the figures for population increase, they were reduced to "real" terms as follows:—

1. By an import price index specially constructed from the various commodity groupings in the Commonwealth Bank's Import Price Index.
2. By the "C" series price index.
3. From actual registration figures.
4. By average costs per completed dwelling unit, derived from data in the Commonwealth Statistician's Quarterly Survey of Building Statistics.

WHEN account is taken of improvements in productivity over the last four or five years (and which have frequently been pointed to with pride by Cabinet Ministers) the increase in consumer spending indicated by our figures could hardly be regarded as excessive. Admittedly, the increased spending on motor cars has been substantial, but it needs to be borne in mind that this is partly due to the greater availability of cars; also to a return to normal hire-purchase facilities, consequent upon the removal of capital issues controls—in which the Commonwealth Bank itself has actively participated—and the modification of bank advance policy. Housing has been rightly regarded all along as a special social problem and, in any case, the purchase of homes has been strongly encouraged by governments themselves through the provision of easier credit facilities.

All in all, the evidence is hardly sufficient to substantiate the view that there has been, all of a sudden, a terrific boom in personal spending, particularly on consumption goods. This does not mean that the level of consumer spending carries no responsibility for the external difficulty. *But it does mean that if consumer spending is taking place at a much higher* *level than the economy can sustain, then this is not something which has arisen in the last two years; it has been with us for a considerable period.*

The important point is that people don't suddenly indulge in a splurge of spending just for the "sheer hell of it". With rare exceptions, the spending of most people is carefully controlled in accordance with their present and prospective income and commitments. True, in times of financial buoyancy, too many take an over-optimistic view and spend more than they should, thus mortgaging to too great a degree their future earnings. But the majority are usually pretty canny judges in their own case. If the level of consumer spending in relation to the needs of the economy is excessive, then it is, in the main, only so because incomes and standards of life are greater than the economy can afford. But the "excess" portion of these incomes is in turn, to a very large extent, the resultant of government policies and decisions of industrial tribunals. Indeed the strongest single influence on total consumer spending in Australia today is the development and migration programme of the Commonwealth and State Governments. It can surely not be denied that the foot on the accelerator which regulates the tempo of spending through the economy belongs to the Government.

THE call for voluntary restraint in spending, insofar as it applies to the individual in a personal capacity, is hardly likely to be effective. People do not regulate their spending—and cannot be expected to—on any assessment of national needs but solely by reference to their personal desires and the resources available to them to satisfy those desires.

* * *

If the trade crisis cannot be properly attributed to a sudden surge in consumer spending, to what then is it primarily due?

The Prime Minister rejected the idea that a development boom was mainly responsible. Certainly, in the last year or two, there has been no sudden rise in developmental expenditure which could justify the title of "boom." But what the Prime Minister's advisers have chosen to ignore is that there has been a *continuing developmental boom* in Australia for a good part of the post-war period. Indeed at no time in Australian history, except perhaps in the gold rush days of nearly a century ago and for a few years in the late 1920's, has there been a period of development remotely approaching the present.

The rate of population increase has been faster than that of any comparable country and the proportion of resources devoted to investment one of the highest in the world. Each year we are now adding nearly a quarter of a million people to the population.* This demands a corresponding concentration of resources on investment to provide employment, houses and a wide range of community services. Over the six years since 1948/9, public and private capital expenditure have together averaged around 25% of Gross National Product compared with about 18% in the six years preceding the war. Government expenditure on public works has been of the order of 9% compared with less than 7% before the war. The expansion in manufacturing has, by any standard, been extraordinary. Since before the war the numbers employed in the manufacturing industries have nearly doubled and output has possibly more than doubled. *It is worth noting that since* 1948/9 *the proportion of Gross National Product devoted to consumption purposes has been substantially lower than in pre-war years.*

THE maintenance of a high ratio of investment to national product—in other words, the rapid pace of development—has pressed heavily on resources and has been a major factor in the post-war inflation and the almost chronic condition of labour shortage. This has given rise to over-award and overtime payments, because of manpower shortages, and thus to heavy consumer spending which, in turn, has encouraged further industrial expansion.

The rapidly growing population has added, year by year, to the nation's requirements of imports of essential consumer goods, materials and parts for the new and expanded industries, and of capital equipment of many kinds for both private and public projects. But this great expansion, while increasing the need for imports, has not added correspondingly to the

* It was pointed out last May by the Australian delegate to the Economic and Social Council of the United Nations, Mr. William Forsyth, that few countries in the world could show as rapid an increase in recent years, or, indeed, at any time.

capacity to export. *Here lies the basic reason for the chronic inability to balance overseas expenditure with export earnings.* Had not the terms of trade been so favourable to Australia in the post-war years, the rate of development which has been maintained would clearly have been impossible. Now that the terms of trade are moving against us, is it feasible to think that we can persist with development and migration on the same scale as previously?

In 1954/55, notwithstanding restrictions, imports amounted to nearly £100 per head. With population growing at the rate of 230,000 a year, this would imply an addition to our import bill every year of nearly £25m. or, in four years, £100m.

The import cost of the migration programme presents a special problem. The migrant sets up immediately a demand for capital which has been variously estimated at from £2,000 to £3,000 per head. Taking the lower figure it can be shown that the additional imports—that is over and above what they would otherwise be—necessitated by the present migrant intake of 100,000 a year would average out over a ten year period at something like £87 million a year.* Admittedly, these figures can be estimated only in the most approximate terms, but, whatever the estimate, there can be no shadow of doubt that the migration programme is one of the most powerful contributing factors in the balance-of-payments difficulty.

If the trade problem arises fundamentally from the development and migration programme, and not from a sudden consumption boom, it follows that attempts to maintain the developmental programme must aggravate the overseas position. *If population increase continues at a rate approaching a quarter of a million people a year, and an investment programme on the scale needed to absorb such an increase is maintained, the balance-of-payments problem must become progessively more acute.* In 1956/7, imports are to be licensed at the rate of £650 million a year. (This would be equivalent to just under £70 a head.) As population increases, the severity of the restrictions necessary to achieve this figure will increase too, unless there is a recovery of export income. Is it likely that Australians will be content to put up with a

* See Appendix.

progressively increasing burden of import restrictions once they begin to feel the impact of these restrictions on their everyday convenience and comfort—as soon they must?

THE continuation of development and migration on its present scale will place unbearable pressure on the balance of payments. The attempt to maintain the rate of economic expansion in the face of a chronic and increasing balance-of-payments difficulty must result in the imposition of more and more government controls designed to divert resources to developmental projects and away from immediate consumption, and would eventually lead back to a tightly controlled economy resembling that of the war and immediate pre-war years.

Fortunately, such a train of consequences is not likely to come about, because both economic circumstances and political pressures, arising from the desire of people to satisfy their demands for consumption goods, would soon compel a reversal of such a policy. There is no escape eventually from a sharp cut-back in development and migration. It may not be hard to understand why the Government is reluctant to do this and why it is prepared to gamble to the last on a recovery in export prices. It is more difficult to understand why its advisers have been so keen to shift responsibility for the external unbalance from its fundamental cause.

A reduction of the developmental programme would automatically check the rise in consumption spending. In addition, an educational drive, combined with special financial inducements, to persuade the people to save more might help the Commonwealth Government to secure a real budget surplus, where increases in tax would almost certainly fail.

While the diagnosis advanced by the Prime Minister is regrettable, some of the cures he has propounded, although no more than stop-gaps, must be applauded. The import cuts were inescapable even though the prospect of any lightening in the cuts under the Government's present policy is remote indeed. A tighter monetary policy was an obvious and necessary step. The cut in Commonwealth expenditure on public works of £10m., while small, sets an example which should be —but will not be—followed voluntarily by the State Governments. The strong emphasis which the Prime Minister gave to the need for a great expansion in the export field is far-sighted and is clearly the only route which offers a constructive way out of Australia's difficulties. But it is a long-term solution which cannot be achieved in a day. In the meantime Australia has no alternative but to cut its coat according to its cloth and restrict the development and migration programme to what the economy can afford. Otherwise we will soon run into difficulties infinitely worse than the present.

No commentary on the Prime Minister's statement of policy would be complete without commending, in the strongest terms, the Government's intention to issue periodically a Government paper setting out the basic facts of the economy and to present a yearly economic report to Parliament on the state of the nation. This should bring Australia into line with governmental practice in other modern communities and should help to prevent in the future the occurrence of unpleasant economic dilemmas such as that in which we now find ourselves.

* * *

AUSTRALIA has reached one of those historic turning points in its economic evolution, which, at some time or other, come to all nations. A quarter of a century ago we confronted such a turning point in the Great Depression. Now we are at another. No one can clearly see the paths ahead, or predict with confidence how the serious, and apparently chronic, deficiency in the balance of payments will affect our internal economic condition or the prospects of continued large-scale development.

It is time to bring to bear on these great questions the best available intellects to study them with fresh and open minds, free of the economic and political dogmas which have shaped our thinking over the post-war decade.

What is wanted is a small commission of the best economists and industrialists, unencumbered for a short period by the distractions of departmental and business duties, to give undivided attention to the problem. Such a commission might clear the air of much of the superficial stuff and nonsense which these days passes for thought, establish the basic economics of the new, industrialised Australia and provide the nation with a set of signposts for the future.

* * *

APPENDIX

The Effect of Migration on the Demand for Imports and the Balance of Payments

IN 1954/5 Australian imports were divided broadly into:

Capital goods	40%
Consumer goods and others	60%

It is impossible to assess Australia's import requirements under conditions of comparatively free importation. In 1954/5 imports averaged £94 per head. Recent restrictions are designed to reduce imports to a rate of £650 million a year. For a population of 9,400,000—likely at the end of 1955/6—this equals just under £70 a head. It seems fair to take a figure of at least £100 a head as a reasonable estimate of the level of imports under conditions of comparatively free importation. Imports of consumer goods (including producers' materials to be made up into consumer goods) would comprise about £60 and capital goods £40. The capital import figure is the overall national average. But the main demands for capital arise from the needs of the additional population brought about by natural increase and migration, and the great part of capital imports are, of course, to cater for the needs of the added population per year.

The demands set up by migration for imported capital can be calculated as follows:—

We have assumed that each migrant requires £2,000 of capital to cover his needs for housing, community services (such as roads, transport, electricity, sewerage, education, etc.), and productive equipment and buildings to provide for his employment. In 1954/5 imports of capital goods approached £340 million (i.e., 40% of total imports of £846 million), and therefore comprised about 27% of total capital expenditure of £1,245 million. If the migrant's total capital requirement is £2,000 it is reasonable to assume that 27% of this must be imported, i.e., £540.

Total import requirements of migrants per head would thus be:—

	£
Capital goods	540
Consumer goods, etc.	60
	£600

On a net migration figure of say 100,000, the total import bill in the first year could be increased by approximately £60 million. In the short run it would be possible to get by with a lower level of capital imports, but eventually capital will have to be kept up to customary standards. Over a ten-year period and on the above basis, capital imports would average £54 million a year, consumer goods imports £33 million, and the total for all imports £87 million. Capital imports, of course, remain at £54 million per annum, but imports of consumer goods rise by £6 million per annum as each 100,000 migrants are added to the population.

It may be claimed that this calculation makes no allowance for the contribution which the migrant may make to the replacement of imports and to the increase of export production.

So far as import replacement is concerned, this has already been allowed for in the calculation. The level of imports of consumer goods (i.e., £60 a head) is that which the Australian community is already taking under the existing pattern of production, which of course, includes production replacing imports. It cannot necessarily be assumed that additions to the population will have a greater import replacement factor than the existing producers. The only reasonable assumption to make is that it would be roughly the same. The same considerations apply to the import of capital. In 1954/5 Australia's capital imports comprised about 27% of all capital expenditure. This is the ratio under the present pattern of production and includes the contribution of that pattern in replacing imports. Again, there is no particular reason to suppose that the ratio of imported capital to total capital expenditure will alter greatly with additional population.

It cannot be claimed that migrants have added anything substantial to export production, which consists mainly of the primary industries. Production in these industries has risen about 20% since pre-war, but the numbers employed have declined. The increased output has been achieved as a result of better farming methods, mechanisation and pest eradication and not as a consequence of the employment of additional manpower.

Indeed, on the export side the only conclusion which can be reached is that migration, along with the natural increase in population, has tended to reduce surpluses available for export below what they would otherwise have been and its effect on the balance of payments is therefore adverse.